

**The Essential Network:
Business Relationships of the Chinese in the Philippines**

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Declaration

Except where otherwise indicated, this thesis is my own work.



Melizza U. Chua

July 2003

To the memory of my grandparents

Chua Vit and Tan Ua

Uy Huat Suy and Chua He

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ABSTRACT

The ethnic Chinese are important players in the Philippine economy. Many believe that networking plays a role in their business success. This research aimed to develop a theory of business relations that explained why and how ethnic Chinese businesses enter into long-term business relationships. It sought to identify the antecedents to long-term business relationships and to discover how businesses chose their partners and structured their relationships. The research also investigated the tangible and intangible outcomes of these relationships. Eight in-depth case studies of ethnic Chinese firms were constructed using data from ethnographic-type interviews, observation, documents and literature.

Using modified grounded theory, the core motivation for entering into long-term relations was identified as accessing scarce resources. Resources were defined widely and included finance, technology, raw materials and skills. A framework termed 'essential network' was developed. This network was composed of each firm's most valuable set of partners. In some cases, these partners could be its key customers or major suppliers or both and in others, its technology partners. The findings revealed that contextual variables (economic, social and political conditions) and the firms' strategies influenced the nature of their business relationships.

Goodwill trust was not necessarily a precondition of cooperation. The preconditions lay partly in the objective circumstances, and partly in the accumulation of knowledge with reference to mutual interests and the potential satisfaction of those interests through cooperative behaviour. The four conditions

that sustained cooperative interaction were related to (a) payoff structures, (b) end-game conditions, (c) embeddedness and (d) tit-for-tat mechanisms.

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GLOSSARY

DSA	Domestic Shipowners Association
FFCCI	Federation of Filipino-Chinese Chambers of Commerce and Industry
GDP	gross domestic product
GOCC	government-owned and controlled corporation
GSIS	Government Security and Insurance Service
ISO	International Standards Office
MARINA	Maritime Industry Authority
Metrobank	Metropolitan Bank of the Philippines
PCIBank	Philippine Commercial International Bank
PhP	Philippine peso
PSE	Philippine Stock Exchange
RCBC	Rizal Commercial Banking Corporation
SEC	Securities and Exchange Commission
SSS	Social Security System
US	United States (of America)
USD	United States dollar

Chapter 1

Business Networks and Chinese Economic Success

1.1 Chinese economic success

There are an estimated 25 to 30 million ethnic Chinese outside of China (Wang 1996). When the Chinese of Hong Kong and Taiwan are included, they total over 50 million (Economist 1992). They are a heterogenous group. But many have observed that no matter where they reside, the Chinese are quite successful in their economic pursuits (East Asia Analytical Unit 1995; Suryadinata 1996; Tan 1992). The economic importance of this group in Southeast Asia (except Vietnam) is illustrated in the following commercial profile.

Approximately 3.5 per cent of Indonesia's population is of ethnic Chinese descent and they control an estimated 73 per cent of listed firms by market capitalisation (East Asia Analytical Unit 1995). In Malaysia, approximately 29 per cent of the population is of ethnic Chinese descent and they account for 61 per cent of national capital (Irwan 1995). The ethnic Chinese community in the Philippines is one of the most economically influential groups in the country. This community of about 1.2 million (or two per cent of the total population) controls between 50 and 60 per cent of share capital by market capitalisation (East Asia Analytical Unit 1995). Firms controlled by ethnic Chinese account for 35 per cent of total sales turnover in the Philippines (Palanca 1995).

The Chinese constitute 77 per cent of Singapore's population and are estimated to control 81 per cent of Singapore's listed companies by market capitalisation. The number of Chinese in Thailand is difficult to estimate due to

their high degree of assimilation and decades of intermarriage with ethnic Thais. Ten per cent is commonly stated. The Sino-Thai community is estimated to control 81 per cent of listed companies by market capitalisation and is active in virtually all sectors, including agriculture, manufacturing, banking and finance, construction and real estate, and retail and wholesale trading (East Asia Analytical Unit 1995; Irwan 1995).

Why are the Chinese economically successful? There is wide debate on this question. In a review of the literature, Mackie (1992) concludes that various explanations have been advanced but that there has been no consensus about which have been most important. One of the earlier explanations advanced to account for the ability of so-called outsiders to excel at commerce is given by Yambert (1981). It is simply this: the very fact of being an outsider. The outsider has no roots either in the sense of intimate attachment to the soil or in the figurative sense of an established position in the social environment. The outsider, hence, enjoys mobility and freedom from social commitments that is both cause and effect of an existence restricted to intermediary trade and finance.

Certain cultural dispositions, such as an ethic of trustworthiness, have also been put forward as contributing to business success (Redding 1991). Chinese capacity for hard work, frugality, and high saving rates has been cited as a reason for business success (Mackie 1992). The values of Chinese immigrants are much more focused on money, or what is termed 'money mindedness', than the locals (Abegglen 1994). This set of contrasts leads to the conclusion that the difference in the values held by immigrants and the locals is responsible for their differential rates of success in business. However, the fact of 'being different' is inadequate to explain, by itself, differential success in commerce. Which groups will prosper as

traders cannot be deduced from the fact of their difference alone but requires further assumptions that are often introduced only tacitly into the discussion (Yambert 1981).

Other scholars however believe that values and ideas must be translated into action to be useful. Superior economic performance is attributed to behavioural manifestations of these values and ideas, such as the various ways in which members of a given population associate and interact with one another (Yambert 1981).

More recently, there has been a focus on ethnic Chinese business networks. Many scholars attribute the economic success of the ethnic Chinese in Southeast Asia to a unique informal network that has the effect of facilitating information and providing access to ready credit (Crawford 2000; Limlingan 1986; Mackie 1992; Wu and Wu 1980; Yoshihara 1988). Tanzer (1994) characterises this 'bamboo' network as a 'vast web of interlinked, cooperative Chinese firms across Asia, all held together by verbal agreements and trust'. Business success is, in large part, based on the existence of familistic ties such as kinship and common place of origin (Landa 1983; Yoshihara 1988).

Indeed, the 'economy without borders' of the ethnic Chinese in Asia is estimated to generate an annual economic output of more than 500 billion USD - equivalent to the gross national product of mainland China itself (Tanzer 1994). Additionally, it is estimated that the ethnic Chinese national product is compounding at 7 per cent to 10 per cent a year. The Economist (1992) contends that this is a 'global network through which money, goods, ideas and occasionally people flow from one firm to another'.

Is this network more apparent than real (Lim 1992)? Is it possible to conclude that a 'Chinese economic zone' in Asia is emerging despite the fragmented nature of the different economic zones of the region? The differences among the Chinese themselves cannot be minimised. Competition and conflict between different groups of Chinese should not be underestimated (Lim 1992).

A paradox also lies within family networks: family ties are at once the strength of Chinese business and the weakness. Constrained by the emphasis on keeping ownership and management within the family, Chinese firms tend to be limited in the size and complexity to which they can grow (Tanzer 1994).

There is no doubt that the ethnic Chinese are important players in the economies of Southeast Asia and many believe that networking plays a central role in their business success. Networking is therefore the focus of this thesis.

This chapter comprises five sections. The previous section provided a brief commercial profile of the Chinese in Southeast Asia. The second presents the two major arguments as to why networks are important in the ethnic Chinese business context. The third section covers the extent of understanding of this research topic: What do scholars know about Chinese networks and how they develop? Fourth, what are the gaps in research? The final section summarises the research problem and comments on the significance of the study.

Ethnic Chinese defined

Before proceeding to the second section, the definition of ethnic Chinese needs to be clarified. Wang Gungwu (1996) uses the term 'ethnic Chinese', or *huaren*, to refer to those of Chinese descent who live outside the territories of China, that is, outside mainland China, Taiwan and Hong Kong-Macau. This term reflects

the fact that the majority of Chinese sojourners have settled down and sought local nationality. Each group of ethnic Chinese would now be moulded by the different influences and conditions of the nation states of which they are citizens. A more thorough discussion of the Chinese as a distinct ethnic group in the Philippines, the field site for this research, is found in Chapter 4.

1.2 Why focus on networks?

The two main arguments presented by scholars for focusing on networks are institutional and strategic. The first argument, deriving from the work of researchers such as Chen and Hamilton (1991), Crawford (2000), Orru (1991), and Biggart and Hamilton (1992), contends that the institutional logic in Asia is different from that in the West. They argue that while the crucial economic actor in the West is the individual, in Asia it is the network. Strategic arguments, on the other hand, focus on transaction costs and the competitive advantage provided by being part of a network (Kay 1993). The institutional perspective emphasises the origins of networks, on what brings networks into existence. The strategic perspective concentrates on what networks accomplish - organizationally - that atomistic markets ('markets') and hierarchical organizations ('hierarchies') cannot (Orru 1991). While these two arguments are not mutually exclusive and tend to overlap, it is conceptually useful to discuss them separately.

The institutional environment

Chen and Hamilton (1991, 5) argue that 'the most important organizational feature of Asian capitalist economies is that they are organized through networks of firms.' Whereas companies in many Western economies are more or less autonomous from and competitive with other companies, firms in East and Southeast Asia are interlinked, thus creating vast, cooperative networks of

independent firms (Redding 1994). Using the firm as the ultimate unit of analysis is therefore inadequate and difficult to reconcile with the networked structures of much of Asian business (Chen and Hamilton 1991).

While the neoclassical 'asocial' concept of economic action is appropriate for the West, it is argued that Asian economies are organized through networks of economic actors that are believed to be natural and appropriate to economic development. The institutional logic in Asia is therefore different (Biggart and Hamilton 1992; Orru 1991). Described as 'alliance capitalism' in Japan by Gerlach (1992), the crucial economic actor in Asia is not the individual, but the network. Relations between economic actors do not impede market functioning, but rather promote it (Biggart and Hamilton 1992).

The Japanese case is a significant frame of reference. The prevalence of network organization in the Japanese economy poses a formidable challenge to Western economic theories that view hierarchical organizations and atomised markets as the polar twin mechanisms through which transactions in an advanced economy take place (Gerlach and Lincoln 1992). On the one hand, the Japanese economy appears to make less use of bureaucratic structures in the organization of production and exchange than does the American economy. Japanese firms are, on average, smaller, more specialised to particular industries, less vertically integrated, and far less likely to pursue growth and diversification through merger and acquisition. Yet the alternative to formal hierarchy in Japan is not impersonal arm's-length markets, but informal networks based on trust and long-term 'relational contracting'. Like the myriad other ties that thread through the Japanese economy, they have an enduring, obligatory and cooperative character that economic models of efficient markets fail to capture.

By comparing 'Western' and 'Asian' economic actors, is the institutional logic argument making sweeping generalisations? Studies abound of networks in 'Western' economies. The 'Third Italian' district is characterised by a high degree of cooperative coordination (Langlois and Robertson 1995). Lazerson (1995) reports on the closely coordinated knitting industry in Modena, and Uzzi (1997) finds that embedded (or personal) ties characterise critical exchanges in the New York apparel industry. There are, therefore, major concerns with using the institutional logic argument to explain networking behaviour. The second reason for focusing on networks addresses the following question: What does the network accomplish that markets and hierarchies cannot?

