19 Business Groups and Social Organization

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Introduction: The Problem of "Business Groups"

"Business groups" are sets of legally separate firms bound together in persistent formal and/or informal ways. The level of binding is intermediate between, and should be contrasted to, two extremes that are not business groups: sets of firms linked merely by short-term strategic alliances, and those legally consolidated into a single entity. Because business groups dominate the economies of many emerging and developed countries, they are worth considerable attention.[1]

Understanding business groups is a special case of a central problem of modern sociology: what determines the scope of relationships in which individuals and larger social units engage. Microsociology has much to say about this, but typically considers individuals in groups that lack formal structures, persistent identity, and written rules of interaction that may be codified by laws regulating and requiring involvement with political authorities.

Organization theory, developed specifically to address the issues that such formal structures imply, confined its analysis to single units until the 1960s, when theorists first objected to analyzing organizations without reference to their environments. Among the environments then scrutinized for impact were those constituted by consumers, government, the general public, and especially other organizations. Subsequently, analysts drew on population ecology and treated organizations as competitors for resources in niches that could not bear unlimited occupancy (see Hannan and Freeman 1989). But organization theorists were slower to see organizations as forming larger social entities, networks of cooperating units. The spectacular success during the 1980s of Japan and South Korea, however, forced attention to the fact that the identity of individual firms in these countries was less significant than, and subordinated to, that of larger groups of organizations with which they were connected. The new interest in the *chaebol* of Korea and the *keiretsu* of Japan raised to prominence the importance of "business groups" in modern capitalist economies. But such groups hardly originated in this period; instead, the economies of many countries had been dominated by such well-defined collections of firms for decades and in some cases a century or more.

That theory was slow to address this reality should not surprise. In economics, there was little sustained attention even to the question of why such an entity as a "firm" should exist at all until Ronald Coase wrote his pathbreaking 1937 paper "The Nature of the Firm." It was clear to Coase, and indeed to any casual observer, that isolated individuals hardly mattered in the production of goods and services compared to individuals organized into social units called "firms." Yet the classical economic theory of production treated firms as no more than individual actors. Our recognition here of the central role of business groups in relation to firms elevates Coase's insight on the relation of firms to individuals to a higher level of analysis.[2]

My treatment of business groups in this chapter is more inclusive than some valuable recent accounts that limit their focus to "diversified business groups," which comprise firms in a wide variety of industries "under the general guidance of a single entrepreneur" (Guillén 2001, 60; cf. Ghemawat and Khanna 1998, 35). Confining our attention to these would exclude important cases such as Japan, Taiwan, and others, where diversification and coordination among group firms are variable and often limited. But my definition is not endlessly inclusive: because it specifies that the formal and informal ways in which a collection of firms is bound together must be "persistent," networks of firms with shifting ties, and without clearly persistent subsets, should not be considered "business groups." Thus, sets of firms in industrial districts, connected to one another by a dense network of ties, may or may not be classed as groups, depending on whether clearly identifiable cliques of firms persist over time.

My definitional requirement that group firms be legally independent is useful but arbitrary. Some multidivisional firms are technically legally integrated, yet individual division managers may be more autonomous than those in business groups whose firms are legally separate. Despite legal separation, one or more central individuals, often a family, may own a controlling interest in every group firm, directly, or indirectly through holding companies and pyramids, thus making component firms' legal independence virtually meaningless. Adding to confusion, the term *conglomerate* is used loosely in the literature for both kinds of collections of units, and at times interchangeably with *business group*.

A reasonable operational criterion for distinguishing which conglomerates should not be treated as business groups is suggested by Harry Strachan: exclude cases where a "common parent owns the subsidiaries but generally few operational or personal ties exist among the sister subsidiaries . . . [since] within business groups . . . there are generally personal and operational ties among all the firms" (1976, 20). Most American conglomerates fit the first description, as component companies are acquired and divested mainly on financial grounds. Such a set is likely to be reshuffled as financial outcomes dictate, rather than stable and closely related over time, rotating personnel back and forth, and sharing resources, brand names, and a single identity. I therefore do not treat conglomerates like Tyco or Berkshire Hathaway as business groups.

But some cases still resist easy classification by this criterion. Some conglomerates are mixtures of divisions and subsidiaries,[3] such as General Electric. Companies previously organized as multidivisional firms may reorganize their divisions as subsidiaries for financial reasons, such as tax advantage (see Prechel 2000). Such "families" of firms may continue to operate in many ways as they did when the subsidiaries were divisions, to the extent this is not forbidden by law. And there are groups of firms controlled by American families that look substantially like business groups in other countries, but whose public profile is very low. For example, the Pritzker family of Chicago (see Weber and Woellert 2001; Kilman, Brinkley, and Bulkeley 2002) controls a variety of interests, including the Marmon group—more than 60 legally separate companies tied together, as indicated on the group's web site (www.marmon.com): "While the member companies operate independently, a small professional organization in Chicago, Illinois—The Marmon Group, Inc.—manages and invests the member companies' financial resources and advises them on accounting, tax, finance, legal, regulatory, real estate and other matters." There are many such family-dominated groups and multisubsidiary firms in the United States (see the Dun and Bradstreet directory *America's Corporate Families*), and what is most striking is their absence from public or scholarly discussion, perhaps because of the dominant image of American companies as individual enterprises. In this absence, it is hard to form a clear impression of their overall role in the American economy (but see Bethel and Liebeskind 1998, 50 for some limited data on the prevalence of large U.S. firms that have domestic subsidiaries).

Because of these definitional ambiguities, there are collections of firms whose status as business groups is arguable. Ultimately we would want a more refined way to classify collections of firms that are linked to one another than whether or not they should be called "business groups," and such a classification should consider several dimensions of how firms in such collections relate to one another. Nevertheless, for many purposes it is reasonably clear whether a set of firms is a business group as defined here, and it is useful to develop arguments about such groups; therefore in the remainder of this chapter I abstract away from the ambiguities.

Because component firms are legally separate, business groups can be invisible. This is one reason they were largely ignored in theories of economic organization until recent years.[4] Countries vary dramatically in the extent to which groups have name recognition, but it is very rare for the groups to have clear legal status. (One exception is Chile; see Khanna and Palepu 1999a, 272n.) Chung points out that corporate law worldwide is highly focused on the idea of the corporation as an autonomous unit, and rarely recognizes the reality of complex network relationships within groups of corporations. This focus makes regulation of groups difficult, ad hoc, and often ineffectual (Chung 2000, chap. 5; Maman 2003; also see Teubner 1990; Antunes 1994; Dine 2000).

Inhabiting a legal limbo does not reduce business groups' economic clout. To give just a few examples, at the end of the 1980s, the top 20 groups in India accounted for more than two-thirds of private sector industrial assets (Ghemawat and Khanna 1998, 42); the top 100 groups in Taiwan produced 45 percent of the 1996 GNP (Chung 2001, 722); and by the mid-1990s, "business groups had already come to dominate the Chinese economy" (Keister 2000, 9), despite not having existed until the 1980s. Collin (1998, 726) reports that the two largest groups in Sweden controlled corporations that in 1995 represented about 52 percent of the Stockholm stock exchange's capitalization. And the 10 largest national private groups in Mexico include 127 of the country's 500 biggest companies (Garrido 1994, 166).

Why Business Groups? Explaining the Organizational Form

I ask first why firms adopt the organizational form of the business group rather than some other form, and what explains the many variations in the way business groups are constructed. In subsequent sections I inquire as to the efficiency and consequences of the business group form, and then consider the future of business groups in the modern economy.

The Emergence of Business Groups: General Arguments

Some general discussions of business groups suggest that actors may choose from among a variety of organizational forms in order to get goods and services produced. Thus we might consider the business group an organizational form "competing" with the forms of separate individual firms, multinational enterprises, and state-owned firms, as in Guillén (2001). What the balance of such forms might be in a given situation has been addressed by organizational ecology (Ruef 2000), transaction cost economics (Williamson 1985), and the "new sociological institutionalism" (e.g., Scott 1995). As Ruef notes, however, despite "considerable theoretical interest in form emergence, these major organizational paradigms have yet to produce a generalizable explanatory model" (2000, 659). This is in part because the requirements for such a model are daunting: the emergence of forms "is best understood in the context of a concrete system of interrelationships between organizational suppliers, consumers, regulators and intermediaries operating in an institutional arena" (Ruef 2000, 660). Ruef develops such an analysis with rich data for American health care organizations. No such comprehensive analysis is in view for generalized business organization forms, and it is unclear whether the data for such an analysis could be acquired, or even clearly defined. This high standard of analysis, however, is useful to keep in mind as we assess the validity of what *has* been argued.

