East Asian Economic Models for Chile

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Abstract

The Asia-Pacific constitutes one of the most dynamic regions in the world’s economy. East Asia’s economy grew at the rapid rates in the 1970s through 2000s, with its population representing about 50 percent of the global population, and with its economic output totaling 45 percent of the world’s GDP. In recent years, East Asia has become an important place for Chilean economy, because it constitutes the most dynamic market for Chilean exports, with reported annual growth rates of over 200 percent. This paper examines the Chilean economy and its enterprises with respect to those of East Asian economic models of Keiretsu (Japan), Commonwealth (China), and Chaebol (South Korea) using case study approach in order to understand the ways in which these East Asian economic models have affected economic performance and development. Our analysis shows that job specifications in East Asian structure are less detailed and not strictly tied to individual tasks, and that the formal rules and procedures tend to be interpreted rather flexibly. The similarities of Chilean structures in this matter could allow better understanding of them to achieve a higher level of performance in its operation. Economic groups and medium Chilean enterprises could learn from the way in which Keiretsu, Commonwealth, and Chaebol expand into global market, using different sources of competitive advantage, achieving higher efficiency, risk management, and global innovations.

Keywords: East Asian economic models, Chilean economy, Keiretsu, Commonwealth, Chaebol.

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Introduction

The Asia-Pacific constitutes one of the most dynamic regions in the world's economy. East Asia's economy grew at the rapid rates in the 1970s through 2000s, with its population representing about 50 percent of the global population, and with its economic output totaling 45 percent of the world's GDP. In recent years, East Asia has become an important place for Chilean economy, because it constitutes the most dynamic market for Chilean exports, with reported annual growth rates of over 200 percent. Nowadays, 33 percent of the Chilean export goes to Asia, and it is estimated to be the principal market for the years to come. In light of the expansion of Asia Pacific Economic Cooperation (APEC) and free trade arrangements, there is a unique opportunity and also challenge towards the cross-Pacific economic cooperation. More specifically, Chilean enterprises could learn from East Asian economic models and its high skilled management, in order to get advantage pertaining to the global efficiency, risk management, and skillful innovations.

The main objective of this paper is to examine the Chilean economy and its enterprises with respect to those of East Asian economic structures using case study approach. First, it seeks to analyze East Asian economic models of Keiretsu (Japan), Commonwealth (China), and Chaebol (South Korea) in order to understand the ways in which these East Asian economic models have affected economic performance and development. Second, it seeks to identify what organizational aspects of East Asian economic models that could be adopted by Chilean enterprises toward the higher level of performance at both domestic and global markets.

Our analysis shows that job specifications in East Asian structure are less detailed and not strictly tied to individual tasks, and that the formal rules and procedures tend to be interpreted rather flexibly. The similarities of Chilean structures in this matter could allow a better understanding of them to achieve a higher level of performance in its operation. Chilean economic groups could learn from Japanese Keiretsu and South Korean Chaebol, while Chilean medium enterprises from the Chinese Commonwealth model, in order to utilize different sources of competitive advantage, achieving higher efficiency, risk management, and global innovations.

Chilean Economy in Global Perspective

Chile has a market-oriented economy characterized by a high level of foreign trade and a reputation for strong financial institutions and sound policy that have given it the strongest sovereign bond rating in Latin America. Exports account for more than one-fourth of GDP, with commodities making up some three-quarters of total exports. Copper alone provides one-third of government revenue. During the 1990s, Chile's reputation as a role model for economic reform was strengthened when the democratic government has implemented economic reforms and trade liberalization. Chile claims to have more bilateral or regional trade agreements than any other country with 57 such agreements (not all of them full free trade agreements), including with the U.S., the European Union, Mercosur, China, India, South Korea, and Mexico. One of the keys to Chile's success and economic stability is its well-developed domestic savings base that serves as solid financial foundation for all other economic activities. This propensity has helped Chile to avoid the classic boom-bust cycle experienced by some of its neighbors and to shelter both its economy and the stock market from the vagaries of international capital flows.
One of the strengths of Chilean economy is its economic, social and political stability, ranking as one of the best places to invest in Latin America. Chile has an open and deregulated economic system, natural tendency toward integration to other economies like Asian-Pacific countries. Furthermore, Chile participates as an associate member of Mercosur which integrates Argentina, Brazil, Uruguay and Paraguay, offering an opportunity for East Asian economies to reach these markets through Chile. Further, Chile has an open and deregulated capital market for foreign investment and has a stable currency which is one of the strongest currencies in Latin America. Chile also enjoys a growing productivity by increasing efficiency in human and productive resources.