Strategic outcomes

If the ethnic Chinese firm is taken as the prime unit of economic action, then one set of conclusions is possible: that the firm stays within a narrow field of specialisation normally associated with the knowledge and inclinations of the 'paterfamilias'. On the other hand, networking can provide an expansion of activities without necessarily requiring a more complex integrative structure. The principal economic actor thus becomes an informal coalition, a linked network of units (Redding 1991).

For example, Redding (1994) argues that the structure of Hong Kong's most successful industries is one of networked small and medium enterprises. The use of network alliances permits a firm to transcend the limitations of its own small scale. The efficiency of the system as a whole rests heavily on trust-bonding. To concentrate on networking is not to suggest that networking alone is the prime determinant of growth. It is clearly important in the Chinese case, but it lies in the context of a wider system (Redding 1991).

Several features of Chinese business organization constrain firm sizes. Most possess simplified organizational structures and centralised decision making and are predominantly family owned and controlled. However, two responses allow the size limitations to be transcended. The first is the careful strategic choice of business field. The second is networking. These are commonly combined to produce formidable organizations, some of which have legal status and some of which are virtual in character but highly effective nonetheless (Redding 1995). Table 1.1 summarises the strengths of networking in terms of efficiency, reliability and flexibility. The table also identifies the weaknesses of networks.

Table 1.1. Strengths and weaknesses of Chinese business networks

<i>Strengths</i>	<i>Weaknesses</i>
<ul style="list-style-type: none"> • efficiency of transaction costs • reliability of networks and linkages • manoeuvrability of linkages 	<ul style="list-style-type: none"> • limited field for cooperative relations; tendency to small scale • mistrust and urge to control leading to capital starvation • technical limitations caused by scale restrictions

Source: S.G. Redding, 'Weak organizations and strong linkages', in *Business Networks and Economic Development in East and Southeast Asia*, ed. G. Hamilton (Hong Kong: University of Hong Kong Press, 1991).

As most Chinese family businesses are small and managed by core family members, they are heavily dependent on business opportunities and credit lines provided by their business network (Chen 1995). This network also provides access to market information and ready availability of funds in societies with underdeveloped financial institutions (Mackie 1992).

Networking also operates in the field of ownership. The process of creating informally allied business groups provides strategically useful outcomes for capital raising, competitive behaviour, and political cooperation. This is done by an elaborate net of interlocking directorates. A web of relations ties the ethnic Chinese economy together through to the base of the system where either partnership or trust bonds serve to maintain the potent balance of two elements: flexibility in meeting market demand and reliability in seeing economic transactions completed (Redding 1993).

In summary, the two arguments for focusing on networks have a common element: networks deliver economic benefits to participants. However, the institutional logic argument stresses that these networks are somehow unique to Asian economies. On the other hand, strategic arguments consider that networks perform functions that complement markets and hierarchies. These two arguments will be revisited when the gaps in research are considered in the final section.

What is the extent of understanding of the business networks of ethnic Chinese? The following section begins by considering a brief history of the development of commerce in China, followed by a discussion of business networks in Southeast Asia. Three sociological concepts surrounding Chinese relationships – *xinyong*, *guanxi* and *renqing* – are then outlined.

1.3 Networks in Chinese history

Before the Tang dynasty (AD 618 - 906), most of the population in China remained little affected by commerce. The government restricted commerce to specific areas and firms. During the ninth century, this old system gave way to an era of vastly increased economic freedom (Elvin 1973). This period of change (Sung dynasty AD 960-1275) signalled the decline of the hereditary privileges of the

great families and the end of formal constraints on social mobility for commoners. Officials supported the development of strong urban merchant associations (*hang*) and, through them, supervised all aspects of trade and manufacturing (Hamilton 1991).

The Chinese economy had become commercialised. One sign of this was the increased complexity of business structures. There was a wide variety of business associations, some linking larger and smaller merchants, others joining essentially equal partners. Functions became more specialised and services like storage became an independent trade in itself (Elvin 1973).

Increased contact with the market made the Chinese peasantry into a class of adaptable, rational, profit-oriented, petty entrepreneurs. A wide range of new occupations opened up in the countryside: from vegetable and fruit production to sugar refining, paper manufacturing and textile production (Elvin 1973).

The next period of change began in the Ming dynasty (1368-1644) and continued through the Qing dynasty (1644-1912). With the founding of the Ming dynasty, the institutional focus turned away from an urban centred economy toward a rural centred economy. This shift in institutional focus strengthened local rural associations, especially lineage organizations. As a complex marketing system developed in the late Ming and Qing periods, economic organizations were, accordingly, extensions or adaptations of the institutions of rural society. In particular, these rural institutions were the form of networks spawned by ties of kinship and common regional origin (Hamilton 1991).

Some scholars have argued that the Chinese were incapable of creating large private economic organizations during the period of late traditional China (Ming

and Qing dynasties). It was said that the lack of commercial law was partly the reason. Moreover, the Chinese had difficulty trusting anyone to whom they were not related, or with whom they had no long-standing relationship. Therefore businesses tended to stay small and restricted in geographical scope and their dealings with customers, employees and other businesses usually had to be mediated through brokers, guarantors, contractors or middlemen of some kind. According to Elvin (1973), there is a measure of truth in these contentions, but they need to be qualified in a number of ways.

Commercial contracts could be enforced in the law courts, at least up to a point. Likewise, kinship bonds and partnerships could be the basis of quite large businesses. The device of commercial discipleship was used to extend the range of a business still further. There were, thus, many enterprises that were anything but small. Nor should it be assumed that Chinese businesses were always short-lived. Some of the account houses dealing in silk cloth were more than two hundred years old (Elvin 1973).

The emigration of Chinese to Southeast Asia occurred against the backdrop of the second period of change. There had already been substantial emigration to Southeast Asia in the Ming Dynasty, but a new wave began during the Qing dynasty. The greatest waves of Chinese emigration took place in the second half of the 19th century, which saw more than two million people move from their homeland between 1848 and 1888 (Pan 1990). However, the first official recognition of the right of the Chinese to leave their homeland did not eventuate until 1870 (Purcell 1965).

1.4 Networks in Southeast Asian history

The Chinese who were drawn to Southeast Asia came almost exclusively from the coastal areas of the provinces of Guangdong and Fujian. China had long had a complex economy marked by general use of money and credit, considerable manufacturing, and substantial regional and longer-distance trade. This was even more the case with the South China coast. Here, a distinct seafaring and trading tradition had developed over the centuries, the merchant's way of life was more highly honoured, and commercial skills were more highly developed (Steinberg 1987).

In earlier times, merchants from the region had traded along the shores of most of Southeast Asia, normally staying over in port towns. In the seventeenth and eighteenth centuries, as the trade of Southeast Asia continued to grow, Chinese began to settle in larger numbers. Some came as merchants, simply moving outward along their commercial channels from China's coast cities. But the great majority came as simple labourers, owing passage money to those for whom they first worked. They arrived to work as labour for the docks, hand sawmills, rice mills, and building trades in the port cities and towns of Southeast Asia (Steinberg 1987).

Eventually, the majority of the labourers took a further step, becoming shopkeepers in the towns and villages and middlemen in the growing export trades, at the same time settling down and marrying in what became their new homes. Chinese merchants served as middlemen for peasant-produced export crops, while Chinese labour was generally concentrated in the service industries, on the docks, and in the processing mills, which for a long time held no appeal for Southeast Asians (Steinberg 1987).

Mackie (1995) identifies five different manifestations of what could be called international networks in Southeast Asia over recent centuries. First are the early trading networks built up by the Chinese junk traders from Southern China between the 15th and 19th centuries. The second is the cobweb of shipping-commercial-financial linkages that extended out from the Singapore hub to numerous ports and river-mouths in eastern Indonesia and Sumatra in the 'Joseph Conrad era' of small steamers and sailing ships from the 1870s on. The third represents the well institutionalised networks developed by the remittance system to channel the savings of thousands of poor coolies back to their families in China in the half century before World War II. During this period, private postal exchanges were the most important institutions for overseas Chinese remittances. Usually operated by traders and traditional Chinese banks, some expanded their business in Southeast Asia by operating jointly with inns (Hicks 1993). Fourth are the highly unusual networks created by the smuggling trade across the Malacca Straits during World War II and the Indonesian war of independence between 1945 and 1949. Fifth are the various contemporary forms of commercial and financial networks that have come into being since the 1950s. All but the last came into being in circumstances where trust and personal connections were essential if trade was to be possible, and ultimately proved quite ephemeral in character.

These five types of networks are essentially trading networks. To illustrate, by the end of the nineteenth century, the Netherlands East Indies trade with Asia was characterised by two different commercial systems. The first was made up of personalised, informal trading networks, mainly controlled by ethnic Chinese. They dealt in a wide range of agricultural products, foodstuffs and consumer articles destined for the indigenous population. Within this 'Asian' commercial system, low

profit margins, large and quick turnovers, trust, personal linkages and integrated credit networks were customary. As a kind of superstructure, there was a more Westernised commercial system dominated by European merchant houses. Within this contractual and impersonal network, high profit margins were the rule and commodity flows consisted mainly of bulk goods, such as sugar, coal, oil, timber and tea. This Westernised superlayer, linking small capital-intensive Western enclaves in the Asian region, was completely dependent upon Chinese intermediaries as it had few real links to local indigenous producers and consumers. Japan's export industry producing cheap goods destined for the indigenous consumer also depended on Chinese networks instead of European business networks in Asia (Post 1995).

In pre-World War II Indonesia, Japan's rise as an industrial nation seemed to have brought greater benefits to the *singkeh* (new immigrants from China) than to the *peranakan* (local-born Chinese). *Singkeh* dominance of local trade in the archipelago, especially after the First World War, was due to their better integration with ethnic Chinese networks and their closer connections with southern China and Japan (Post 1995).

An account of ethnic Chinese business in West Kalimantan in the 1930s described the Chinese trading network as comprising Chinese merchants who set up trading posts deep in the interior of West Kalimantan to collect forest products such as rattan and resin from the Dayaks. These merchants were, in turn, connected to other Chinese dealers and importers who were at the same time exporters of the forest products. In addition to channelling local products to the outside markets, Chinese merchants also brought in various commodities that they obtained from the importers in the larger coastal towns. In Malaysia, the Hokkienese dominated the

rubber trading network that spanned the towns and port cities since they controlled the town-dealerships and the export of rubber (Irwan 1995).

A common explanation for Chinese commercial ascendance in Southeast Asia is that their extended family organization and kinship networks provided them with greater capital resources than any that Southeast Asian traders could muster (Steinberg 1987). How and why do their family organization and kinship networks assist them in business? The next part examines several sociological elements of Chinese relationships, including *xinyong*, *guanxi* and *renqing*.

1.5 Elements of network ties

Xinyong, or trustworthiness, is a key component of economic exchange for the ethnic Chinese (Redding 1991; Silin 1976). Why is it considered important?