I classify arguments about the emergence of organizational forms according to the level of analysis emphasized. Some focus on the rational action of individuals or organizations trying to produce the best results. In the case of business groups, what such theories look like should depend on whether a group emerges out of a single firm that acquires or spins off multiple related and subordinate firms, or coalesces from a set of previously independent firms without a clear central firm that organizes the group. These two ways that groups can emerge are ends of a continuum, but it is convenient to think of them as separate ideal types. In the latter case, typical of some Latin American groups (see, e.g., Strachan 1976), one would need to consider what benefits individual firms derive from alliance. But virtually all recent literature confines itself to the special case where groups emerge from the diversification activity of a single firm.

Standard economics and organization theory long ignored why firms grow, including diversification. This silence was broken by Penrose's influential 1959 work, which conceptualized the firm as a "collection of physical and human resources" that needed to be managed to extract maximum benefit, and originated what has come to be known as the "resource-based" view of the firm. Growth, she argued, results from rational effort to exploit underutilized resources. Penrose broached a theme that became common in later discussions of the evolution of firms and their structure, that unrelated diversification is unlikely to persist over long periods because it does not make optimum use of the firm's existing resources. No firm, she suggests, can "acquire every likely firm in sight . . . ; it must choose . . . those enterprises which seem most likely to complement or supplement its existing activities" (1995, 129); and while there are conglomerate firms whose acquisitions do not focus on any particular field, they are unlikely to be profitable or even survive over long periods. "Sooner or later such 'firms' either break up or settle down to the exploitation of selected fields. The force responsible is that of competition" (1995, 131).[5]

Bethel and Liebeskind (1998) consider why diversified firms might choose to operate as "corporate groups," making some lines of business legally separate subsidiaries rather than divisions. Their argument goes beyond Penrose's emphasis on competition, to the importance of corporate law, including a desire for "reduction or avoidance of the costs of product liability and other types of tort liability" (1998, 50), tax advantages (cf. also Prechel 2000 and Chung 2000, chap. 5), and the ability of large shareholders to leverage their control through pyramids. They add to these a stylized model in which under certain well-defined circumstances, corporate groups "can economize on transaction costs, relative to a simple corporation" (1998, 50) by resolving conflicts of interest between fixed and residual claimants to a firm's profits.

Economists working in an evolutionary tradition considered broader aspects of firms' environments than competition and the legal system. Teece et al., for example, assessed how a variety of factors in firms' environments affects the likelihood of survival for unrelated diversification (1994; see also Lowe, Boerner, and Teece 2001). They suggest that with low path dependency, slow learning, and weak selection, conglomerates with few intracorporate transactions may persist, but that as selection tightens, "such as during recessions, we expect that the most egregious examples of this form will get weeded out. Conglomerates are thus a transitional form" (24). On the other hand, in situations of rapid learning, colliding technological trajectories, and tight selection, network firms may arise, in which firms become "enveloped in a dense skein of intercorporate relationships involving partial equity holdings and joint ventures," and such network firms may persist (24). Guillén (2001) focuses on the impact of government economic policies on organizational form. In particular, he argues that diversified business groups have an advantage and can effectively profit in circumstances where government policy is asymmetric between whether it allows outward and inward flows of capital and goods to and from its country. In his view, organizational form is determined by strategic actors whose possibilities are shaped by a nation's institutional traditions and constraints, insofar as these determine policies on finance and trade.

All of these arguments posit firms rationally trying to maximize economic results, and focus in a bottom-up way on strategic actors coping with their particular environment. The environment appears as a constraining background factor, rather than a major focus of analysis. A different argument, made since the beginning of serious discussion of business groups, is that groups result from the need to compensate for market failures. This gives more emphasis to the level of entire economic systems, and less to that of strategic actors. Leff suggested, for example, that the "group pattern of industrial organization is readily understood as a microeconomic response to well-known conditions of market failure in the less developed countries" (1978, 666), especially imperfect markets in capital and intermediate products. Khanna and Rivkin (2001) broaden this account by arguing that groups may fill a number of "voids left by the missing institutions that normally underpin the efficient functioning of product, capital and labor markets" (46–47), such as labor market intermediaries, business schools, well-functioning judicial institutions, venture capitalists, financial analysts, mutual funds, and a vigorous financial press (cf. Khanna and Palepu 1999a). Groups fill these voids, they argue, because it is profitable to do so, and that the effort is sustained so long as it is beneficial for the overall economy.

One troublesome finding in relation to these assertions is that it is very variable, as I detail below, whether groups and group firms are indeed more profitable than other organizational forms. Khanna and Rivkin address this variation by suggesting that inability to profit from group membership indicates "poorly developed selection environments, where weak organizational forms are not weeded out" (2001, 47). This comment, however, must raise the question of whether functionalist explanations for the persistence of the business group form are falsifiable. There are two issues in the logic of such an argument. The first is how one might show that an organizational form such as the business group arises as a "response" to market failure. This ostensibly historical statement may in fact result from telling an "adaptive story" (Gould and Lewontin 1979) about what environmental problems business groups solve. But it could be that groups do not emerge to solve problems, but rather because of special skills and abilities of entrepreneurs, families, and alliances to mobilize resources. The visible groups at any moment are those that survived, in part because they developed capabilities superior to nongroup firms. It is then tempting to interpret this in cross-section as a response to some imputed market "failures." Without detailed historical evidence that groups were a response to such failure, this imputation is problematic.

A second issue is how to validate the implicit assumption that there exists an ideal state in which individual firms would not *need* to affiliate with one another because the missing institutional functions that groups serve would be managed by intermediaries that emerge from the market. Having arisen from market processes, these would be as efficient as possible. Thus, once economies reach this ideal state, the need for business groups disappears and they will disintegrate. (See, e.g., Khanna and Palepu 1999b, 126.) To be persuasive, such an argument would require detailed institutional analysis comparing the costs and effectiveness of economic functions performed inside versus outside of business groups. The idea that product, labor, and capital market intermediation can be performed at lower cost outside groups assumes that market discipline forces nongroup intermediaries to operate at minimum cost. In fact, however, this is highly problematic even in advanced economies. Such institutions as business schools, the financial press, venture capital, and mutual funds operate in highly constrained environments, and are supported and shaped by a wide variety of institutional forces many of which are not subject to market discipline, and which may impose their own costs on the economy as externalities difficult to bring into account. On the other hand, the same functions when performed within business groups are themselves under pressure for efficient operation from the market competition groups impose on one another. Therefore it is by no means self-evident without detailed study of particular cases that the evolution of market institutions should undercut the value added by groups. I address this question in more detail below under the topics of the success and future of business groups.

Finally, Feenstra and Hamilton (forthcoming) consider all these accounts only partially persuasive, because they slight analysis of the particular economic tasks firms are trying to execute, and how these change over time. Focusing especially on manufacturing, they suggest that a crucial question is how upstream-downstream relations among firms that involve intermediate goods can best be managed. They suggest that different institutional and structural features of nations, combined with changes in global demand, may create conditions in which business groups dominate some sectors of the economy, but in quite different ways across countries.

These widely varying accounts of how the business group form originates result in part from the actual enormous variations among business groups around the world. To treat this variation as representing a single "organizational form" may be misleading and a source of theoretical confusion. Thus, a more feasible task in our present state of knowledge might be to make arguments that try to account for these variations. Before doing so, I pause to outline the main dimensions of variation.

Variations in the Form of Business Groups

Business groups vary along six dimensions:[6]

1. Source of solidarity. Many business groups have some sense of identity based on common social bonds among component firms and their personnel, often involving association with a single family. Though mid-twentieth-century modernization theory argued that economic development required the detachment of family and kinship from business, detailed empirical analysis such as that of La Porta, Lopez-de-Silanes, and Shleifer 1999 shows that families still control most firms around the world, including those in the advanced economies.[7] Both family-run groups and others may achieve solidarity in part because key members derive from the same ethnic, religious, or regional origin.

2. Extent of "moral economy." Groups may but need not be coherent social systems in which participants have a strong sense of moral obligation to other members and a well-defined conception of what is proper behavior. Such conceptions are almost invariably accompanied by a strong sense of group identity, which confers a normative and extraeconomic meaning on economic action.

3. Structure of ownership. Groups vary from those that are essentially owned by a single family—very common, though this ownership may be masked by indirect control through holding companies and pyramids—to those composed of independent firms that have allied with one another. These latter alliances are enduring, rather than strategic, and at times involve substantial cross-shareholding among component firms.

4. Structure of authority. Groups vary from those quite loosely coordinated, with no real central authority, such as some large Japanese *keiretsu* (see Gerlach 1992), to those ruled with an iron hand by a single group chairman, typical of Korean *chaebol*, especially in the 1960s and 1970s. Centralized ownership may be the vehicle for centralized control, but the correlation is far from perfect.[8] For example, Chang's sophisticated network analysis shows that in Korea, strong central control is supported by patterns of shareholding that concentrate ownership in a single family, across large numbers of group firms (1999); but a similar analysis by Chung (2004) for Taiwan,

shows that while shareholding is similarly structured, control is more loosely coordinated, and a "set of core leaders . . . occupy duplicate leadership positions in various group firms" (Chung 2000, 76).

I note that nearly all of the extant literature on business groups assumes the special case of highly centralized ownership and authority.