Generally, big enterprises in Chile are known as “economics groups,” owned by affluent local families or independent businesses. They represent the main economic power of the country operating in major economic sectors, and consequently, these groups are accountable for large export earnings and profits. Each group commonly consists of 30 to 60 different independent units, owned by principal shareholder groups. Moreover, each group has financial operation that includes bank, insurance company and mutual fund, providing financial support and resource to the group’s affiliated companies.

Chilean economic group operates in a wide range of industrial sectors, including mining, finance, agriculture, forestry, extractive materials, and export trade. Economic group’s human resource base has high professional and technical qualification, with continuous training and education. Often times, in the case of family groups, the dominant member of the family manages at the strategic level, maintaining tight control of the overall operations, which is similar in corporate characteristics of Japanese Keiretsu and South Korean Chaebol.

Medium and small enterprises in Chile play an important role against poverty and regional decentralization. Due to the fact that Chile has a very narrow and elongated geographic shape, the government provides various support and incentives for medium and small enterprises such as financial assistances, business consultations, and job trainings. From a broader Chilean economic picture, medium and small enterprises constitute about 90 percent of the total enterprises in Chile, generating around 80 percent of labor force, and account for about 25 percent of total sales in volume. Furthermore, these Chilean medium and small enterprises are growing faster than the overall Chilean economy, with an annual growth rate of about 10 percent overall, and share similar characteristics with the Chinese Commonwealth model. And in these regards, Chilean economy provides a stimulating case study for the East Asian economic models.

### East Asian Economic Models

The most important and well-defined economic models in East Asia, are the Japanese Keiretsu, the Chinese Commonwealth, and the South Korean Chaebol. They represent the main economic engines as efficient and effective organizations in production, distribution, and globalization. These economic models have varying economic structures and relationships between the members, thus it is useful to examine the organizational and operational frameworks to identify their potential implications for Chilean's enterprises.

**Japanese Keiretsu.** Keiretsu, or corporate alliance, is considered a form of business organization that links companies together in industrial groups, providing Japanese business with a substantial competitive
edge over non-Keiretsu organizations. Keiretsu descended from the Zaibatsu, huge industrial conglomerates that virtually controlled the Japanese economy before World War II.\textsuperscript{11} Four of the largest Zaibatsu, Mitsubishi Mitsui, Sumitomo, and Yasuda, accounted for about a quarter of all Japanese industrial assets. Zaibatsu were outlawed after the World War II as the result of the U.S. occupational reform and Keiretsu emerged as a variation. Today, there are six major industrial Keiretsu groups and eleven lesser ones.\textsuperscript{12}

Keiretsu held together by cross-shareholding, interlocking directorates, long-term relationships and social and historical links. At the hub of each Keiretsu is a bank or cash-rich company that provides low-cost and long-term capital. Keiretsu are organized along financial, production, and sales-distribution, that are linked together by cross holding of shares, by sales and purchases within the group, and by formal and informal consultations.\textsuperscript{13} The vertical Keiretsu is a web of interlocking, long-term relationship between a big manufacturer and its main suppliers. Vertical Keiretsu are pyramids of companies that serve a single master (a manufacturer) that dictates virtually everything, including prices it will pay to hundreds of suppliers who are often prohibited from doing business outside the Keiretsu. At the pyramid's base is a swarm of shops and family ventures with primitive working conditions and subsistence-level pay and profits. The third category, sales-distribution Keiretsu, consist of vertically integrated manufacturing and distribution companies. The trading company, the center of a distribution Keiretsu, coordinates a complex manufacturing process that involve thousands of small companies that sell through the Keiretsu's distribution network.

What could Chilean enterprises learn from Keiretsu business structure? First, the high level of stability among member relationship is an important fact to be considered for Chilean economy, especially when this characteristic is much less consolidated in Chile. Second, the stability between Keiretsu members brings the following advantages: encourages investment in new technologies; allows manufacturers and suppliers to share the cost of development of new products; suppliers are involved from early stages of the design period and they are expected to work with the manufacture to provide continuous design improvements, continuous price reductions, and technological upgrades. Stability also promotes the free flow of information, tightly coordinated production schedules, wide dissemination of technology, and long-term planning all resulting in better quality and shorter time between idea and production. Cooperation among competitors is the third factor that Chilean enterprises rarely undertake. Some of the reasons for the lack of cooperation in Chile include distrust in eventual benefits; fear of losing a core competence, and inexperience in doing business in a cooperation method with competitors. One particular aspect of the Japanese cooperation that has an important implication for Chilean enterprises is research and development (R&D) of new technology, which can be too expensive to duplicate efforts. This Japanese cooperation is given in pre-competitive level of research.