The formation of networks outside China is argued to be in part a special response to the two problems of insecurity and mistrust. The first is the insecurity that emerges in a society living traditionally close to the subsistence level, and where officialdom's behaviour is unpredictable and not always benevolent. Wong (1995) argues that the Chinese rely on personal relations as a defence against the state. For Chinese entrepreneurs, relationships precede organization. This tends to heighten the importance of knowing people who can be trusted and, of course, greatly strengthens the centripetal pull of the family. Secondly, modernisation that introduces institutions such as law, bureaucracy, contract and other means of resort when trust fails or is unavailable, has not yet moved to a point where the old-fashioned means of coping can be abandoned (Redding 1993).

Wong (1991) speculates that business trust as found in late traditional China was personal and particularistic in nature. Personal trust is dependent on familiarity,

and is thus limited in scope. Upon examination of the legal, political and mobility structure of Hong Kong, Wong (1991) concludes that system trust has been solidly established. Yet this has not diminished the vigour of personal trust in business life. Particularistic ties still prevail. For example, many small factory owners in Hong Kong depend heavily on particularistic relations to get business orders. Highly personalised methods are used, such as introductions and recommendations by former employers or employees, friends and relatives.

Fukuyama (1995) argues to the contrary and describes Chinese society as a familistic community, characterised by weak voluntary associations because unrelated people have little basis for trusting each other. He refers to Taiwan, Hong Kong and China as examples, but argues that this economic culture can also be observed within the Chinese enclaves in Malaysia, Thailand, Indonesia and the Philippines.

Xinyong, guanxi, renqing

Xinyong is a fairly complex concept, and can be translated in different ways, depending on the context. Colloquially, it means 'to credit, to have confidence in; to be worthy of confidence and credit.' One speaks of a person's *xinyong*, meaning their trustworthiness, their willingness and ability to meet business and financial obligations. *Xinyong* is cultivated based on a series of mutually satisfactory transactions. Reports of transactions with others are also taken into account when calculating the *xinyong* of a particular businessman (DeGlopper 1972).

Guanxi refers to special relationships two persons have with each other. It can be translated as 'friendship with implications of a continual exchange of favours' (Pye 1988). *Guanxi* binds people through the exchange of favours rather than through expressions of sympathy and friendship.

In the Chinese art of relationship management (that is, the cultivation and development of *guanxi*), *renqing* plays an important role. *Renqing* can be interpreted as 'human feeling', which covers not only sentiment but also its social expressions such as the offering of congratulations or condolences and the making of gifts on appropriate occasions. The extent of *renqing* that two persons enjoy can clearly indicate the quality of *guanxi* between them (Chen 1995).

For the bureaucracy in China, *guanxi* hampers the implementation of institutional rules based on instrumental rationality, leading to low efficiency and greater confusion. For individuals, *guanxi* not only brings convenience but also obligations. The more benefits one gets from one's *guanxiwang* (or one's sphere of *guanxi*), the more obligations one incurs in one's *renqingwang* (or one's sphere of *renqing*). To develop *guanxi* with others is a kind of social investment and incurs responsibility and obligation. Therefore, in Chinese societies throughout history, there are plenty of socio-cultural mechanisms to limit the role of *guanxi*. In feudal China, for example, there was a system that strictly prohibited the assignment of officials to their native place (Chen 1995).

Chinese societies have developed a 'compartmentalisation' strategy to separate the functionally specific economic exchanges from the fundamentally diffused social exchanges. In the Chinese business world, there is a saying that '*guanxi gui guanxi; shengyi gui shengyi*', which means that when good friends are engaged in business dealings they should follow the principle of separating business from their friendship in order to keep their friendship (Chen 1995).

Personal relations. In traditional Chinese society, the family is not only a tightly-linked unit; it is also a nucleus of all important social life. The family is an individual's first line of defence. Kin groups represent the individual's second line

of defence. When a person is in danger or in trouble and when he needs help in the performance of an economic task, he may require a measure of assistance beyond what his own immediate family can provide. In such circumstances, he can turn to the members of his larger kin group for aid. The need for the second defence line is more pronounced for immigrants who are living under a foreign government and among groups of people whose languages are unintelligible to them. In this way, kinship ties become even stronger. An 'old fashioned' practice is the use of verbal promise as a form of business contract. A transaction amounting to a few thousand US dollars can be made merely by the exchange of a few words. Disputes arising from such a mode of transaction can hardly be prosecuted in court (Hwang 1992). In practice, however, the breaking of trust has widespread social ramifications: the individual concerned is likely to be ostracised and to find it difficult to re-establish connections (Redding 1991).

In the range of personal relations used by Chinese entrepreneurs to maintain business trust, family and regional ties are singled out as particularly important. On the whole, family ties play a critical role in cementing the internal organization of Chinese firms in Hong Kong, while regional ties are prominent in regulating inter-firm transactions (Wong 1991).

Wong (1995) separates Chinese familism into structural and normative elements. Structurally, family ties are important in cementing the internal core of Chinese enterprises. Familism tends to sustain ownerships bonds. Therefore, the importance of familism is in upholding the internal solidarity of the firm. But normatively, familism can be a powerful force in sustaining external, inter-firm relationships. It furnishes the ethical framework for entrepreneurs to spin their

business webs, provides the idiom for economic interaction and generates the blueprint to create personalised linkages.

Basing his research in Hong Kong, Wong (1991) argues that familism found there is impermanent. Since sons are equal heirs in a Chinese family, there is an inherent tendency towards segmentation in the life cycle of the family. As the family is not a permanent entity, family reputation is likewise short-lived. Thus, he concludes that the Chinese family does not furnish a secure basis for long-term business trust to be maintained. Therefore, entrepreneurs, in their business dealings, are fully aware that trustworthiness is essentially tentative and transient, and personal trust has to be continually renewed.

In inter-firm transactions, regional ties based on common territorial origins are more important than familism, Wong (1991) argues. Regional ties play an important role in the establishment of a stable network of personal relations for several reasons. First of all, an individual's place of origin has long been emphasised by the Chinese state as a mechanism of social control. Second, because of the tradition of regional specialisation in occupational activities in China, people from the same locality usually have common economic skills and outlook. This is the tendency for people within one regional grouping to stay within a certain range of occupations, such as Hokkien or Chiu Chow (Redding 1993). Third, regional identity is flexible. The regional scope can contract or expand to suit the situation. Fourth and last, an important condition exists in Hong Kong that keeps most Chinese entrepreneurs within the effective reach of their regional networks. It is the credential barrier imposed by education qualifications, which reduces the possibilities of occupational and geographical mobility. As immigrants from China, most entrepreneurs were not proficient in English. Thus they turned to small scale

industry for advancements and had to mobilise regional ties for their business activities (Wong 1991).

In a study of business relations among enterprises in Lukang, west Taiwan, DeGlopper (1972) notices that the population in Lukang is homogenous, in the sense that nearly everyone who lives there was born there. Hence, it would be very difficult for an outsider to succeed in business in Lukang. Some of the factors that influence business relations in ethnic Chinese communities do not operate in Lukang. After all, if all of one's potential partners in a business relation are one's *tongxiang* (province mate), and every third one bears the same surname, one cannot use such criteria to narrow down the field of possible partners. What other criteria are used instead?

Business relations. The very first observation about the structure of business relations in Lukang is that one does not do business with people one does not know. No one deals with strangers. Nevertheless, the businessmen of Lukang recognise a category of relations called 'business relations'. With the exception of retail sales, business relations can be described as those in which post-dated checks are exchanged. In such relations *xinyong* and some degree of intimacy are important. But such relations can be established with anyone at all, and they are not influenced by such things as kinship, co-residence, brotherhood, or relations that could be said to involve an element of sentiment, of *renqing*. *Xinyong* is said to be determined entirely by a man's performance as a businessman, and to have nothing to do with the solidarities of common surname, schooling, or worship. Business relations are described as explicitly predicated on economic rationality and mutual self-interest (DeGlopper 1972).

Similar findings come from a study of a Hong Kong wholesale vegetable market by Silin (1972), who describes the selection of partners among wholesalers as predicated on three criteria. First, partners are selected on the basis of reliability. Second, there is an inclination to first select from individuals with whom they have previously worked, or who are bound to them by traditional bonds of solidarity. Third, trading relations do develop between individuals not linked by particularistic bonds. In this market, he observes that the trading relations are hierarchical - between an agent and a jobber or between a jobber and a retailer - and bear many resemblances to patron-client relationships.

Silin (1972) concludes that non-kin play a role equal to, if not more important than, that of kinsmen. The essential distinction is not between kin and non-kin but between those who continually validate their relationships and those who do not. The significance of universalistic criteria for the maintenance of trading relationships is little understood and yet is an important aspect of Chinese economic activity, one that gives traders considerable flexibility. But under what circumstances do strong personal ties come into play?

Personal versus business relations

DeGlopper (1972) argues that business involves much more than just buying and selling, and in practice the different categories of social relations tend to overlap somewhat. Simple economic rationality and functional specificity suffice to explain much of the pattern of economic relations in Lukang, but they are not the only forces at work. If one looks at other aspects of business life, one finds that, in certain situations, what may be loosely described as particularistic and functionally diffuse personal relations are of considerable significance. Their importance is most easily

seen if one looks at problems of credit, of access to restricted or limited supplies or markets, and of business partnerships.

To start a business and to meet unexpected difficulties, businessmen must rely on credit obtained through informal, private channels. The best way is through a rotating credit society. One establishes the good character necessary for acceptance in the sphere of credit and mutual assistance only by participating in 'society', by knowing a lot of people and interacting with them in the role of community member rather than in a narrowly defined occupational role (DeGlopper 1972).

DeGlopper (1972) summarises his study in this way: to do business in Lukang one must know people and establish relations of mutual confidence, but one need not know people terribly well, and it is better to have limited relations with a lot of people than very close ties with only a few. Close, particularistic relations are important only in special circumstances. The small businessmen of Lukang desire to maximise their autonomy and freedom of choice, and prefer limited, functionally specific relations to diffuse ties fused with personal relations. Close personal relations are of less importance in Lukang's business relations than in those of other Chinese communities described by other scholars.

1.6 Gaps in the research

The basic critique is spelled out by Mackie (1995). Very little empirical data or analytical rigour about how Chinese networks operate, or what they actually achieve, has been evident in writings on the subject. The socio-economic functions of reducing transaction costs and risks served by networks are not so much mysterious as complex, variegated and still not well researched. Mackie argues that it is highly dubious to contend that most or all of ethnic Chinese networks are tightly

connected. It would be more accurate to say that there are innumerable smaller networks of various kinds among the Southeast Asian Chinese, many of them intermeshed in various ways.

A source of confusion about how networks operate and what functions they serve stem from imprecise uses of the term 'network'. It has been used to describe ties with a common ethnic heritage (East Asia Analytical Unit 1995; Economist 1992; Tanzer 1994), interlocking directorates (Redding 1991), business groups (Numazaki 1991), and even industries (for example, the use of 'rubber network' instead of the rubber industry (Irwan 1995)). Because of differing meanings of 'networks', studies done across industries and in different locations are difficult to compare. This casts doubt on the institutional argument that was discussed in the second section, as the concepts and terminology are not clearly specified. Business networks are almost always assumed to bring benefits to businesses, but how and why they do have not been researched in detail.