5. The role of financial institutions. Since the provision of capital to group firms is a central issue everywhere, many but not all business groups include among their member firms one or more banks or nonbank financial institutions (such as insurance companies). There is great variation in the power position of such financial firms within and beyond the groups. In some groups, they dominate to such an extent that analysts refer to them as "financial groups" (e.g., Kurgan–Van Hentenryk 1997), and may even pose a serious competitor to the state for national sovereignty (see Makler and Ness 2002, especially 7–8). In others, they are clearly subordinate to the head office, and perhaps to the state as well (cf. the cases of China, Keister 2000, 88, 97; and of Korea from the 1960s to the 1990s, Kim 1997). Johnson notes that although Russian groups are known as "financial-industrial groups" (FIGs), the main banks in some of them were clearly subordinate to industrial firms with which they allied (2000; chap. 5). In many family-run groups, the situation may not be much different from early-nineteenth-century New England, where banks were not independent actors, but rather the "financial arms of the extended kinship groups that dominated the economy" (Lamoreaux 1986, 659; see also Lamoreaux 1994).

6. Relation of groups to the state. Business groups' autonomy in relation to the state runs the gamut. Some groups evolve largely independent from government sponsorship and at times in clear opposition to political elites and mandates (cf. Camp 1989 for Mexico). In other cases, groups are assembled by the state from state-owned firms (Keister 2000 for China and Johnson 2000, 159, for Russia) or by leading political actors who use the state apparatus for their own business purposes (Indonesia under Suharto, see Robison 1986; or Nicaragua under Somoza, see Strachan 1976). Where groups are independent, the state may still dominate them, as in 1960s and 1970s Korea. But as Kim (1997) notes, the more effective states are in creating successful business groups, the more likely are the groups to become independent power centers that ultimately resist state control, and become at least coequal actors.

National Institutions, Isomorphism, and Business Group Form

The theories of business group origins reviewed previously (in "The Emergence of Business Groups: General Arguments"), which stress bottom-up rational action of a single founder, may have difficulty illuminating the dimensions I have listed, beyond those of ownership and authority. Top-down interpretations of groups as responses to market failures suggest that groups' distribution across these dimensions should derive from the set of institutions missing in their countries. Poorly developed capital markets should lead to a dominant focus on finance and capital allocation. Lack of education and training for managers should prompt groups to internalize educational functions and put substantial energy into developing employee skills. A nation's institutions would then impact business group form insofar as they determined which economic functions markets cannot fulfill.

This implies that some organizational form always arises to handle essential tasks that markets fail to manage. Though we may doubt such inevitability, the argument does help us identify which functions business groups have economic incentives to tackle, which is important to know. This does little, however, to explain the axes of solidarity, the nature of ownership and authority, the existence of normative consensus, or the group's relation to the state.

Many scholars argue that to understand these requires careful attention to legal, political, and normative structures that make some business forms far more plausible and likely than others. This argument doubts that all organizational forms will eventually be driven by market competition toward some common model that optimizes returns to firms and owners by solving "agency" problems. Dobbin refers to "industrial logics" that vary by country and derive principally from their political systems (1994). In their study of the auto industry, Biggart and Guillén propose that each country has a prevailing "institutional logic," and that business practices that diverge from it will not be easily comprehensible to the relevant actors (1999, 726). Whitley refers to national "business systems" that vary in the "degree and mode of authoritative coordination of economic activities, and in the organization of, and interconnections between, owners, managers, experts and other employees" (1999, 33). Hollingsworth and Boyer speak of "social systems of production"—the way a country's economic institutions combine with its politics and with "customs and traditions as well as norms, moral principles, rules, laws and recipes for action" (1997, 2).

Such theorists argue that institutions have more causal force than individuals' strategic action. Thus, Hollingsworth and Boyer comment that whereas the "neoclassical paradigm assumes that individuals are sovereign, we argue that individual action is influenced by the hold that institutions have on decision making" (1997, 3). Hall and Soskice occupy a middle ground by acknowledging the importance of "varieties of capitalism," but arguing that institutions do not fully determine the contours of the economy; rather there are multiple equilibria in which the strategic action of actors and firms can make a major difference. Though game-theoretic in spirit, their argument acknowledges that what "leads the actors to a specific equilibrium is a set of shared understandings about what other actors are likely to do, often rooted in a sense of what it is appropriate to do in such circumstances. . . . [This is] an entry point in the analysis for history and culture" (2001, 13).[9]

Hall and Soskice argue that national economies fall broadly into two categories: liberal market economies (LMEs) and coordinated market economies (CMEs). In the former (e.g., the United States), coordination and agency problems are resolved through markets, and such economies "usually lack the close-knit corporate networks capable of providing investors with inside information about the progress of companies that allows them to supply finance less dependent on quarterly balance sheets and publicly available information" (2001, 29). In CMEs, companies are more likely to have access to finance that does not depend on such current data. This "patient capital" allows firms to retain skilled workers in downturns and make long-term investments. Investors assess performance through "network monitoring": dense networks across firms based in part on extensive cross-holdings. This argument implies that business groups will be less prevalent in LMEs than in CMEs, which the empirical data support.

I now focus more closely on institutional elements that affect the capacity and likelihood for corporate actors to coordinate with one another in ways that might favor the emergence of business groups. High on any such list would be "company" or "corporate" law that prescribes the bounds of permissible collaboration and regulates ownership concentration. Collaboration and common ownership are conceptually separate, but empirically related. Independent firms may collaborate without common ownership. But one typical reason why they do collaborate is that individuals, families, or financial institutions hold substantial ownership in the separate companies and coordinate the firms' activities in an attempt to improve their own financial or social situations.

If corporate law strongly shapes organizational form, what shapes corporate law? Law and economics scholars usually argue that it evolves so as to resolve economic problems and maximize overall wealth (cf. Posner 1998). Agency theory proposes that the role of corporate law is to establish governance of corporations in such a way as to align managers' incentives with those of owners. In this view, market forces help shape corporate law so that managers are disciplined and discouraged from seeking their own advancement at the expense of shareholders. This implies that some statutes are superior to others and that as countries advance, they will increasingly adopt similar legislation.

This view dates especially from the 1980s, when the phrase *corporate governance* first came into vogue (Blair 2001). It is widely accepted in law and economics, debated within more general economics, and greeted with some skepticism outside these circles. One general line of argument that leads in a different direction is the "new institutionalism" in the sociological theory of organizations (e.g., DiMaggio and Powell 1983; Powell and DiMaggio 1991), which proposes that "structural change in organizations seems less and less driven by competition or by the need for efficiency. Instead . . . forms of organizational change occur as the result of processes that make organizations more similar without necessarily making them more efficient" (DiMaggio and Powell 1983, 147). One such source is what they call "coercive isomorphism," including the state and its laws.

Consistent with this view is Roe's influential argument (1994) that corporate law varies by country in ways that primarily reflect political processes. Arguing that law about the economy derives from noneconomic sources tilts against convergence assumptions. In theory, idealized markets operate the same everywhere, so that if law were endogenous to market process, any well-functioning market would eventually produce the same efficient legal structures. But if law about the economy is shaped by politics, this is far less plausible, requiring the assumption that political structures will also converge everywhere—a proposal sometimes made (e.g., Fukuyama 1992), but belied by the events of recent years.

Though not directly addressing the issue of business groups, Roe inquires why the shareholding of American firms is more dispersed than in most other major economies. I note that this dispersed shareholding is inconsistent with the form of business groups, typically characterized by highly centralized shareholding or by extensive cross-holdings among group firms, or by both. Roe notes that while American firms typically coordinate through merger, such as vertical integration, there is an alternative: institutions like banks or mutual funds could hold big blocks of stock in firms as well as in their customers and suppliers, and these firms could then remain separate and be coordinated by the large shareholders. Instead of one firm being a division of the other, "each would be partially owned by an overlapping group of financial institutions. Neither would be a controlled subsidiary, but there would be connections, information, exchange, and . . . a mediator to settle . . . disputes" (1994, 14).

But Roe asserts that American politics deliberately fragmented ownership. It "preferred Berle-Means corporations [i.e., with strong managers and weak owners] to the alternative of concentrated institutional ownership, which it precluded" (1994, 22). The reason is not economic, but political and ideological: Since the founding of the republic, American public opinion has mistrusted large private accumulations of power. Moreover, relevant legislation was more readily passed in a federal political system that allowed localized interests more leverage in Congress than would be available in a more centralized system. Sanders (1986) makes a similar point in her account of how regional rivalries in the late nineteenth century produced antitrust legislation (see also Fligstein 1990). Correspondingly, managers threatened by takeovers in the 1980s—the "discipline" that agency theory recommends—persuaded legislatures in most states to enact antitakeover legislation, supported by labor and the general public, which resented the costs of corporate disruptions to their careers and communities (Roe 1994, chap. 10; see also Davis and Thompson 1994). Roe concludes that firms in "nations that have tolerated large pools of private economic power evolved differently than did firms in nations that have repeatedly fragmented financial institutions, their portfolios, and their ability to network blocks of stock. The firm is not isolated. . . . it operates not just in an economic environment but in a political environment as well" (1994, 285–86).