**Chinese Commonwealth.** For many generations, emigrant Chinese entrepreneurs have been operating comfortably in a network of families and clans, laying the foundations for stronger links among business across national borders. Chinese-owned businesses, also known as Chinese merchants, in East and Southeast Asia, the United States, Canada, and other areas are increasingly becoming part of the so called Chinese Commonwealth.

Not based in any one country or continent, this Commonwealth is primarily a network of entrepreneurial relationships. From restaurant to real estate to plastic-sandal makers to semi-conductor manufacturing; from a staff of five or six family members to a plant floor of thousands, the Chinese
Commonwealth consists of many individual enterprises that nonetheless share a common culture. Countries with Chinese-based economies have astonishingly large capital surplus. The private and the informal capital markets of Chinese family and clan associations provide financial resources that can be deployed for new venture activities without the intervention of commercial banks, professional venture companies, or government investment agencies. Additionally, unlike the Japanese, the Chinese Commonwealth has an “open architecture.” It represents access to local resources like information, business connection, raw materials, low labor costs, and different business practices in various environments, more adaptable to changing circumstances and conditions.

This new Chinese management model is grounded in both traditional Chinese values and Western practices that encourage flexibility, innovation, and the assimilation to local and regional context. Confucian tradition emphasizes the importance of social order in Chinese culture for over 2000 years, codifying the ties of individuals, families and society that define a persons’ proper place and position. The Confucian tradition consolidates the following characteristics of the Chinese Commonwealth model:

1. A high, even irrational, level of savings is desirable, regardless of immediate needs,
2. Hard work to the point of exhaustion is necessary to ward off the many hazards presents in an unpredictable world,
3. The only people you can trust are family, and a business enterprise is created as a familial life raft,
4. Obedience to patriarchal authority is essential to maintaining coherence and direction for the enterprise,
5. Investment must be based on kinship or clan affiliations, not abstract principles,
6. Tangible goods like real state and natural resources are preferable to intangibles, and
7. Keep your bags packed at all times, day or night.

What could Chilean enterprises learn from Chinese Commonwealth? Chilean medium and small enterprises have certain similarities and dissimilarities with the Chinese Commonwealth model. First, the network's method in which Chinese enterprises are linked to each other in interlocking web of mutual support and multiple channels is rarely observed in Chilean enterprises. The Chinese Commonwealth shares information of business opportunities and own experiences, and give business connections to other firms that are trying to expand its operations abroad. While the strategic alliance and joint venture are practically an unknown way to do business for Chilean medium and small enterprises when going abroad, the Chinese Commonwealth model thrives and takes its advantage of these informal agreements. Thus, the adaptation of this mechanism for Chilean medium enterprises would represent a source of competitive advantage even in the Chilean domestic market.

Second, due to its origin and development, the Chinese Commonwealth has learned to adapt into many different global marketplaces based on enduring family values and connections. This tendency toward family connections of the Chinese Commonwealth model provides an important advantage in adapting and assimilating into new economic environment. Although Chilean small enterprises are based on family ties, most of Chilean medium enterprises do not consistently practice family values and connections, for instance, if a family member does not performed to his/her expectation then the person is most likely to be terminated or demoted.

In rapidly changing economic and global environment, the Chinese Commonwealth model with multiple networks of economic connections facilitates flexible and more advantageous production-cycles
that are cost-effective and competitive for Chilean medium enterprises for opening and penetration of new marketplaces.

**South Korean Chaebol.** In South Korea, there are several industrial conglomerates called Chaebol that is substantially different from Japanese Keiretsu is in ownership and control. As noted earlier, member firms in the Keiretsu are said to own minority equity in each other and are led by a leading bank or firm in the network. In the case of Chaebol, a family and its members own the companies in multiple industrial sectors. Chaebol has dominated South Korean economy since its economic development in the 1960s.\textsuperscript{17} The largest Chaebol in South Korea-- including Samsung, Hyundai, Lucky-Goldstar, and Daewoo--can be characterized as conglomerates as the ownerships are held by the families and are controlled therein. Some of them have origins in the trading practices resembling those of the Zaibatsu, however, all Chaebol are now engaged in many of the key industrial sectors of South Korean economy including electronics, automobiles, ship building, and consumer products. In contrast to the relative specialized and narrowly focused large Japanese companies, Chaebol coordinates variety of resources and tends to be more self-sufficient with direct control over its corporate activities. Sub-contracting is thus much less marked than those of Japanese companies. Chaebol, however, tend to focus on related business fields and vertical integration rather than on unrelated diversification. The connection between ownership and control in Chaebol is reflected in its heavy-handed influence of family ownership in the management process, through a highly centralized decision-making process. Authority stems directly from the ownership and the founder or his son is involved in all major and minor decisions. A considerable number of highly educated managers are employed in these large enterprises, and bureaucratic control systems are quite highly developed. Personal attributes and connections are more important than formal rules and procedures, thus, hierarchical relations are more patrimonial and paternalistic than legal-rational.\textsuperscript{18}