Ethnic networks are often more apparent than real, since time and space distances, and language and experience gaps separate Chinese communities (Lim 1992). Old links have changed and disappeared, as have many traditions. Competition and conflict between different groups of Chinese should also not be underestimated. It cannot be assumed that the ethnic Chinese residing in Southeast Asia still look to China as their homeland, nor that they subscribe to a common united purpose.

Another crucial distinction researchers need to make is whether ethnic Chinese networks are different from non-Chinese networks. Mackie (1995, 4) says that, '... we really know very little in detail about those Overseas Chinese networks, or how they function, or in what ways they differ from the many kinds of personal,

social and business networks that can be found in nearly all advanced industrial societies.' Braadbart (1995) asserts that the mobilisation of kinship networks in the pursuit of economic goals is a commercial strategy that is universal.

1.7 The research

Studies of Chinese business have demonstrated the importance of relationships based on kinship, common place of origin, schooling and other particularistic personal ties. In order to understand why economic relations take the form they do, it is necessary to understand the categories of personal relations, to consider the conditions under which relations of trust can be established and the way credit is established and granted, as well as the reasons given for trading with one firm rather than another (DeGlopper 1972).

McVey (1992) states that intra-regional and international connections of Chinese businesses have hardly been mapped, and little is known about how their capital flows from one area to another. The Southeast Asian Chinese business culture remains an enigma to many observers, but its increasing power in the region, and especially its significance for the future of China, means that understanding it has become crucial to those handling business strategies in or for Pacific Asia (Redding 1995). Therefore,

co-operativeness is an important issue, as it is this feature which converts an otherwise disparate group of entrepreneurs into a significant economy, whose power is normally hidden from view due to the simple fact that it cannot be represented in any national statistics. (Redding 1995, 62)

Cooperation is investigated in this research. In particular, the research problem is how and why Chinese firms network with other firms. The next chapter presents a theoretical framework for the study of networking and addresses the

definition of networks. The approach used to examine networking is to examine dyadic interorganizational relationships. The research methodology used is the case study method (Chapter 3). The resulting evidence gathered consists of both qualitative and quantitative data. These are analysed using the constant comparative method, with the aid of the Ethnograph software (Chapter 3).

The study explores the networking behaviour of the Chinese in the Philippines. There is no comparable work done on networking or business relationships for this particular community in the field sites chosen (Manila and Cebu). Omohundro's (1981) study of Chinese merchant families in Iloilo is the only detailed study of the influence of kinship and friendship ties on economic activities in the Philippine context. There is no comparative work for Manila and Cebu, the two field sites for this research. Yoshihara's (1985) study of Philippine industrialisation covers the Chinese community and their contribution to the economy, but it is based on a general analysis of economic statistics. Palanca (1995) uses an approach similar to Yoshihara to construct an economic profile of Chinese business using 1990 data. Hicks and Redding (1982) also estimated Chinese ownership of the top 259 corporations in the Philippines using 1980 data.

Manila is chosen as one field site because it is the most populous city in the Philippines and is the capital of the country. An important work on the Manila Chinese community is Amyot's (1973) anthropological study of Chinese family and lineage. However, this study does not cover their economic activities. Limlingan's (1986) study of Chinese business strategies covers the Southeast Asian region generally and does not provide much detail for each country. More recent is a study on the management practices of a few Chinese enterprises by Roman et al (1996).

The case studies in this research focus on the internal management system of the firms.

Cebu, a city approximately 300 kilometres south of Manila, is the other field site. No studies exist on contemporary Chinese business activities in Cebu. The work by Fenner (1985) on Cebu during the Spanish occupation (1521-1896) emphasises the importance of the Chinese during this period. The city presents an interesting opportunity to study the interaction between Chinese, Spanish and Filipino enterprises. It is also notable that several of the important Chinese businessmen started their business careers in Cebu, including John Gokongwei and Henry Sy. Several of the largest Chinese-owned enterprises are also based in Cebu.

See (1989) contends that the field of Chinese economic activities in the Philippines is a difficult area of research because it involves delving into the business secrets and financial status of businesses. Chapter 3 outlines the strategies adopted by the researcher to address this difficulty.

Case studies of Chinese-owned firms in Manila and Cebu are analysed within the historical and political context of Chinese business in the Philippines (Chapter 4). The individual firm's strategy needs to be considered in conjunction with the business and political environment in which it operates (Whitley 1992; Yeung and Olds 2000). A flaw in considering only one aspect of economic actors, such as their values, is illustrated by Weber's (1951) conclusion that the failure of China to achieve modern capitalism was due to the lack of the 'capitalist spirit'. The problem with China was not the lack of capitalist ethics, Tan (1992) argues; rather, China's failure to develop modern capitalism lies with other structural forms. Chapter 4 therefore considers the historical and political context within which Chinese business in the Philippines operates.

Three main analytical chapters on the case study firms follow (Chapters 5 to 7). The analysis begins with a consideration of the antecedents of business relations (Chapter 5). The chapter addresses the question: Why do Chinese firms engage in networking? The nature of business relations is considered in Chapter 6. This chapter focuses on the different types of business relationships that firms have formed. Concepts of trust and reputation are examined to understand how these affect business relationships. The strategic consequences of these relationships are outlined in Chapter 7. This chapter considers two questions. First, what are the outcomes from networking? Second, how do networks change over time?

The concluding chapter (Chapter 8) ties the research findings together. It shows that while networks are not a unique feature of Chinese business, Chinese networks have unique features. The chapter also explains why the data analysis shows that trust is not always a precondition for cooperation.

Chapter 2

A Theoretical Framework for Analysing Business Relations

A theoretical framework for the analysis of business relations is presented in this chapter. The first objective is to arrive at a working concept of 'network' by distinguishing between the many uses of the term and recommending a practical application. It will be evident that the term can be amorphous, thereby rendering it unsuitable for precise usage. The next section demonstrates why the use of the term interorganizational relation (IOR) is more appropriate for this research.

Section 2.2 outlines the framework used in the research. The framework incorporates four perspectives from corporate strategy that affect a firm's decision in sourcing activities and resources. Another element of the framework is the consideration of the social, political, and historical context in which Chinese business in the Philippines operates. Section 2.3 presents the research questions.

2.1 The network concept

The term 'network' is generally used to refer to a particular type of organization or to attributes of any organization. In the first application, 'network' is used to refer to a particular **type** of economic organization, often by contrasting this type with a hierarchical organization or the market. Although the precise definition of the so-called 'network organization' varies from person to person, in general it is regarded as having many felicitous properties - flexibility, responsiveness, adaptability - not found to the same degree in alternative organizational forms (Kanter and Eccles 1992). In contrast, 'network' is also used to refer to an **attribute** of any organization to describe the pattern of ties that exist,

defined by hierarchical supporting relationships (such as business groups), task interdependencies or information sharing (Birley 1985; Hara and Kanai 1994; Yanagida 1992). For example, Numazaki's (1991) study of Taiwanese business groups (*guanxiqiye* or related enterprises) defines these as a cluster of enterprises owned and controlled by a group of persons tied by a network of various *guanxi*. The focus is on network properties that can be identified in any organization or set of interorganizational relationships (Gerlach and Lincoln 1992). The next section examines these two views in greater detail.

Network as an attribute

This perspective portrays societies as systems of actors - people, groups, organizations - related to each other. Interorganizational networks consist of interacting organizations. There is a division of work in the network, yet no formal authority or hierarchy that alone can impose the necessary amount of coordination (Hellgren and Stjernberg 1987). Thorelli (1986) argues that 'probably the most salient part of the environment of any firm is other firms'. The entire economy, according to him, may be considered a network of organizations with a vast hierarchy of subordinate, criss-crossing networks. This point of view is taken by Johanson and Mattsson (1987) in analysing industrial markets. Networks are complex arrays of relationships between firms and are established through interactions with each other. Competing is, hence, more a matter of positioning one's firm in the network rather than attacking the environment.

The argument for taking a network (or structural) approach in analysis is that the impact of markets cannot be properly understood outside the ensemble of intercorporate ties in which they are embedded. The behaviour of the business community requires an understanding of these business networks in all their

complexity. In the study of organizations, the network approach suggests that by understanding the structure of relations among organizations, and among individuals who span organizational boundaries, it is possible to learn a great deal about the behaviour of those organizations, as well as their internal workings (Mizruchi and Schwartz 1987). A comparison of the network and traditional approaches is summarised in Table 2.1.

Table 2.1. The network approach compared with the traditional approach

	Traditional approach	Network approach
Role, development and performance of companies	<ul style="list-style-type: none"> • a function of how they autonomously exploit a given set of resources 	<ul style="list-style-type: none"> • explained by their ability to develop relationships
Process of resource development	<ul style="list-style-type: none"> • takes place within companies 	<ul style="list-style-type: none"> • takes place between companies
Efficiency in the performance of internal activities	<ul style="list-style-type: none"> • internal technical matter 	<ul style="list-style-type: none"> • to a large extent dependent on supplier and customer relationships

Source: H. Hakansson and I. Snehota, ed., *Developing Relationships in Business Networks* (London: Routledge, 1995).

Markets, hierarchies and networks

The characterisation of markets and hierarchies serves as the starting point in the conceptualisation of networks as a type of organization. Networks are seen, in this case, as an intermediate form of economic organization. In terms of a spectrum of arrangement, from loose to tight, from arm's-length bargaining to total

integration, networks lie somewhere in between (Thorelli 1986; Zajac and Olsen 1993). And while there has been no clear definition as to what constitutes a network organization, there appears to be general agreement as to what it is not.

This form of coordinating production is not quite complete integration into a single firm, but not quite exchange between two separate firms in markets (Sako 1992). Interorganizational networks are an institutional form different from the multidivisional corporation (Chandler 1962) and the large bureaucracy (Chandler 1977). Grandori and Soda (1995, 184) define an inter-firm network as a 'mode of regulating interdependence between firms which is different from the aggregation of these units within a single firm and from coordination through market signals...and which is based on a cooperative game with partner-specific communication.' The common agreement among proponents of network organizations is that transactions occur through networks of individuals engaged in reciprocal, preferential, mutually supportive actions (Powell 1990).

A critique of this general definition is that a continuum running from market to hierarchy can be misleading (Bradach and Eccles 1989). First, elements of the ideal types (or the poles of the continuum) are often found mixed together empirically. Second, markets, hierarchies and 'combinations' are embedded in or lead to the formation of collateral social structure. Bradach and Eccles (1989, 279) contend that 'the control mechanisms, price, authority, and trust - which map roughly on to market, hierarchy, and relational contracting - are useful concepts provided we recognize that they are independent and can be combined with each other in a variety of ways.'

This critique can be addressed by examining Jarillo's (1988) typology. The network concept becomes clearer when the two variables of cooperation and

ownership are juxtaposed against each other. Jarillo's typology results in four distinct forms of economic organization (Table 2.2), with the network being portrayed as a type of cooperative, market-like arrangement. Arm's-length transactions characterise the classic market type.