Chung (2000) points out that although legislation is important in determining organizational form, it is important to carefully examine the feedback from organizations to legislation. Taiwanese company law established important tax advantages for the business group form, which helps explain its initial establishment. Further legislation was the result of a continuous struggle among different political and economic interests, and was deeply influenced by business interests themselves once the business group form was dominant (Chung 2000, chaps. 2, 5; 2001). In countries where the form of business groups was not originally strongly affected by legislation, its maintenance is subsequently facilitated by revisions in corporate law and regulatory procedures on which the groups themselves actively lobby (as is well documented for Korea; see Kim 1997; Chang 2003). The case of Germany from the 1980s on illustrates that complex controversies that work themselves out through court decisions can produce a body of de facto administrative law (here called *Konzernrecht*) that is not easily traced in any deterministic way to national institutions, but may still open the way for strategic actors to use the new rules, as suggested by Hall and Soskice (2001). In particular, German industry participants created a new form called the "management holding," closely resembling a business group, in which a parent company confines itself to strategy and finance, and owns operational subsidiaries that are legally separate. Part of the reason for this was for the parent firm to avoid legal liability for mistakes of the subsidiary firms, given the doctrines of responsibility that had evolved in German law. This form spread rapidly, in part through imitation, and has been credited with reviving the fortunes of major German industries such as machine tools (Griffin 1997, chap. 5; Herrigel 1999).

There are situations where the coercive aspect of isomorphism is even more palpable than that of legislation, as when the leaders of South Korean *chaebol* were all arrested shortly after General Park Chung Hee's 1961 coup, and released only on condition of cooperating with the general's plan to revitalize the Korean economy. This plan focused the lion's share of resources on a few large business groups, and led to growth that astounded the world in the 1960s and 1970s (see, e.g., Jones and Sakong 1980). Even the details of how *chaebol* would invest were determined by state policy. Expansion by debt rather than profit maximization followed from negative real interest rates and the likelihood of bailouts in case of failure. And the high debt-to-equity ratio made it especially easy for families to control a large number of firms with relatively small outlay of capital. Diversification was sensible since state-mandated target sectors changed rapidly enough to make it imprudent not to have a finger in every pie (Chang 1999). (Note that although this account is standard, Feenstra and Hamilton [forthcoming], strongly dispute the centrality of the Korean state in producing business group [*chaebol*] domination of the economy, asserting that this outcome resulted from a combination of national institutions and global patterns of product demand, and would have occurred even in the absence of strong state action, albeit at a slower pace.)

In Japan, from the 1930s on, the business groups known as *zaibatsu* were forced by the state to adopt more centralized governance, and non-*zaibatsu* firms were pushed in this direction as well, to serve increasing military needs (Lincoln and Gerlach 2002, chap. 6). Thus, the dense web of connections that Allied occupation forces sought to break up after the Second World War, often attributed to Japanese cultural sources, were in part the product of government fiat.

Even when political forces do not explicitly prescribe an organizational form, they may bear indirect responsibility for it. Highly centralized political structures, such as that of General Park in Korea, Juan Perón in Argentina, or August Pinochet in Chile, create a situation in which the central political figure prefers to deal only with a few leading businessmen. Even if it is not technically required, business groups then find it expedient to become highly centralized themselves so as to be able to negotiate effectively with the corresponding centralized interlocutors in the state.

DiMaggio and Powell (1983, 152) argued that norms and ideas held by influential social groups may impact organizational form. Their main example was professionals, whose networks "span organizations and across which new models diffuse rapidly" (1983, 152). A different type of pressure toward uniformity in organizational form is what I would call *cross-institutional isomorphism*, in which business organizations take on a form similar to that of nonbusiness institutions with which they are involved. Chang (1999) argues, for example, that Korean family structure is distinctive even within Asia, and that the form of the *chaebol* derives clearly from the norms and traditions that surround families. Biggart (1991) suggests that the Korean feudal tradition impacts the conduct of business groups. Feenstra and Hamilton (forthcoming) stress the long Korean tradition of primogeniture in inheritance, and patrimonialism in politics, in which systems of control over slaves, tenants, and other political dependents were organized as extensions of family authority. This made an economy organized through large firms centrally controlled by a single family a path of least cultural resistance. Makler (2001, 5664) makes a similar argument for Brazil, in discussing the relation of the central government to leading regional families and their banks.

Very general sets of cultural ideas and preferences can also cross over to impact the form of economic institutions, especially through political action. One example already discussed is Roe's assertion of the centrality to American political life of pervasive suspicion of large private accumulations of power. Another has to do with the way governments in developing countries deal with multinational corporations (MNCs). As Guillén (2001) and others have argued, what goods and investment capital governments allow MNCs to import makes a difference in what space is available for business groups, and whether those groups are autonomous or work closely with large foreign firms and investors. Such government decisions are affected by the attitude of important interest groups in the economy. Guillén notes, for example, that Spanish labor has been positive on globalization and multinationals since the 1960s, thus allowing governments to bring MNCs in as partners—which, he argues, combined with export orientation, has made it difficult for business groups to persist (2001, 147–54); Argentine labor, by contrast, has been persistently anti-MNC, which has often affected government policy and at times led to dominance of the economy by business groups (2001, 133–40).

Feelings of national pride that result from political history may strongly impact policy. When General Park drafted *chaebol* leaders into his 1961 scheme for economic development, it would have been theoretically plausible for him to partner instead with multinational corporations that already had the capital and know-how that had to be painstakingly assembled by the *chaebol*. But as E.M. Kim notes, given Korean political sensitivities after a half-century of Japanese colonial domination, it would have been "politically suicidal" for even a military strong man to bring in large foreign investors in such a dominant position (1997, 119).

The ideology of political elites may influence their economic policies, which in turn facilitate or block the formation of business groups. Comparing South Korea and Israel, Maman notes that in both cases, during the 1960s and 1970s, state elites enacted policies that were either directly (as in Korea) or indirectly (as in Israel) friendly to group formation, because they "held a developmental ideology, did not count on market forces for economic development, and had a desire to greater economic and military self-sufficiency" (2002, 738). But quite opposite ideologies, such as neoliberalism among elites, may also create fertile conditions for group formation. Thus, Garrido reports that privatization, carried out by the substantial sale of state industrial assets in Mexico in the late 1980s and early 1990s, ended up as a "great act of business re-engineering guided by the State, whose strategy was aimed at strengthening the big national private groups as actors in the new economic model, by transferring to them its share of economic power" (1994, 167). Goldstein and Schneider (forthcoming) similarly observe that state-directed privatization presented unparalleled opportunities for business interests to expand or create entirely new conglomerate groups in Brazil, Chile, Argentina, and Mexico, among others (cf. also Makler 2000).

Finally, we should not underestimate the impact of cross-national mimetic isomorphism. Once models are well known, they may lead to imitation. Korean *chaebol* mimicked Japanese business group forms in the 1950s because the *zaibatsu* were still familiar from the period of Japanese colonial domination; later, in the 1980s, Japanese multinationals invested large amounts in Korea, and Korean firms had to reorganize to match their own functions with those in corresponding Japanese companies (Kim 1997, 84–89). Imitation can be quite self-conscious; thus, Keister reports that reformers in China "studied the *keiretsu* and the *chaebol* for many years and, in the mid-1980s, began building a Chinese version of these conglomerates" (2000, 9). Aside from imitating success, reformers also were attracted by the prestige of creating forms that looked like these well-known models (Keister 2000, 74–75). Similarly, Johnson indicates that in supporting FIGs (financial-industrial groups) during the 1990s, the Russian government invoked the "example of South Korean and Japanese conglomerates" (2000, 161). And imitation may result from conceptions of business organization carried by migrants across national borders. Thus, many of the early Israeli entrepreneurs and managers who constructed groups were from Germany and central or eastern Europe, where the "German model of capitalism, including organizing business in the form of *konzernen* [conglomerate business groups] was dominant before the rise of Communism" (Maman 2002, 740).

Factors Affecting Business Group Performance

One main reason to analyze organizational forms is to understand their consequences. Thus it is worth asking whether the business group form is successful and efficient compared to alternate ways of organizing the economy. In this section, I first summarize some findings on business group performance, and then discuss two important determinants of such performance: the extent of common identity among firms in a business group, and the network overlap between business groups and other institutional sectors.

Performance: Innovation and Profitability in Business Groups

Among the many possible measures of how well business groups perform, I select two of great importance: the ability of business groups to create innovations, and the extent of groups' profitability. In both cases, one must compare the performance of groups to that of stand-alone firms.

Regarding innovation, there are few studies that directly compare groups to firms, but an interesting clue is provided by the distinction drawn by Hall and Soskice between "incremental" and "radical" innovation. By "incremental" they mean "continuous but small-scale improvements to existing product lines and production processes," and by "radical," "substantial shifts in product lines, the development of entirely new goods, or major changes to the production process" (2001, 38–39).