This characteristic of Chaebol encourages relatively long term employer-employee commitment with seniority-based promotion system which rewards loyalty along with job performance. Seniority-based reward systems and the large-scale recruitment of top college graduates by the Chaebol are associated with extensive job rotation and on-the-job training. However, this training is not closely linked to job assignment of future promotional opportunities.

Most importantly, Chaebol is directly linked to state agencies and dependent on their priorities than are Japanese firms, and the growth patterns reflect the preference of, and opportunities provided by executive power and state planners.\textsuperscript{19} The state of South Korea still functions as an essentially patrimonial system and dominates the economic system. Certainly the leaders of the Chaebol are closely connected to members of the political and bureaucratic elites and in my instances have received preferential treatment, especially in the past. Consequently, Chaebol are highly dependent upon banks, state agencies and political connections.\textsuperscript{20}

What could Chilean enterprises learn from South Korean Chaebol? Despite strong professionalism, South Korean Chaebol are strongly ingrained into the political economic fabric that personal attributes and connections are more important than formal rulers and procedures in order to be successful. This is particularly important reminder for Chilean enterprises because of its growth, the value of the personal contact, and close relationships with partners are being replaced by technical rules and professional management systems. Furthermore, the state in South Korea acts as a complementary partner of Chaebol and the success of Chaebol depends largely on the governments' commitment. These relationships
provide mutual benefits and stability which are not always mutual between government and enterprises in Chile. For instance, Chileans' decision to join the Mercosur agreement produced an enormous dispute between Chilean government and business sectors that are still being debated. Overall, Chilean enterprises could learn how to advance to desirable objectives and agreement that South Korean government and Chaebol have developed over the years.

**Discussion and Conclusion**

To further our discussion, we note the following characteristics about the East Asian economic models. First, they are specialized in taking advantage of national differences: labor costs, labor skills, technology. Second, they are strong "risks-diminishing," sharing it with whenever they can--with the state, with related enterprises and with outsiders and even competitors. Third, Asian structures are dynamic, always seeking for better ways to improve their organization and productive systems. They obtain this learning from national differences where they work, with scale economies and scope economies that they could find on their own processes. Fourth, the networks are also commonly used as a strong market defense mechanism against foreign competitors, in other words, as non tariff barriers. All of these characteristics of Asian economic structures can be utilized by Chilean enterprises, of course, when the situation and specific conditions would be appropriated.

The comparative analysis among economic enterprises in Chile and the East Asia reveals three categories of the benchmarks that would serve as useful organizational instruments: enterprise specialization, authority loyalty and division of labor, and enterprise co-ordination. First, enterprise specialization deals with two separate dimensions--the extent to which business activities are specialized around distinctive capabilities of skill, knowledge and experience, and the degree of relational contracting with suppliers and other industry partners. Chilean economic groups have a middle position in both business specialization and relational contracting between Keiretsu and Chaebol. Because of the high level of specialization of resources and activities which could be risky when markets and technologies are unstable, economic groups in Chile have been expanding their operations toward diversification. They have been also encouraging this trend because they are "high-seekers" of market opportunities, which are disseminated over the whole of economic activities. In the case of Japanese Keiretsu, the long-term commitment to core employees increases this risk and restricts the feasibility of major diversification strategies. Variations in enterprise specialization are linked in a positive way to the degree of interdependence or relational contracting with industry partners and subcontracting processes. Because of the lack of high skilled sub contraction system in Chilean economy, large conglomerates are unable to advance toward higher levels of specialization like the Keiretsu case.