Table 2.2. The four modes of organizing economic activity

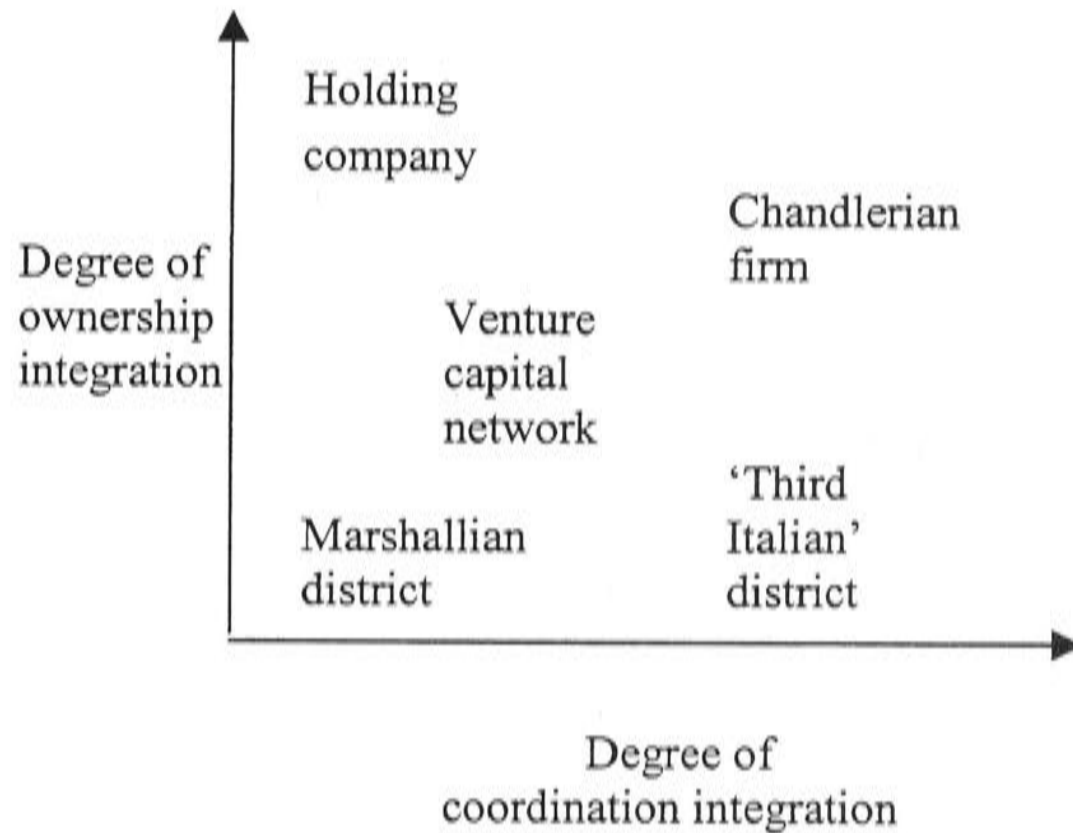
		Approach to the relationship	
		Non-cooperative	Cooperative
Legal form	No common ownership	Classic market	Strategic network
	Common ownership	Bureaucracy	Vertically-integrated Company

Source: C. Jarillo, 'On strategic networks,' *Strategic Management Journal* 9 (1988), 31-41.

The network concept becomes sharper still when the assumption of cooperation is replaced with that of coordination and set against the degree of ownership integration on a continuum (Figure 2.1). The loosest type of network is the **Marshallian industrial district**. Alfred Marshall based this concept on a pattern of organization that was common in late-nineteenth-century Britain in which firms concentrating on the manufacture of certain products were geographically clustered. Transaction costs are minimal and there is high reliance on market mechanisms. A recent variation on the industrial district is the **venture capital network**, represented by Silicon Valley and Route 128 in the U.S. As in Marshallian industrial districts, coordination integration is low in these districts, but

some coordination is supplied by venture capitalists who put up the initial seed money (Langlois and Robertson 1995).

Figure 2.1. Integration and networks



Source: R. Langlois and P. Robertson, *Firms, Markets and Economic Change*, (London: Routledge, 1995), 124.

The '**Third Italian' district** is characterised by a higher degree of cooperative coordination than would be present in a Marshallian industrial district. The German textiles industry in Baden-Wurttemberg, Southwestern Germany, is a recent illustration of this type. Most of these German textile producers are highly specialised and the production system depends on an extensive subcontracting system in which key technologies are developed in a collaborative manner. In Emilia-Romagna in North Central Italy, firms employing fewer than 50 employees engaged 49 per cent of the Italian labour force, and the average manufacturing firm had only 9.19 employees in 1988. This is an example of an industrial district in which firms have a very low degree of vertical integration (Powell 1990). Networks are also prevalent in craft industries such as construction and book publishing.

Eccles (1981) found that in the U.S., the relations between a general contractor and his subcontractors were stable and continuous over long periods of time, and only rarely established through competitive bidding.

In summary, the value of the goods to be exchanged in markets is much more important than the relationship itself. When relations do matter, they are frequently defined as if they were commodities. The benefits to be exchanged are also clearly specified. **Markets** offer choice, flexibility and opportunity. However, markets are a poor device for learning and the transfer of technological know-how. **Networks** are appropriate for situations in which there is a need for efficient, reliable information. Network forms of exchange entail indefinite, sequential transactions within the context of a general pattern of interaction. In **hierarchies**, communication occurs in the context of the employment contract. Relationships matter and previous interactions shape current ones, but the patterns and context of intraorganizational exchange are most strongly shaped by one's position within the formal hierarchical structure of authority (Powell 1990).

Towards a working concept

Kanter and Eccles (1992) see no reason to engage in a debate over whether a network is a property of any organization or a particular kind of organization. From a network perspective, all organizations can be characterised as networks and indeed are properly understood only in these terms. So, to say an organization has a network form is a tautology. By treating networks as a distinct form of organization, those who advocate this perspective deliberately direct attention to particular network characteristics that are to some degree relevant to any organization but are especially salient in so-called network organizations, such as dense horizontal linkages across formal organizational boundaries (Hakansson and Snehota 1995;

Johanson and Mattsson 1987), reciprocal relationships between small firms in a regional economy (Oru 1991), or interlocking relationships among economic institutions in Asian economies (Biggart and Hamilton 1992; Gerlach and Lincoln 1992; Numazaki 1991).

It is the rhetorical framing of network as form that forces the analyst to attend to what it is that makes these arrangements efficient, governable, and flexible compared with traditional modes of organizing. It calls for analysis in network terms and directs attention to key features of these organizations that can be understood only from a network perspective, such as the role of linking-pin institutions in the governance of these organizations and the role of ties that create trust (such as shared ethnic, geographical, ideological, or professional background) (Nohria 1992). In this context, the term network is often used metaphorically and therefore neither defined precisely nor measured. An example is the use of terms such as web of kinship and web of group affiliation to represent human beings connected by a complex network of social relations (Barnes 1972).

As a precisely defined concept, it is necessary to define which individuals belong to a network and classify the kinds of social bonds that exist between them. A total network refers to all the bonds between the constituent individuals, in contrast to partial networks, which contain only links of some specified kind (Barnes 1972). This research takes a partial network approach to analysing the structure of Chinese business relationships. The aim is not to map all the ties of a firm, but to identify the most important ties, as defined by the firm. Dyadic relationships are referred to as inter-organizational relationships (IORs). When all relationships between multiple partners are aggregated, then the focus of inquiry is the network

(Alter and Hage 1993). IORs are equivalent to Sako's (1992) conceptualisation of obligational contractual relations (OCR).

Sako's (1992) two ideal types of relations are helpful reference points in distinguishing a short-term relationship from a long-term one. At one extreme, firms rely on arm's-length contractual relations if they wish to maintain full independence. This involves not only being unaffected by the decision of other companies, but also by one's own decisions (such as over sourcing and sales) made in the past. The arm's-length nature of contracts also enables firms to engage in commercial bargaining to obtain competitive prices (Sako 1992).

At the other extreme, firms enter into an OCR if they prefer high trust cooperativeness with a commitment to trade over the long run. This may involve taking on other obligations and requests, such as for just-in-time and ship-to-stock delivery. The benefits of accepting these obligations, however, lie in good quality and service, growing or stable orders and other non-price aspects of trading born out of a tacit understanding over time (Sako 1992). This research considers as part of a firm's network those relations that gravitate towards OCR and that are of a long-term nature. The primary emphasis is on dyadic relationships. Nevertheless, a firm's set of IORs is also examined.

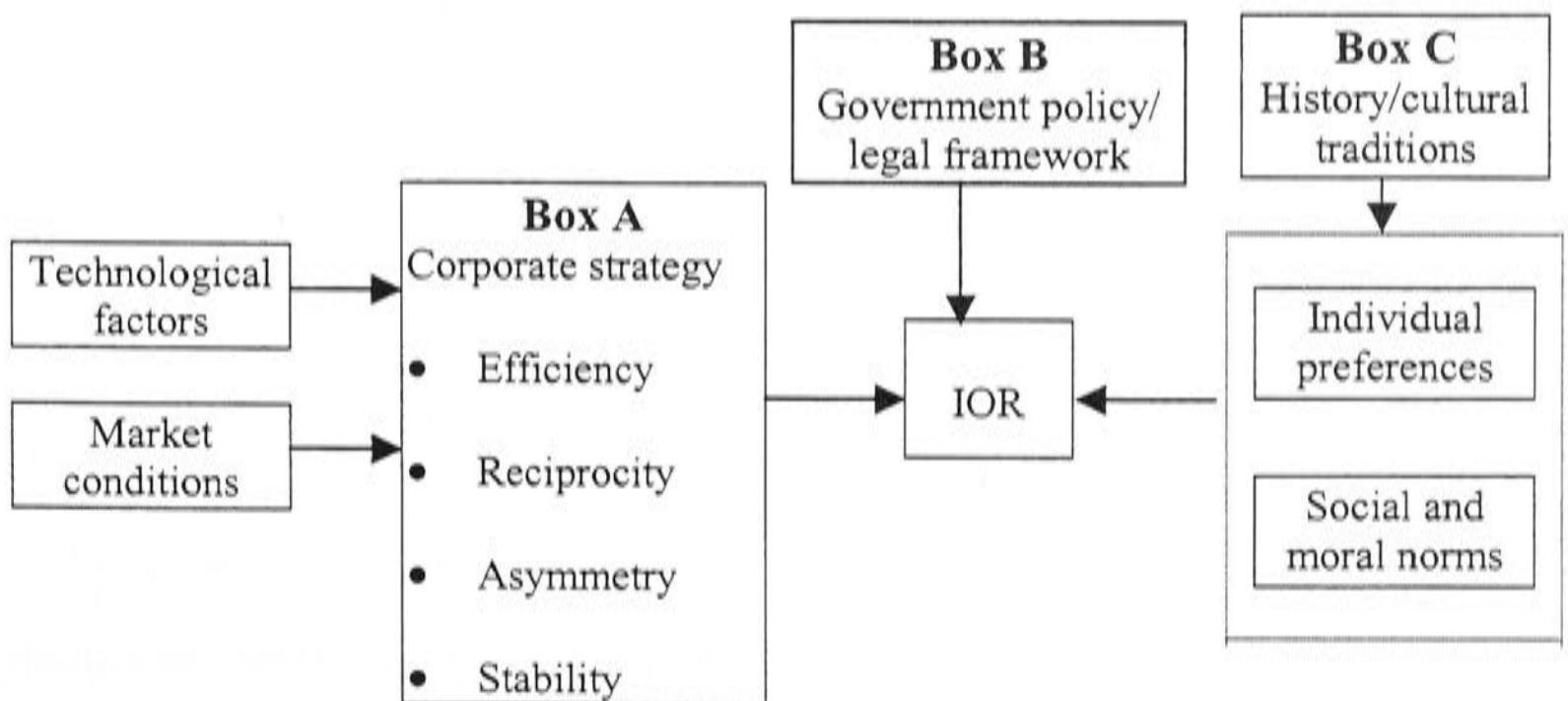
2.2 Theoretical framework

A framework for analysing the formation of IORs is presented below (Figure 2.2) and is partially adapted from Oliver (1990) and Sako (1992). This framework addresses calls for an inter-disciplinary approach to research on ethnic Chinese enterprises (Biggart 1997; Gomez and Hsiao 2001; Redding 1993; Whitley 1992).