They do not analyze the relative strength of organizational forms in these different types of innovation, but instead broadly generalize that economies characterized largely by market coordination ("liberal market economies") are weak in incremental but strong in radical innovation, with the opposite being true for economies where nonmarket coordination is strong ("coordinated market economies"). The logic is that in the latter case, employment is secure and close interfirm collaboration "encourages clients and suppliers to suggest incremental improvements to products or production processes" (Hall and Soskice 2001, 39). The dense network of intercorporate linkages is associated with a system of corporate governance that insulates firms against hostile takeovers, and thus reduces sensitivity to immediate profits. This encourages "corporate strategies based on product differentiation rather than intense product competition," and a "reputation for risk-taking or cutthroat competition is rarely an asset in such networks" (40). By contrast, in liberal market economies, the stress on current profits implicit in the market for corporate control reduces employment security and thus discourages employees from cooperating in attempts to innovate. Instead, they cultivate their own career and general skills above loyalty to company; moreover, contract and antitrust law discourages collaboration between firms on incremental innovation. However, the fluid labor market and the ability of firms "seeking access to new or radically different technologies to do so by acquiring other companies with relative ease" encourage radical innovation (2001, 40).

Though couched at the level of entire national economies, all these considerations map easily onto the distinction between business groups and stand-alone firms, and imply that groups will excel at incremental innovation but separate firms at radical innovation. A similar argument seems implicit in the work of Amsden and Hikino (1994), who propose that one great advantage of diversified business groups in emerging economies late in the twentieth century was their superior ability to execute technology transfer from more industrially advanced nations. Though they do not distinguish between incremental and radical innovation, the kind of transfer they discuss seems to be incremental, as it does not involve creating entirely new products or diverging dramatically from existing ones.

If high technology innovation counts as "radical," it does appear that this has emerged mainly from liberal market economies, such as that of the United States, with other more coordinated market economies specializing in incremental improvements to the new models. It also seems clear, however, that even if a liberal market economy is a necessary condition for radical innovation, it is not sufficient, as such innovation rarely occurs. Saxenian's well-known arguments about divergences between regions in the United States in their capacity for radical innovation suggest that even within a "liberal market economy" with stand-alone firms, some sectors or regions may not produce the relevant conditions (Saxenian 1994). And this suggests that it may be hazardous to extrapolate from arguments about the innovative potential of organizational forms to that of entire economies, because countries may vary widely internally in the distribution of forms and even of types of coordination (cf. Locke 1995 on Italy; Herrigel 1996 on Germany; and the rapidly growing literature on the mixed economy of China).

Further insight may come from an argument on a different plane from those on entire economies, but which may point to a similar conclusion: David Stark's emphasis on the importance for dramatic innovation of a diverse population of firms whose networks can be easily shifted and recombined, in industries where it is important to avoid adaptation at the expense of adaptability (2001, 72–74). If this is correct, then the stable identity of the firms that compose a business group, which is part of the way I have defined such groups, may hinder innovations that require firms to rapidly shift the composition of interfirm alliances from which they derive technological insight.

Profitability has been studied more systematically than innovation. Khanna and Rivkin (2001) analyzed 14 emerging economies where groups are significant: Argentina, Brazil, Chile, India, Indonesia, Israel, Mexico, Peru, the Philippines, South Africa, Korea, Taiwan, Thailand, and Turkey. They found that business group "affiliates perform better than nonaffiliates in six countries and worse than nonaffiliates in three, with no difference in profitability levels in the remaining five countries" (2001, 46). Though consultants often advise governments to rein in the diversification of business groups in favor of greater focus, they report that in 11 of the 14 countries there is no evidence of a diversification discount, and "if anything, there is often evidence of a diversification premium" (2001, 47). Thus they suggest that "owners and managers of business groups should be wary of strategy advice from advisors whose knowledge base originates in advanced economies" (47).[10]

Profitability varies across nations because groups have sources of both performance strength *and* weakness in their structures, and which dominates often depends on circumstances outside their control, including government policy, political change, international financial markets, and noneconomic social institutions. For Korea, Chang (2003, chap. 3) notes that the extensive group-level sharing of resources, such as brands, technology, and personnel, and also group-level organizational structure help firms learn from one another's experience and enhance profitability. But these synergies can be eroded in several ways. First, as more affiliates become listed companies, minority shareholders object to resource flow out of their company with no immediate return. (Major shareholders do not object since they are typically composed of the family that controls other companies in the group.) Perhaps more significant, especially in the crisis of the late 1990s, the "value creation that occurred at the individual [group firm] level through resource sharing was often totally wasted in some other part of the group due to ill-conceived strategies or to cross-subsidization of poorly performing affiliates" (2003, 107). The same centralized structures that led to useful synergies between affiliates increasingly became a liability from the 1980s on, due to bad decisions. The problem arose because once the state backed off of bailouts and strong control of strategy, the groups did not have a functioning governance system to perform due diligence on major decisions (Chang 2003, chap. 3).

This should remind us that groups are more than the sum of their firms. Because they are internally socially structured, it is misleading to measure average profitability of firms within a group, as each may play a different role and thus achieve correspondingly different financial results. Chang, for example, referring to the fact that single families typically dominate even the largest of the Korean *chaebol,* calls these organizations "privately owned social structures." His blockmodel analysis of 1989 equity ownership ties among firms within the top 49 groups shows that group firms are arranged in a "nested hierarchy": that is, there is asymmetry in sending and receiving equity ties across blocks (1999, 136–40).[11] Portfolio management is "targeted at maintaining family control rather than the returns they can expect from the investment" (1999, 148). If profit maximization were the goal, we would expect to see higher ROA (return on assets) for firms higher up in the structural hierarchy, but in fact the opposite is the case. Those firms are not free to invest for highest yield, but instead must play their network role and invest in appropriate chaebol subsidiaries. Thus, the higher a firm is in the network of directed ties, the greater its opportunity cost. This means that other things equal, ROA is negatively correlated with position in the hierarchy (1999, 149). On the other hand, when growth is the dependent variable, a measure of "control efficiency" that "captures the degree of control amplification through crossholdings" does have predictive value across groups (169–79).

Thus, a focus on family control may compete with short-term profit maximization. Even in the absence of a controlling family, individual firms' profit maximization may be subordinated to group welfare when group identity is strong. Japan presents a striking example. It has long perplexed analysts that companies affiliated with the six largest intermarket (i.e., cross-industry) *keiretsu* are less profitable and show lower rates of sales growth than unaffiliated firms. Lincoln and Gerlach (2002, chap. 5) reproduce this common finding in their analysis of Japan's 200 largest manufacturing firms. But they point out that this is misleading, since the typical OLS (ordinary least squares) specification of the outcome does not take a firm's own past performance into account in assessing the impact of *keiretsu* membership They stress especially whether a firm has been in serious trouble, not merely experiencing stagnant earnings, but actually losing money, which harms a firm's reputation and that of its main bank and close partners. Going into the red is more likely than weak performance to provoke a rescue response from other group members. Using such measures, they find that group membership has quite a different impact on different firms: it helps weak firms, hurts strong ones, and leaves middling performers alone.

Economists often interpret mutual assistance and bailouts within Japanese groups as a rational insurance scheme, in which strong performers pay a "premium" by helping weak firms, so that they will receive help in case of future problems. But since there is little evidence that firms think about bailouts in this way, or indeed that strong firms ever collect on such insurance "investments," this seems more an expression of faith in rational action than a falsifiable argument. Lincoln and Gerlach suggest instead that strong firms could not take advantage of weaker group members because they would be sanctioned by other group firms for "deviating from the norms of the community by extracting rents from business partners" (2002, 5–25). They go on to say that the rational mutual insurance argument assumes a "degree of individual self-interest seeking unconstrained by social commitments and normative rules that is scarce in Japan. The network structures within which Japanese economic action is embedded allow corporations limited degrees of freedom to chart their own course, to freely pick and choose alliances . . . on the basis of unilateral calculations of advantage" (2002, 5–75).

Thus, in both Korea and Japan, it is misleading to measure the average performance of group firms because the social structure of the group makes it inappropriate to consider an individual firm's performance without accounting for the role it plays in relation to other group firms. The extent to which a firm's performance is closely tied to that of others in the group rather than being decoupled in ways that justify separate analysis depends significantly on the strength of overall group identity. Such identity is a factor in determining behavior and performance that is difficult if not impossible to explain from a purely economic viewpoint.