Second, authority loyalty and the division of labor focus on the importance of personal authority relationship and the commitment to the individual leader, as opposed to impersonal and formal relation of subordinations. In general, the more paternalistic and personal the relationships of subordination, the more they tend to be broad in scope and not restricted to specific areas of work. Thus, the authority of the boss in the Chinese family business is wide-ranging and not precisely delimited. In Chilean medium enterprises, this is quite similar in that there is a direct owner control of enterprises that is linked to personal and paternalistic authority relations as well as to considerable centralization of decision-making. The long term commitment is reinforced by working conditions, carrier development opportunities and the status of a
"permanent" labor force that are practiced by many East Asian enterprises, particularly in Japanese and South Korean firms.

Third, enterprise co-ordination is concerned with how enterprises are interconnected, and how their activities coordinated in different societies. This, in turn, deals with the extent to which dominant economic actors and groups across major sector boundaries form alliances that are relatively long term and help to reduce risks and uncertainty: that is, the degree of inter-sector horizontal coordination. And the extent to which strategies and plans are coordinated around more general objectives, typically by state agencies, and risks are shared by other collective structures, also called “vertical coordination.” These cases imply two important lessons for the management of Chilean big and medium enterprises. Chilean enterprises still do not work with their partners as closely as East Asian enterprises do, in sharing knowledge, risk of investment, pooling resources, learning from the partners, and research and development costs and risks. In addition, many East Asian states promote development of more effective system of financial sources and risk capital and unfortunately Chile is slow in catching up to this task.

In our final analysis, based on our cross-national case study, the incorporation of Chile as a regular member of APEC constitutes an important issue for Chilean enterprises, in order to learn new ways of achieving efficiency through the network of organizational structures and practices from East Asian economic models.22 Job specifications in East Asian structures are less detailed and not strictly tied to individual tasks, and the formal rules and procedures tend to be interpreted rather flexibly. Because authority is relatively personal, obeying the decisions of superiors and meeting their goals are more important than following formal rules. The similarities of Chilean structures in this matter could allow for a better understanding of them, taking advantage of these applications and getting higher performance in its operations. Economic groups and Chilean medium enterprises could also learn the way in which Chaebol, Keiretsu, and Commonwealth have transformed into global operations using different sources of competitive advantage, achieving efficiency, managing risks, innovations, and learning.

For Chilean medium enterprises, they would obtain an important competitive advantage if they utilized the model of Chinese commonwealth, going abroad as a global network, in which many medium enterprises could come up with a variety of solutions at an acceptable level of risk. For Chilean economic groups, Keiretsu and Chaebol models constitute a wide range of structures, operations and strategies, which utilized all of their power, influences, and technical capabilities in order to obtain its organizational goals. It is also possible, to recognize some of the similarities among East Asian and Chilean organizational styles, which could allow more interactions with East Asian enterprises, and eventually, the establishment of joint ventures or strategic alliances. Once analyzed, the methods of doing business of some East Asian enterprises, it is plausible that Chilean enterprises could occupy some unfilled position at the local government level, political and social systems in general, facilitating higher level of influence towards its goals, as in the East Asian economic systems.
References


Endnotes


2 According to Asia-Pacific Economic Cooperation (APEC), three main objectives of APEC are: To develop and strengthen the multilateral trading system; to increase the interdependence and prosperity of member economies; and to promote sustainable economic growth.


4 Economic reforms in Chile have expanded and acerbated with the democratic transitions in the early 1990’s which were based on economic policies initiated during the earlier authoritarian regimes.


7 Mercosur, "Common Market of the South," is the largest trading bloc in South America in which is an associate member. Mercosur's full members include Argentina, Brazil, Paraguay, and Uruguay. Mercosur's primary interest has been eliminating obstacles to regional trade, like high tariffs, income inequalities, or conflicting technical requirements for bringing products to market. See, Joanna Klonsky, Mercosur: South America's Fractious Trade Bloc, Council on Foreign Relations, 2009.


12 Six major industrial groups in Japan are: Mitsui, Mitsubishi, Sumitone, Fuyo, Sanwa, and Dai Ichi Kangyo.

13 Helou, pp. 213-243.

14 For example, Taiwan holds one of the largest foreign reserves per capita and Singapore has a foreign exchange reserve over $200 billion.


16 Kao, pp. 24-36.

17 See, Won K. Paik, United States Trade Relations with Newly Industrializing Countries in the Pacific Basin, New York: Garland Publishing, 1997, for more broader discussion about South Korea’s import penetration into U.S. market.


19 For more on this connection between state actors and economic performance of South Korea, see: Won K. Paik and Russell Mardon, “Industrial Policies and Economic Performances of South Korea,” *Pacific Focus*, vol. VI, no.1, 1991, pp. 59-76.

20 Whitney, pp. 199-200.