The framework incorporates four perspectives from corporate strategy, which are, in turn, influenced by technological factors and market conditions. It also includes variables associated with the social, political, and historical context of doing business (Boxes B and C). It is important to analyse organizational behaviour in its environmental context. As Powell (1990) strongly argues, serious progress in understanding the diversity of organizational forms requires arguments that are much more historically contingent and context dependent. Whitley (1992) also considers a complex set of determinants in his study of East Asian business systems. Whitley's study brings into play the effects of government policies, financial systems, and historical features of the development process and the borrowing of organizational techniques from elsewhere.

While organizational behaviour and the context in which organizations operate are interrelated, they will be discussed separately for clarity. The next section focuses on theories under the 'Corporate Strategy' heading (Box A) while the latter sections deal with Boxes B and C.

Figure 2.2. Framework for analysing IOR formation



Corporate strategy

From an organization's point of view, why does it need to engage in IORs? Firms establish many different kinds of relationships. Kay (1993) argues that the most important is the spot contract – an agreement for immediate exchange. Many important relationships are made as classical contracts – long-term, legal arrangements which contain detailed provisions as to how dealings between parties will evolve as events unfold. A relational contract is also a long-term relationship. However, its provisions are often only partly specified and it is enforced, not by legal process, but by the need the parties have to go on doing business with each other.

Larson (1992) highlights four perspectives from corporate strategy that influence a company's decision to engage in IORs: efficiency, reciprocity, asymmetry, and stability. Technological factors and market conditions affect the operation of these strategic choices. For example, technological factors include variables affecting relationship patterns that are derived from the nature and extent of investment into production equipment. Sako (1992) hypothesises that IOR-type transactions are more likely to emerge if suppliers contribute to the product design and development process than if they do not. Market conditions include demand patterns and growth. Sako posits that a history of steady, rather than fluctuating, demand growth is considered more conducive to relational contracting as it creates a favourable condition for building mutual trust and confidence.

Efficiency. Why are there any market transactions at all, if by internalising one can eliminate certain costs and in fact reduce the cost of production? Why is not all production carried on by one big firm? Coase (1937) argues that this is due to limiting returns to management. First, as a firm gets larger, there may be decreasing

returns to the entrepreneur function, that is, the costs of organizing additional transactions within the firm may rise. Second, it may be that as the transactions that are organized increase, the entrepreneur fails to place the factors of production in the uses where their value is greatest, that is, fails to make the best use of the factors of production. Third, the supply price of one or more of the factors of production may rise because the 'other advantages' of a small firm are greater than those of a large firm.

What determines whether markets, hierarchies (formal organizations) or networks will be used? In the 1930s, Coase (1937) made an argument that lay the foundation for transaction cost economics, namely that the decision to use a market or, alternatively, a firm depends on the transaction costs involved. **Transaction costs** arise from any activity that is engaged in to satisfy each party to an exchange that the value given and received is in accord with their expectations. These costs arise principally when it is difficult to determine the value of the goods or services. Such difficulties can arise from the underlying nature of the goods or services or from a lack of trust between the parties (Ouchi 1980). In Williamson's (1985, 19) words, transaction costs are 'the equivalent of friction in physical systems'.

Transaction cost economics holds that the main purpose and effect of economic organization is economising on transaction costs (Williamson 1996). Transaction costs are often difficult to quantify, but it is the difference between them, rather than their absolute magnitude, that matters. The question is whether or not organizational relations (contracting practices, governance structures) line up with the attributes of transactions as predicted by transaction cost reasoning.

In a perfect market, transactions are carried out without transaction costs. Information is freely available and decision-making is rational. There are always

alternative suppliers and buyers and there are no carry-over effects from one period to the other of a specific transaction between two parties in the market. When these conditions do not prevail, transaction costs emerge because there is a need to devote efforts to organizing, carrying out and controlling transactions among interdependent actors. The transaction cost approach tries to explain the institutional form, that is, the 'governance structure' (market, hierarchy, or intermediate forms), of these transactions (Johanson and Mattsson 1987).

Two behavioural characteristics are postulated: decisions and actions are characterised by **bounded rationality**, whence behaviour is 'intendedly rational, but only limitedly so' (Simon 1953) and **opportunism**, which is a condition of self-interest seeking with guile (Williamson 1985). Under conditions of certainty, it is possible, *ex ante*, to gather information and to specify contracts between supplier and buyer, to take care of various future contingencies, and also, *ex post*, to control the fulfilment of the agreement between the parties. However, when **uncertainty** prevails, contracts will be very complex and costly both to construct and to enforce, especially in the case of **small-numbers bargaining** (Table 2.3). The latter means that there are few, if any, alternatives open for a buyer or a seller to replace each other in a transaction. The major reason for this is that the **asset specificity** is high.

Asset specificity is defined as the need to dedicate investment to a particular transaction or business relationship (Kay 1993). Personal knowledge or skills, type of machinery or products, geographic location and so on are not homogenous across the population of buyers or sellers. The higher the asset specificity, the more dependent the parties will be on each other, and the higher the costs of switching to another party will become (Johanson and Mattsson 1987). For example, if the activity incorporates advanced technology with proprietary information, it is

possible that the knowledge of that activity may leak to a competitor. Therefore, the contracting firm is exposed to risks associated with the potential exercise of opportunistic behaviour by subcontractors. The contracting firm experiences contingent loss, leading to a loss of potential future sales, loss of market share or even defeat in the marketplace (Edwards and Samimi 1997).

Table 2.3. The transaction cost model

Behavioural factors	Atmosphere	Environmental Factors
Bounded rationality	<----->	Uncertainty/ complexity
Opportunism	<----->	Small numbers bargaining

Source: S. Douma and H. Schreuder, *Economic Approaches to Organization* (Hertfordshire: Prentice Hall, 1992).

The firm can respond to this contingent loss in two ways: internalisation or subcontracting. It can decide to carry out the activity itself. Internalisation, however, involves a cost as the firm has to divert resources from more highly valued activities to the activity that it would have preferred to have subcontracted to the market. Alternatively, if feasible, the contracting firm can break the activity into a number of smaller component parts and subcontract these to different firms, thereby limiting the amount of proprietary knowledge gained by any one subcontractor and so eliminating their ability to exercise opportunistic behaviour. This is known as 'decomposed' subcontracting. This alternative also involves added cost for the firm; it has to divert resources from preferred activities to cover the added costs of transacting product flows with subcontractors (Edwards and Samimi 1997).

Another reason for internalisation centres on asset specificity. A subcontractor may be required to invest in equipment or skill development specific to one end-user only, the contracting firm. The investment may have no alternative use and thus have no resale value. The subcontractor would be aware that, once the investment is undertaken, the contracting firm may set prices below a level that gives adequate compensation for asset specific outlays or may not provide sufficient demand to ensure continuous efficient use of asset specific investments. In these instances, the subcontractor is exposed to a contingency loss (Edwards and Samimi 1997).

In summary, some subcontractable activities raise problems of opportunistic behaviour. Because firms often do not know in advance the scope for exercise of opportunistic behaviour, the extent to which it may be exercised, and the level of directly related contingency losses, there tends to be a bias in favour of 'make' rather than 'buy' and, where subcontracting occurs, in favour of decomposed subcontracting even though the scope for opportunistic behaviour may not warrant such a response (Edwards and Samimi 1997).

From an efficiency and transaction cost point of view, the firm takes into consideration the total costs of undertaking an activity internally and externally. An internal activity incurs internal costs (IC). In the case of subcontracting, the external cost (EC) includes the external price (EP) charged by the supplier plus the transaction cost (TC). Therefore, the firm will network if $EP + TC < IC$ (Jarillo 1988).

Alternatively, the firm will integrate if: $EP + TC > IC$, even if $EP < IC$ (Jarillo 1988). Corporations will therefore adopt a multidivisional form or vertically integrate when the costs of transactions with customers and suppliers exceed the

costs of administration and production under the firm's rubric. Therefore, the transaction cost argument is wedded to the concept of efficiency - the idea that changes in corporate behaviour are impelled by the pursuit of the most efficient structure as measured by market performance (Mizruchi and Schwartz 1987; Oliver 1990).

In summary, proponents of efficiency argue that establishing an efficient network implies the ability to lower transaction costs, for it is precisely those costs that lead firms to integrate, shunning the flexibility offered by a market relationship, together with the advantages of specialisation, both their own and their suppliers' (Jarillo 1988; Johanson and Mattsson 1987). Efficiency contingencies are internally, rather than externally, oriented. In this situation, the formation of an IOR is prompted by an organization's goal to improve its internal input/output ratio (Oliver 1990).

Reciprocity. Motives of reciprocity emphasise cooperation, collaboration, and coordination among organizations. According to this perspective, the major advantage of IORs is that they facilitate the pursuit of common or mutually beneficial goals or interests (Oliver 1990; Schmidt and Kochan 1977). Networking is one of the methods by which entrepreneurs can get access to external resources (Jarillo 1988). This is also termed an 'asset-seeking alliance response' (Dunning 1995, 469).

From a strategic management perspective, Langlois and Robertson (1995) argue that transaction cost theorists have a narrow view of the necessity for economic coordination. The efficient coordination of resources not only permits operational efficiency in the production and distribution of goods and services along existing lines, but is also vital for strategic uses that require new, and not always

readily evident, combinations of resources. To put it another way, business institutions may also arise as solutions to coordination games, not merely incentive-alignment (which is what transaction cost theorists argue).

How do reciprocity theorists answer the question of when firms choose to develop new capabilities internally or to purchase them on the market? This depends, it is argued, on a firm's internal capabilities, the range and quality of capabilities available through purchase, and the relative production and transaction costs of the various options. The most efficient relationship between source and user firms also depends on, *inter alia*, the prior existence of information networks, the scope of the innovation, its impact on various user industries, the presence or absence of economies of scale, and the stages of the product life cycle reached by both the innovating product and any product into which it might be incorporated. Specialisation and the appropriability of benefits also exert conflicting influences on the choice of organizational form in an innovative environment (Langlois and Robertson 1995).