Sources of Business Group Identity

Family domination of groups provides one common source of identity. We have no detailed catalogue of family involvement that would allow us to classify business groups worldwide as to which are family dominated. But the results of La Porta, Lopez-de-Silanes, and Shleifer (1999) on large and medium-sized publicly traded firms in the 27 richest countries—where most analysts previously would have been especially skeptical that family control of large and medium-sized firms persisted—are intriguing. They find that only a couple of countries—especially the United States and the United Kingdom—have many widely held firms, and where, more typically, there is controlling ownership, it is "surprising that by far the dominant form . . . is not that by banks or other corporations, but rather by families" (1999, 496). Their results

> leave us with a very different picture . . . than that suggested by Berle and Means. Widely held firms appear to be relatively uncommon. . . . In contrast, family control is very common. Families often have control rights over firms significantly in excess of their cash flow rights, particularly through pyramids, and typically manage the firms they control. . . . Family control appears to be . . . typically unchallenged by other equity holders. (1999, 502, 505)

Since firms in poorer and less developed economies are quite likely to be even more family-dominated than in the richer ones in this study, it is not hard to conclude that families dominate most firms worldwide. Extending our chain of circumstantial inference, it would follow that the typical business group would also be family dominated. Where detailed studies are available, this is clearly the case, as for Korea, India, Chile, and others. It was also true in Japan until the occupation forces removed *zaibatsu* families from control of their groups, in an (as it happened, fruitless) attempt to break up business groups and implement a more Americanized market system. Khanna and Palepu's study of Chilean and Indian groups indicates that most groups in the two countries are "strongly affiliated with a single family" (1999a, 279) and that only one of the 18 groups in their two-country sample has no family affiliation (280n). They comment that it makes sense for families to "invest" in group identity because the family "creates a system of social norms that reduces intragroup transaction costs by encouraging information dissemination among group firms, reducing the possibility of contractual disputes, and providing a low-cost mechanism for dispute resolution" (1999a, 280). While this is unexceptionable, it distracts from the interesting and key question of how families are able to achieve and maintain control over long periods, which is by no means automatic.

In fact, the extent to which this can be managed is extremely variable. Within nations, some families do this much better than others. Families are not always a fount of dispassionate, rational behavior. Consider cases such as the Hyundai group, once Korea's largest *chaebol,* which rapidly disintegrated after the death of founder Chung Ju Yung in 2001, because his six living sons could not restrain the feuds kept within bounds during their father's lifetime (cf., e.g., Kirk 2001). And not just family disputes, but also the perils of demography may threaten persistent family control. Lindgren (2002) shows that for the Swedish Wallenberg family, which dominates Sweden's largest business group, over the course of the twentieth century, there were a number of points when the principle of passing control down through the male line very nearly came undone, due to lack of a suitable heir.

Entire countries may have kinship structures and contexts that make it hard for families to manage large business empires. For example, the Kenyan businessmen studied by Marris and Somerset "seldom find a way to assimilate kinship successfully within a hierarchy of managerial authority," which puts them at a massive disadvantage in relation to Asian, especially Indian businesses, which are built along kinship lines (1971, 35). This results in part because the Asians, "as a minority excluded from agriculture by colonial policy, could bring much stronger sanctions to bear in their business relationships. A man who cheated his family or caste could be ostracized from commercial employment and had few other sources of livelihood to turn to" (1971, 45). In this early period of Kenyan development, however, business was a peripheral activity for Africans, and relatives who did not perform competently or honestly could not be easily controlled by others in the family since they could return to farming with little trouble. Similarly, overseas Chinese in Southeast Asia typically are far more efficient than native populations in creating kin-based business groups, for reasons that may have to do with differences in the kinship system between China and other Southeast Asian cultures (see Granovetter 1995b for a more detailed argument), as well as their limited options outside of business in these countries.

The sense of identity that families bring to business groups may be amplified by additional sources of solidarity. Business groups in India, for example, are typically led by ethnically homogeneous individuals. The Tata group, long among the top few, has historically been closely associated with the small Parsee minority, and the large Birla group with the Marwaris.[12] India provides mind-boggling caste/ethnic/religious group variation as raw material for constructing business group solidarities. But even countries that are more ethnically homogeneous, such as Korea, allow for extrafamilial solidarities through recruitment of compatriots from the same college, high school, and home region, as is common in the *chaebol*.

Operational practices in business groups may also contribute to a sense of group identity. Frequent rotation of personnel across group affiliates reduces managers' identification with any individual firm and increases it with the group as a whole. One consequence is that the more intragroup mobility managers experience, the more homogeneous they become in their view and practices. This facilitates resource sharing, but may reduce resistance when the leading family proposes disastrous business decisions (cf. S. Chang 2003, chap. 3, for the Korean case). We may contrast this with some multidivisional firms in which managers have strong divisional identities from long tenures, so that central managers must take their views into account for overall planning in order to achieve good outcomes (as in the case of General Motors, analyzed by Freeland 2001). In Japan, firms in a group that are members of the Presidents' Council (*shacho-kai*) have a much stronger sense of themselves as group members than other firms, from their frequent meetings. They constitute a "self-conscious clique of firms whose reciprocal commitments stem from long association and strong collective identity." Indeed, such companies are "automatically eligible for bailouts or other adjustments to raise or lower profitability. Noncouncil firms are subject to such adjustments only if they have extensive dealings with the group" (Lincoln and Gerlach 2002, 5–45, 46).

Generally speaking, other things equal, the older a business group, the stronger its internal identity. The reasons for this may include all those discussed earlier, as well as others that are harder to pin down, but relate to the accretion of tradition. Thus in their finding about how Japanese groups offer assistance to their own troubled affiliates, Lincoln and Gerlach note that of the six major postwar intermarket groups, such intervention is more likely among the groups with longer histories than among the newer city bank–centered groups that emerged only after the war. And where interventions do occur in the newer groups, they appear to be economically targeted, compared to companies from much older groups like Sumitomo and Mitsubishi, which are "all around busybodies" and intervene even if they are not the main lender or stockholder in a company (2002, 5–44), which would entail more clear economic incentives.

Network Overlap between Business Groups and Other Institutional Sectors

The argument thus far about how efficient business groups are has focused on their own internal functioning. But how well economic actors succeed in their endeavors often depends on how much their networks overlap with those in other institutional sectors. The simplest example of this has already been broached: the extensive overlap of business with kinship systems around the world. The goals of families can conflict with profit maximization for the groups and firms they dominate. At times the clash is entirely financial, as when families shift resources around business groups at the expense of minority shareholders in order to enrich themselves. Such families are still maximizing profits. But families often want more than wealth from their business activities: they also want to enhance their social status. For example, Ghemawat and Khanna note that in India, "as in many other Asian societies, there seems to be a stigma associated with restructuring" (1998, 55). The Tata family, long the dominant force in India's leading business group, enjoys exalted social status based in part on its reputation as an enlightened employer. Thus, when Tata Steel felt compelled in 1999 to lay off 35,000 workers, the "sackings so offended Tata Culture that the company agreed to pay the workers' salaries until the age of 60" (Ellis 2002).[13]

Or, for Japan, Takeda notes that *zaibatsu* shareholders between the two world wars

> did not demand a high dividend rate. . . . Family members were neither allowed to sell their own equity nor to become independent from the family busi-

> ness. The ultimate obligation of family members was to take their family business which had been inherited from their parents' generation, to develop it and pass it on to their children's generation. . . . in Mitsui's case [then and now one of the largest groups] in order to avoid the loss of family assets and to keep the reputation of the family business, the Family Constitution . . . prescribed to the family members to avoid extravagance. (1999, 94)

From a purely economic viewpoint, such tendencies are frictions that derail economic rationality. But a clearer understanding of how business groups function requires a broader view. Especially since families dominate business groups in most countries, our analytical understanding of how they operate has to consider in a single framework their economic as well as their noneconomic goals. In the case of *zaibatsu* families, or the Tatas in India (and their group, the Parsees), one would like to know, for example, where they stand in the overall social status structure of their country, and how their economic and noneconomic goals intersect. Such an analysis would be useful for most of the leading business groups, but would require a kind of sociological-cum-economic analysis that is rarely attempted. Each discipline follows its comparative advantage and stresses especially the set of motives that its theories illuminate. The absence of a unified social science that allows economic and noneconomic motives to be understood jointly, as they operate in real actors, makes it especially difficult for us to comprehend the development of business group strategy.

The extent to which families and business groups are involved in politics is also important but relatively neglected. While virtually all analysts agree that regulation of groups by the state strongly shapes their structures and strategies, state and business are often treated as separate actors. Yet few doubt that the way business and the state influence one another is mediated by the personal networks that link the two sectors. Evans coined the term *embedded autonomy* to describe the characteristics requisite for a state to influence the economy positively—meaning a professionalized bureaucracy largely autonomous from business but with social ties linking to business leaders that are the channels through which influence may be exercised (Evans 1995).