The approach of Swedish researchers to studying networks is to argue that coordination is not achieved through a central plan or an organizational hierarchy, nor does it take place through the price mechanism. Instead, coordination takes place through interaction among firms in the network, in which price is just one of several influencing conditions (Hakansson and Snehota 1995; Johanson and Mattsson 1987). Table 2.4 compares this network approach with Williamson's transaction cost approach in five respects.

The theoretical foundation of the Swedish approach is resource dependence (Pfeffer and Salancik 1978). Organizations engage in resource exchange

Table 2.4. The transaction cost approach contrasted with the Swedish approach to networks

	Transaction Cost Approach	Swedish approach to networks
Theoretical foundations	<ul style="list-style-type: none"> • neo-classical framework focusing on conditions for stable equilibrium 	<ul style="list-style-type: none"> • in terms of control assumptions, based on resource-dependence theory
Problem orientation	<ul style="list-style-type: none"> • aims to explain institutional governance structures 	<ul style="list-style-type: none"> • describes and analyses dynamic aspects of industrial systems and strategies pursued by firms in such systems
Basic concepts	<ul style="list-style-type: none"> • bounded rationality • opportunism • uncertainty • small numbers bargaining • asset specificity 	<ul style="list-style-type: none"> • uses Williamson's basic concepts to describe important characteristics of networks: <ul style="list-style-type: none"> • bounded rationality is an implicit assumption and uncertainty is also linked to relationships in the network • asset specificity is related to heterogeneity, mutual adaptation and market assets. • disagrees that high asset specificity leads to vertical integration
System delimitation	<ul style="list-style-type: none"> • bases conclusions on characteristics of aggregates of specific types of transaction relations 	<ul style="list-style-type: none"> • looks at relationships in networks within context of other network relationships
Nature of relationships	<ul style="list-style-type: none"> • relationships barely exist in markets, only within hierarchies 	<ul style="list-style-type: none"> • industrial markets characterised by lasting relationships among firms because such relationships reduce costs of exchange and production and promote knowledge development and change

Source: O. Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985); and J. Johanson and L.G. Mattsson, 'Interorganizational relations in industrial systems: a network approach compared with the transaction costs approach,' *International Studies of Management and Organization* 17, no. 1 (1987):34-48.

relationships because no one organization possesses a sufficient amount of every resource it needs (Song 1995). Thus, it is predicted that more alliance relationships are expected when resource flows are particularly problematic and environmental uncertainty is high (Pfeffer and Salancik 1978). Williamson's basic concepts are accepted by network theorists, in particular, the assumptions of bounded rationality, uncertainty, and the conditions of asset specificity. However, the Swedish approach disagrees with the transaction cost prediction that high asset specificity leads to vertical integration.

In contrast to the market ideal where relationships are considered friction, the network perspective recognises that firms' activities in industrial markets are cumulative processes. Firms develop relationships that secure access to important resources and the sale of products and services. The basic assumption of the network model is that the individual firm is dependent on resources controlled by other firms: the firm obtains access to external resources through its network position (Johanson and Mattsson 1987).

Another approach that emphasises reciprocity is transactional value analysis. Instead of considering costs as determining network behaviour, it takes the perspective of value as determining network behaviour. Zajac and Olsen (1993) argue that one limitation of the transaction cost perspective in explaining IOR strategy has to do with the notion of value instead of cost. The usual transaction cost minimisation calculation for the vertical integration decision reflects a single-firm, rather than multi-firm orientation. This perspective on the decision to integrate vertically reduces fundamentally to one firm's 'make or buy' decisions. The transaction cost calculations that lead to that decision are conducted by one firm for its own independent purpose and use.

Contrary to transaction cost reasoning, performance gains from accessing internal routines, not performance losses from opportunism in markets, drive boundary decisions (Poppo and Zenger 1995). The resource-based literature rejects the transaction cost notion that opportunism and market failure drive decisions to vertically integrate, arguing instead that vertical integration is a 'creator of the positive' rather than an 'overrider of a negative'. From a resource-based perspective, decisions as to internal or external sourcing of an activity hinge on the degree to which activities can exploit the distinctive knowledge, skill and routines housed within a firm.

IORs are formed voluntarily by two (or more) organizations seeking to create and sustain a relationship that is valuable to both firms. In such cases, exchange partners are not 'eliminated' through the creation of a single vertically-integrated hierarchical entity established through complete ownership, nor can the partners be viewed as only engaging in market-based transactions. Firms involved in a joint venture, for example, while obviously interested in satisfying their own interests, are also interested in maintaining the co-operative arrangement to satisfy these interests - which requires some consideration of the satisfaction of their partner's valued interests. This does not require an assumption of altruistic behaviour on the part of the firm involved, but only an assumption that neither partner in an interorganizational strategy wishes the relationship to be terminated prematurely due to one partner's dissatisfaction with the relationship (Zajac and Olsen 1993).

The crucial transactional issue for IORs is not merely a single organization's concern for minimising its transaction costs, but rather both organizations' concern for also (a) knowing the partner's preferences and concerns as a basis for exchange and mutual gain, and (b) discovering ways in which similarities or shared interests

can be exploited to maximise cooperative joint gains that accrue to both parties. It follows, then, that the type of analysis required is one that addresses how both parties attempt to create and claim value within a relationship over time (Zajac and Olsen 1993).

Asymmetry. Asymmetry refers to IORs prompted by the potential to exercise power or control over another organization or its resources. In contrast to the proposition that resource scarcity motivates organizations to cooperate with one another, a power approach to explaining IORs suggests that resource scarcity prompts organizations to attempt to exert power, influence, or control over organizations that possess the required scarce resources (Oliver 1990; Pfeffer and Salancik 1978). Because organizations are not internally self-sufficient, they require resources from the environment and, thus, become interdependent with those elements of the environment with which they transact (Pfeffer 1982).

The resource dependence perspective is based on two premises: that organizations are the primary social actors and that intercorporate relations can be understood as a product of organizational dependence and constraint. The key to organizational survival is the ability to acquire and maintain resources. This constraint would be simplified if organizations were in complete control of all the components necessary for their operation. However, no organization is completely self-contained: it is embedded in an environment comprised of other organizations (Pfeffer and Salancik 1978). The question becomes: To what extent can intercorporate relations be accounted for by patterns of resource interdependence?

Two forms of dependence are identified by Pfeffer (1987): symbiotic, in which the output of one organization is the input to the other (for example, manufacturers as suppliers of products to retailers), and commensalistic, in which

the organizations compete in the same niche (such as manufacturing firms competing for the same markets). The resource dependence position is that organizations survive to the extent that they are effective. The effectiveness of an organization lies in its ability to create acceptable outcomes and actions.

Pfeffer (1987) cautions that it is important to avoid confusing organizational effectiveness with organizational efficiency. The difference between the two concepts is at the heart of the external versus internal perspective on organizations. Organizational effectiveness is an external standard of how well an organization is meeting the demands of the various groups and organizations that are concerned with its activities. Effectiveness derives from the management of demands, particularly the demands of interest groups upon which the organizations depend for resources and support. Organizational efficiency is an internal standard of performance and is measured by the ratio of resources utilized to output produced. The question of whether what is being done should be done is not posed, but only how well is it being done (Pfeffer and Salancik 1978).

To summarise, from an asymmetry point of view (Johanson and Mattsson 1987), the relationships in an industrial network are significant because they may:

- promote development of knowledge of the respective parties;
- give the parties some control over each other;
- be used as bridges to other firms; and
- be used when utilizing partners against third parties.

Stability. Another reason for relationship formation is to increase stability (predictability). The formation of relations has often been characterised as an adaptive response to environmental uncertainty (Pfeffer and Salancik 1978;

Williamson 1985). Environmental uncertainty is generated by resource scarcity and by a lack of perfect knowledge about environmental fluctuations. Uncertainty prompts organizations to establish and manage relationships in order to achieve stability, predictability, and dependability in their relations with others.

In contrast to the efficiency argument, the emphasis of resource dependence is on reducing uncertainty and dependence through activities which either organize networks of relations or which manage dependencies inside the organization, regardless of considerations of profit or efficiency for the most part. In contrast with the class perspective¹, resource dependence emphasises actions serving the interests of, and being organized by, organizations rather than families, individuals, or social class. The class perspective is more consciously rational in its approach: individuals possess interests, and organize themselves to pursue those interests (Pfeffer 1987).

According to resource dependence theory, organizations employ a variety of strategies for bringing stability and certainty to their environments. They may (a) restructure the organization to avoid instability or its consequences; (b) stabilise exchange relationships; or (c) restructure the set of exchange relationships to enhance stability. Each organizational action taken to reduce uncertainty or manage problematic transactions may alter the connectedness of the system, possibly altering the transaction flows to other organizations. In other words, actions taken to manage interdependence may, in the long run, increase the interdependence among environmental elements, requiring further actions to manage the new uncertainties (Pfeffer and Salancik 1978).

¹ Social class theorists view corporations as tools of a dominant social class whose interests both embody and transcend those of any particular organization (Mizruchi and Schwartz 1987).

From a strategic management point of view, risk-sharing arrangements are basic to the long-term success of the relationship between principal and subcontractor. The networking arrangement gives flexibility to the large firm while the subcontractor is better off because of the risk absorbed by the big firm (Jarillo 1988; Thorelli 1986).

Redding (1993) explains that personal networks among the ethnic Chinese are built in order to control uncertainty in three ways:

- through the gathering of information, for which contacts in an industry are crucial,
- through the stabilising of sources of supply and markets, and
- when starting a new venture.

Implications of corporate strategy for the research design. Several critical variables stand out from the discussion. Transaction cost economics point to asset specificity and small numbers bargaining as highly influential conditions affecting IOR decisions. Under reciprocity theory, however, Langlois and Robertson (1995) caution against narrow efficiency calculations and suggest that industry characteristics such as the extent of information networks and the scope of innovation and its impact on users be considered. The case studies in this research are constructed to take into account of these variables. The fieldwork allows for selection across a range of industries and covers both manufacturing and service industries.

Social, political and historical context

The second part of the theoretical framework focuses on the factors in boxes B and C in Figure 2.2. Granovetter's social embeddedness theory and the

institutional approach are presented, highlighting the importance given to the influences of social structures and institutional arrangements on relationship behaviour.

The central argument of the theories in this section (which include economic sociology, organization theory and institutional theory) is that analysts cannot separate organizational behaviour from its social, political and historical context. For instance, the concept of resource dependence is accurate in the proposition that organizations seek to connect or take over other organizations that control the supply of a critical resource, but less helpful if one needs to explain why certain resources become critical. Indeed, Gomez and Hsiao (2001) argue that to provide a holistic understanding of the operation of Chinese business, issues of state (such as state policies and state-business linkages) and society (such as culture and ethnicity) need to be considered.