But the network overlap between the state and business has not been studied in careful detail. There are some tantalizing clues. For Japan, Taira and Wada (1987) described a "todai-yakkai-zaikai complex"—the overlapping networks of graduates of leading universities, leading families, and top executives—and how these ties facilitate contacts among government and business leaders, who are quite accustomed to interacting in nonbusiness spheres. They go so far as to say that the resulting networks "render the formal structural distinction of government and business almost meaningless in Japan" (1987, 264). It is in part because of this dense network that government can regulate with a relatively light hand and yet have an impact beyond what could be expected from visible formal mandates. This disjunction between the formal and the informal is one reason why there is so much controversy over how powerful the Japanese regulatory system is—one's conclusion depends on whether one focuses on formal actions or actual outcomes. A well-known practice that reinforces network overlap is the colorfully named *amakudari*—"descent from heaven"—the movement of retired government officials to positions in industry from which they activate their social networks in the state bureaucracy to help coordinate state-business interactions. Though *amakudari* is a widely understood pattern, no detailed study of it and the webs it creates across sectors has yet been accomplished.[14]

Where governments or influential political organizations themselves own or run business groups, we can expect to see this affect their views on regulation. Chung reports that the Kuomintang (KMT)—the party of Chiang Kai-shek, which dominated Taiwan in single-party rule from 1949 to the democratization of the 1980s—was also itself a major business interest, controlling 168 corporations in 1996. He refers to it as a "*de facto* business group" that, if ranked among the top 100 groups in Taiwan in 1998 would be twenty-fourth. In part because the party depended heavily on these businesses to support its political campaign, it actively supported limits on government regulation (Chung 2000, chap. 5).

A pioneering attempt to measure the overlap among business, politics, and kinship is Zeitlin and Ratcliff's 1988 study of Chile in the 1960s, which develops the idea of a "kinecon," a "complex social unit in which economic interests and kinship bonds are inextricably intertwined"—a set of "primary, secondary and other relatives among the officers, directors, and principal shareowners, whose combined individual and indirect (institutional) shareholdings constitute the dominant proprietary interest in the corporation" (55). Carefully tracing kinship ties at an unprecedented level of detail, they show that families not only control most of the major corporations through complex pyramids, but that supposed divisions among industrial and agrarian landowning classes are bridged by a dense web of kinship ties, and that leading members of these families are prominent in the state apparatus as well (1988, chap. 5).

Korea is another case where kinship ties between business and the state have attracted considerable attention. It is also a case that illustrates how changes in network overlap can affect economic outcomes. As Kim (1997) points out, during the administration of Syngman Rhee (1948–60), the overlap was very direct: many members of Rhee's Liberal Party were founders, owners, or large stockholders of the *chaebol* (1997, 113). In this classic "rent-seeking" situation, the state became the captive of special interests, and heavily subsidized them, in part possible because of the large infusions of foreign aid from the West following the Korean War. The military coup of General Park Chung Hee in 1961 completely changed this situation. The class and family backgrounds of the new regime were quite different from those of previous elites, and many, including Park himself, were from peasant families. E.M. Kim comments that this new "distance allowed the state to be autonomous from the interests of the landed and industrial classes" (1997, 112). Park's dramatic gesture of arresting major *chaebol* presidents for corruption just 12 days after the coup was facilitated by the little-noticed fact that these business leaders were not well organized to resist—few "formal organizations among businesses existed at the time" (1997, 118). It would be interesting to speculate why the business class was fragmented in this period, and whether this had to do with regional or other rivalries that divided leaders. This new social autonomy of the state from business allowed it to adopt firm policies and demand strong economic performance from the business groups.

But as the economy grew and the state apparatus became more institutionalized, we should perhaps not be surprised to learn that the "number of marriages between the offspring of state officials and business leaders increased leading to blurred class distinction between the two groups" (Kim 1997, 173). The Korean popular press took a special interest in such alliances, with particular attention to the marriage in 1992 of the president's daughter to the son of the chairman of a major *chaebol*, one of many such cross-sector marriages noted by Darlin (1992). Indeed, Cumings (1997, 329) estimates that in the 1990s, about one-third of fathers-in-law of *chaebol* owners were high-ranking government officials. This was one among several factors that reduced the independent power of the state vis-à-vis the *chaebol* in the 1980s (Kim 1997, chap. 6).

The problem in analyses of business-political network overlap, however, is that—especially in relatively small countries like South Korea and Chile—it is hard to know what the null hypothesis is for how many prominent people should be related to one another—the baseline against which we should be impressed by the number of parents, children, spouses, aunts, uncles, and cousins who are represented in the ownership and control of major corporations and linkages to the state. Moreover, showing that many leading co-owners are related to one another or to political figures, or are themselves in politics, does not in itself prove that action has been either coordinated or effective. Guillén notes, for example, that business groups "have loomed large in Argentine politics. . . . Cabinet ministers and other top political appointees have frequently been recruited among the managerial ranks of the largest groups. . . . The Argentine business groups, though, have not always succeeded in influencing policymaking in their favor" (2001, 83).

Thus, we have only scratched the surface of research on this important topic of network overlap among institutional sectors. In the early twenty-first century, when methods for analyzing and visualizing social networks have achieved remarkable advances, in tandem with dramatic increases in computing power on our desktops, the possibility of collecting and mapping data on network overlap in a sophisticated way is real for the first time. Such an effort must be accompanied, however, by better conceptualization and measurement of the consequences of the network patterns we find, including measures of how well different organizational forms achieve their diverse goals.

Anachronism or Avatar? The Future of Business Groups

One's view of where the organizational form of business groups comes from, and how successful it is, will strongly affect judgment about whether groups are an anachronism that arises for lack of a better and more efficient form of organization—such as that provided by a "well-functioning" market, or an avatar of modern organizational forms, which have developed new ways to mobilize resources across disparate social sectors so as to focus on unprecedented new and complex tasks (cf. White 1992; Burt 1992; Granovetter 2002). During the 1970s and 1980s, when the economies of Japan and Korea were considerably more robust and successful than those of the West, the business press, and leading academics (e.g., Vogel 1979), argued that patterns of complex cooperation found in these systems could profitably supplant the (imagined to be) more common Western pattern of widely held autonomous firms that answered only to shareholding owners. When the economic situations reversed in the 1990s, most opinions swung to the other extreme, accounting in part for the often disastrous advice offered to countries emerging from state socialism. In 2003, after several years of weak economic growth and swirling scandals in the United States, previously thought the strongest fortress of shareholder value and accounting transparency, this view is harder to support; thus, no single model now commands universal attention or approval.

Progress requires recognizing that to assess organizational forms from their most recent results is not viable as a theoretical stance nor as a long-term strategy. It makes more sense to look closely at how business groups have responded to changes in the economies they inhabit, and at how we understand their capacities and the way they change over time.

The view that business groups arise in response to missing institutions implies that if those institutions should emerge, groups will lose their competitive advantage and selection pressures will fragment and dissolve them in favor of individual firms. Thus, Khanna and Palepu urge governments not to try dismantling business groups, but rather to build up market institutions. "The dismantling of business groups will, we believe, follow naturally once those institutions are in place" (1999b, 126). Similarly, Chang suggests that because the Korean "chaebols are creatures of market imperfections and government intervention . . . as these forces diminish, chaebols will decline in the long run" (2003, 238).

But as Keynes remarked, "in the long run we are all dead."[15] In the short to medium run, which we are constrained to inhabit, the picture is murkier. Chang himself goes on to note that *chaebol* and "business groups in other countries will not . . . disband overnight. It takes time to build institutions and for the effects of competition to be felt" (2003, 239). Consider Khanna and Palepu's study of how business groups in Chile and India responded to major policy shocks brought on by privatization and deregulation. Despite the shocks, the large groups in both countries did not reduce their activities or narrow their focus. Instead, and belying the "traditional view that liberalization is likely to reduce the role of the largest and the most diversified business groups in the economy," they strengthened their internal structures and processes in ways that "will enable them to increase their role as intermediaries in domestic product, labor and capital markets, and in international markets for capital and technology," and furthermore, "their actions are associated with performance improvements" (1999a, 274) and with an increase of group identity. Khanna and Palepu attribute this outcome to the fact that deregulation alone does not build institutions, so that when the government exits functions it had previously performed, and new institutional intermediaries do not immediately arise, the groups see opportunities to increase their own intermediation.

There is in fact considerable evidence that since the mid–twentieth century, 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. In Japan, American occupation forces meant to dissolve the powerful *zaibatsu* complexes—family-owned business groups that dominated much of Japan's industrial production through the Second World War. By banning the holding companies through which families exercised control, purging families of any role in their former business empires, and directly dissolving the largest *zaibatsu* groups, they imagined that they could engineer a competitive economy made up of many small firms (Hirschmeier and Yui 1981, chap. 4). But despite having been beheaded and dissolved, three and perhaps four of the largest groups reassembled themselves in the postwar period and resumed a position of economic dominance. Planners had dramatically underestimated the extent to which the dense web of ties connecting firms within these groups, and the resulting sense of group identity and patterns of customary cooperation, could persist and regenerate even without direction from family owners.

For Chile, Khanna and Rivkin (2000) note that the stock market returns of companies within groups covary more than equity interlocks alone can explain, which suggests that investors assume that nonequity ties, including kinship, link such firms. They note that this matters a great deal in countries like Korea or South Africa where governments attempt to dismantle groups by unbundling formal ownership ties. They suggest that these ties are just the tip of the iceberg, and that governments

> may have to sever many bonds other than direct equity interlocks in order to break up established groups. Indeed, many of the bonds that appear to be at least somewhat relevant can hardly be legislated. . . . It may require a substantial and sustained effort to replace directors, eliminate owner overlap, install new managers, and alter personal relations. (2000, 35)

In Southeast Asia, economic crisis has severely tested the business group form. The currency shocks of 1997 severely disrupted many Asian economies, and in some of the most seriously affected countries, such as Korea, the International Monetary Fund demanded strong reforms as a condition for bailout loans. The Korean government enacted many of these, aiming to weaken the large groups, reduce their scope, and narrow their focus. They also meant to increase transparency in intragroup transactions, and to ban transactions that had previously supported risky investments, such as mutual loan guarantees among group companies, and excessive cross-holdings (see the excellent account in S. Chang 2003). As a result of the crisis, half of the 30 largest groups in 1997 were reduced in size or liquidated.

But in 2003, what is most remarkable is this story's surprise ending. The Korean economy has substantially recovered and is enjoying economic growth, at a level unimaginable in the darkest hours of the 1997 crisis. Yet this new growth has occurred despite the failure of most reform efforts. Though, as noted, many *chaebol* failed (which would not have been permitted during the period of strong state support in the 1960s and 1970s), the failures were among groups already weak and severely overextended; by contrast, in four of the five largest groups, the number of member firms has actually increased. Thus, E.M. Kim and D. Chang note that "it is difficult to conclude that the corporate restructuring measures succeeded in reducing the influence of the largest *chaebol* in the South Korean economy, which was arguably one of the not-so-hidden agendas of the corporate sector restructuring" (2002, 32).

D. Chang argues that one reason the reforms failed is that they treated the *chaebol* as if they were collections of individual firms; but in fact they responded to the crisis as network units. Repeating the blockmodel analysis he had done for ownership ties in 1989 for 1998 data, Chang found that the hierarchical organization of ties within *chaebol* remained solid; because they wanted to retain control of their *chaebol*, families did not redeploy their investments to more profitable locations. But the nested hierarchy of the earlier period was refined by the most successful groups, in such a way as to increase the leverage available from relatively small holdings; and the more successful *chaebol* are especially those that did so. Chang (2000) refers to this as a "network survival strategy."

In Japan the economy was under pressure for a longer period. The stunning growth of the 1980s ended in 1991, leading most commentators to call the 1980s a "bubble." Japan then entered an economic downturn that persists to the present time. Lincoln and Gerlach carried out a blockmodel analysis of the 259 largest firms in the Japanese economy as of 1980, without making any prior assumptions about *keiretsu* membership, to see if the data reduction reproduced what are usually considered *keiretsu* groupings. In the most comprehensive such analysis ever attempted, they considered four types of interfirm ties: lending, trade, shareholding, and director dispatch. The business press has generally asserted that in the economic crisis of the 1990s, Japanese firms have been jettisoning the excess baggage of *keiretsu* ties and obligations, in order to move toward a more efficient free market economy. But the Lincoln-Gerlach analysis shows something quite different: it was in fact during the 1980s bubble that group ties frayed substantially. During the 1990s, the three groups that had emerged anew after the Second World War (Sanwa, DKB, and Fuyo) did not regain their earlier cohesion, and showed some decline. To some extent we can see these three groups merging into one, so there would now be four major intermarket groups (Lincoln and Gerlach 2002, 6–20). But the older groups with strong *zaibatsu* roots, Mitsui, Mitsubishi, and Sumitomo, clearly strengthened during this crisis period. Lincoln and Gerlach suggest what they call a "countercyclical change": network forms expand and contract inversely with business conditions. During a boom period, the mutual support that group firms offer one another is relatively less important, as the rising tide lifts all boats. During a crisis, groups that can manage to do so return to their group identities for the vital support that flows from them (Lincoln and Gerlach 2002, chap. 3).

It is likely no accident that in both Korea and Japan, the groups that were most resilient were the oldest ones with the strongest sense of group identity. The oldest Korean groups, Samsung and LG, seem especially stable. And in India, the Tata group, with nineteenth-century roots, shows few signs of breakup despite the fragility of some newer business houses. The ties of sentiment and identity that infuse such groups both lower transaction costs across group firms and produce noneconomic motivations among participants for the groups' success. For this reason, we might imagine that countries in economic crisis where groups are of quite recent origin—as in the formerly state socialist countries of Russia and eastern europe—might see groups dissolve much more readily than countries where groups and their families and other participants have long history and tradition to draw upon.

Thus, the argument that emerging market institutions will make groups unnecessary in the long run must confront their apparent resilience in the face of crisis and direct frontal attack by governments. This is not to say that groups might never become superfluous and fade away. What we need, however, to understand this more clearly, is a better-developed theoretical argument about the origins of institutions that mediate between individuals and larger economic structures in the capital, product, labor, and other markets. If business groups already profit from intermediation and add value to their economies by doing so, it seems likely that they will resist attempts to build new mediating institutions that would undercut their functions, and that this resistance may succeed.

New institutional intermediaries that replace business group activity do not emerge magically or instantaneously from free market interactions, but rather in a political context. They must be built by institutional entrepreneurs who have the ability to mobilize resources. In countries that business groups already dominate, the financial and political space for such entrepreneurs to operate in outside of groups is significantly narrowed. Without strong pressures from external, global-level actors such as the International Monetary Fund, it is not clear from what sector or with what resources local actors could manage this feat. To persuade supporters that this would be a good use of resources, such entrepreneurs would need to demonstrate that the new institutions would be profitable and also improve economic and social outcomes for large segments of the population. Such demonstration is most likely to occur in a political arena, including new legislation that might be fiercely contested (cf. Chung 2000, chap. 5 for the case of Taiwan). Resulting compromises are quite likely to preserve important functions that business groups already serve. Predictions for any given country about the future of its business groups therefore should depend heavily on the balance of political forces among major stakeholders in the economy, including not only business, but also consumers, labor, and the state bureaucracy. Strategic actors in all sectors will draw on economic resources, but also on social networks and reservoirs of identity and sentiment, in staking their claims. As in so many social science conundrums, progress in understanding the future of organizational forms depends on our ability to develop a more unified social science with better arguments that privilege neither the political, the economic, nor the social aspects of action, but instead seek to understand how all these intersect in real actors and institutions.

Notes

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1. The present chapter complements rather than replaces my 1994 *Handbook* chapter "Business Groups," so the reader may also want to consult the earlier version. At the time of the first edition, the topic was little discussed. But it has since risen to considerable prominence, and here I attempt to bring some order to the recent outpouring of literature.
2. For further discussion of Coase's arguments and how they relate to business groups, see Granovetter 1995a.
3. A "subsidiary" is a corporation whose stock is majority owned by another, "parent" corporation.
4. The history, causes, and scope of this invisibility are discussed in Granovetter 1995a, 97–100.
5. But see Penrose's discussion of "combines," collections of firms acquired by a single entrepreneur and loosely integrated under a holding company ([1959] 1995, 186–89). This form fits her general discussion only with difficulty, and she discusses it in a section entitled "Empire-Building and Merger," as an example of the effect of "abnormally expansive behavior" (186). She recognizes that such firms may persist and even become profitable and dominant, noting that the activities of such an entrepreneur are "closer to those of the 'financier' than to those of the 'industrialist' and that creates special difficulties for the unambiguous definition of the industrial firm" (189).
6. These are the same six that I discussed in greater detail in Granovetter 1994, 461–70.
7. There is no way of determining from the LaPorta et al. data what proportion of family-dominated firms fall within business groups, but it is clearly substantial or dominant in many countries.
8. See related comments in Granovetter 1994, 464–66, 470.
9. Note that both Hollingsworth and Boyer (1997) and Hall and Soskice (2001) make these comments in introducing edited volumes in which many other authors then develop specific analyses within the general framework they propose.
10. For a much more detailed account of the advantages of group firms in India see Khanna and Palepu 2000.
11. As is typical in sociometric analysis, asymmetry is used as a measure of hierarchy. In this case, a firm or block that

sends equity ties to another but receives none back is considered higher, as the equity tie reflects ownership and possibly control.

To simplify exposition, I refer to "blocks" in Chang's analysis. Because he uses a role-equivalence algorithm to reduce the data, he refers instead to "role-sets." See Chang 1999, 115n, and the detailed discussion in Wasserman and Faust 1994, chaps. 10–12.

12. See Timberg 1978 for a useful discussion of how complex the "Marwari" category is.

13. More detail on the House of Tata can be found in Khanna, Palepu, and Wu 1998.

14. But see the promising leads in Taira and Wada 1987, 285–88.

15. This famous quip comes from chapter 3 of his *Tract on Monetary Reform* (1924), where he argues that the "long run is a misleading guide to current affairs. In the long run we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again."

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