Orru's (1991) 'institutional logic' argument posits that economic action is socially specified and is never simply a matter of cost-benefit calculations in an abstract way. Economic action is also a matter of:

- specified cultural values and beliefs;
- socially shaped interpersonal and institutional routines and expectations; and
- identifiable authority claims and legitimation principles.

Yambert (1981) asserts that any explanation of the competitive success of immigrant (or other minority) groups requires reference not only to the characteristics of the population, but also to the wider order of institutional arrangements and intergroup relationships within which the groups are located.

Historically, prior positions of prominence and influence of immigrants translated into access to goods and markets. Trading connections are an important aspect of their commercial predominance in subsequent levels of incorporation into the European economy in the 19th century. Success has also been furthered in many instances when the interests of immigrants coincided with the political and economic interests of powerful groups.

Is there a cultural aspect to the development of networks? One strand of argument is that Chinese networks derive their legitimacy and attraction from certain cultural predispositions, most of which are traceable to Confucian values (Crawford 2000). The very success of these networks encourages other cultural predispositions, such as patrimonial authority patterns that give high organizational influence to key individuals, and an ethic of trustworthiness, which provides discipline and moral justifications to the system. This reciprocation releases other forms of efficiency, which can be explained technically in terms of low transaction costs, strategic flexibility, and a capacity for innovation, all of which facilitate a continuation of the successful recipe in the future (Redding 1991).

An opposing argument emphasises that motivation and values can activate orientation towards economic success only in a larger society whose economic and administrative systems are rationally organized for economic achievement and where there is room for economic expansion. The ability to adapt to changing conditions is shaped by the nature of the society and the opportunities available: both structural and cultural factors are necessary for explanation (Tan 1992). However, it would be wrong to assume that conditions for networks exist only in the East because of Asian culture. Silicon Valley's semiconductor industry manifests network properties. In Europe, there are also examples of cooperative contracting in

specific industrial areas such as Northern Italy, Sweden, and Western Denmark (Alter and Hage 1993).

Embeddedness. The efficiency perspective on networks is sharply distinguished from the embeddedness argument within economic sociology, which claims that the notion of efficiency cannot be used to explain existing institutions, in the economy or elsewhere (Bradach and Eccles 1989; Granovetter 1985; Swedberg 1991). How behaviour and institutions are affected by social relations is one of the classic questions of social theory. Granovetter (1985) compares the 'undersocialised' and 'oversocialised' conceptions of human action in economics and sociology. Classical and neoclassical economics operate with an atomised, undersocialised conception of human action, he argues. The fact that actors may have social relations with one another has been treated as a frictional drag that impedes competitive markets. The literature on economic development from the 1940s to 1970s typically assumed that any embeddedness of economic action in non-economic relations was a barrier to 'true' economic development (Granovetter 1985).

Granovetter (1985) maintains that **new institutional economics** (transaction cost theory) explains why daily economic life is riddled with mistrust and malfeasance. Malfeasance is averted because clever institutional arrangements make it too costly to engage in. Therefore, social institutions and arrangements are better viewed as the efficient solution to certain economic problems. He notes that the institutions do not produce trust, but instead are a functional substitute for it. This theory implies an 'undersocialised' conception of human action. '**Generalised morality**' arguments, on the other hand, have the oversocialised characteristic of

calling on a generalised and automatic response, even though moral action in economic life is hardly automatic or universal.

The **embeddedness** argument, however, stresses the role of concrete personal relations and structures (or 'networks') of such relations in generating trust and discouraging malfeasance. Social relations, rather than institutional arrangements, are mainly responsible for the production of trust in economic life. Granovetter (1985) argues that, as a solution to the problem of order, the embeddedness position is less sweeping than alternative arguments, since networks of social relations penetrate irregularly and in differing degrees different sectors of economic life. In addition, social relations may often be a necessary condition for trust and trustworthy behaviour, but they are not sufficient to generate these.

Williamson (1985), on the other hand, treats social structural influences on market behaviour as exceptions, although he acknowledges that social context has a bearing on economic activity. Granovetter (1985) contends that the anonymous market of neoclassical models is virtually non-existent in economic life and that transactions of all kinds are rife with the social connections described. Table 2.5 summarises the differences in explanation and prediction between Williamson's transaction cost approach and Granovetter's embeddedness view. The latter argues that pressures toward vertical integration are expected in a market when transacting firms lack a network of personal relations or where such a network eventuates in conflict, disorder, opportunism, or malfeasance. On the other hand, where a stable network of relations mediates complex transactions and generates standards of behaviour between firms, such pressures should be absent. In terms of empirical studies, Orru's (1991) study of small-firm economies in Italy and Taiwan illustrates the embeddedness view.

Table 2.5. A comparison of the transaction cost model and the embeddedness approach

	Williamson's approach	Embeddedness approach
Explanation of institutions	<ul style="list-style-type: none"> explains inhibition of 'opportunism' in economic life and the general existence of cooperation and order by the subsumption of complex economic activities in hierarchically integrated firms 	<ul style="list-style-type: none"> a high level of order can be found in the 'market' and a correspondingly high level of disorder within the firm whether these occur depends on the nature of personal relations and network relations between and within firms
Prediction	<ul style="list-style-type: none"> whatever organizational form that is most efficient will be the one observed 	<ul style="list-style-type: none"> pressures toward vertical integration should be expected in a market when transacting firms lack a network of personal relations or where such a network eventuates in conflict, disorder, opportunism, or malfeasance on the other hand, where a stable network of relations mediates complex transactions and generates standards of behaviour between firms, such pressures should be absent

Source: M. Granovetter, 'Economic action and social structure: the problem of embeddedness,' *American Journal of Sociology* 91, no. 3 (1985): 481-510 and O. Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985).

Granovetter (1985) suggests that research on the markets-hierarchies question should pay careful attention to the actual patterns of personal relations by which economic transactions are carried out. Small firms in a market setting may

persist because a dense network of social relations is overlaid on the business relations connecting such firms and reduces pressures for integration.

Whitley's (1992) view is that the embeddedness of organizations in a societal context leads to certain formulae or 'recipes' becoming dominant as a result of their special appropriateness for that context. An important component of any recipe is the way economic exchange in a society is coordinated and made to run smoothly. In many Western economies, the main efficiencies in coordination derive from large-scale organization. It is argued that in the case of the ethnic Chinese, the equivalent efficiencies derive from networking (Redding 1991).

2.3 Research questions

The main research question is: How and why do Chinese firms engage in IORs with other firms? The following three supporting questions refine the main question:

- How can both technical (economic) and value factors be used to explain relationships?
- What is the relationship between the firm's stage of development (size, complexity, age) and its networking behaviour?
- How does the nature of the industries affect networking behaviour?

The 'why' question considers the technical and strategic questions: How do the firm's strategic considerations explain IORs? The 'how' question looks at who the firm's IOR partners are, how it chooses its partners and how it structures its relationships.

The four elements in corporate strategy box of the theoretical framework (efficiency, reciprocity, asymmetry and stability) are examined in this research. On a

practical level, the fieldwork considers several variables that might affect IOR behaviour from a strategic point of view. These variables include opportunism and transaction costs, a firm's internal capabilities and its need for external resources.

In addition, the research also looks into any possible relationship between the firm's stage of development and its IOR behaviour. This question allows the research to focus beyond just one point in time and to study the changes in IORs over time. Finally, the industry that the firm operates in may influence IOR behaviour. In particular, the research looks for influences from the other firms in the industry and government policy. The next chapter on research design demonstrates how the study goes about answering these questions.

Chapter 3

Research Design

This chapter discusses the research design for the study of the interorganizational relationships (IORs) of ethnic Chinese firms in the Philippines. The aim of this research is theoretical development: to seek answers to the questions of how and why Chinese firms engage in IORs with other firms through the development of case studies and their analysis using modified grounded theory. The research also considers the environmental context within which these businesses operate. It is anthropological in approach.

The following section discusses why the research follows the case study method and the modified grounded theory approach to data gathering and analysis. The three stages of research design are then presented. The **research strategy** incorporates the criteria for selecting cases and the method for data collection. **Data collection** discusses the sources of data, period of collection and the pilot study. Finally, **data analysis** incorporates three levels of coding, starting from general (or open) coding to specific (or selective) coding where categories of data are developed. The objective of coding is to find patterns in the data. Patterns within individual cases are discovered (within-case analysis). In addition, cases are also compared to find similarities and differences (cross-case analysis).

3.1 The case study method and grounded theory

The methodological approach to field research adopted in this study is described by the term 'clinical field research'. It is defined as the detailed understanding of individuals or companies through the use of comprehensive

descriptions (cases) and detailed analysis of their problems, decisions, and operating environments. A particular strength of this approach is the flexibility and ability to collect rich data. In addition, the results may be more significant than broader, extensive surveys. The approach also takes into account the impact of culture, history, and economic and political systems on organizations (Wright, Lane, and Beamish 1988, 55-56).

Yin (1994, 8) argues that it is necessary to obtain a fit between the research approach and three conditions: (a) the type of research question posed, (b) the extent of control the investigator has over behavioural events, and (c) the degree of focus on contemporary as opposed to historical events. Table 3.1 displays these three conditions and demonstrates how each is related to five major research strategies in the social sciences. In this particular study, both 'how' and 'why' questions are being asked about a contemporary set of events over which the investigator has little or no control. It is these situations that are most suitable for using the case study strategy.

In addition to these three conditions, the nature of the inquiry and its relationship to existing theory must also be considered. Case studies are appropriate, Parkhe (1993) argues, where existing research is at the stage where the phenomenon is not well-understood and relationships between phenomena not clear. In such situations, a novel, testable and empirically valid approach is the use of case studies. Indeed, Gomez and Hsiao (2001) encourage the use of historically-based, micro-oriented analysis to understand Chinese entrepreneurship.

A case study is an empirical inquiry that investigates a contemporary phenomenon in its real-life context, especially when the boundaries between phenomenon and context are not clearly evident (Yin 1994, 13). It is a research

strategy that focuses on understanding the dynamics present within single settings (Eisenhardt 1989).

Table 3.1. Relevant situations for different research strategies

Strategy	Form of research question	Requires control over behavioural events?	Focuses on contemporary events?
Experiment	how, why	yes	yes
Survey	who, what, where, how many, how much	no	yes
Archival analysis	who, what, where, how many, how much	no	yes/no
History	how, why	no	no
Case study	how, why	no	yes

Source: Robert Yin, *Case Study Research, 2nd ed.* (California: Sage, 1994), 6.

The analysis of IORs in a case study context is the main outcome of this research. The main sources of data for the case studies are interviews, observation and source documents. Data gathered are both qualitative and quantitative. Data analysis takes guidance from the grounded theory approach (Glaser and Strauss 1967) and is qualitative in emphasis. Theoretically, grounded theory proposes no preconceived concepts and theory before going into field and during data gathering. In practice, highly inductive and loosely designed approaches are suitable when

researchers have plenty of time and are exploring exotic cultures or understudied phenomena. When one is interested in better-understood phenomena within a familiar culture or subculture, however, a loose, highly inductive design is a waste of time (Miles and Huberman 1984, 27). Hence, a theoretical framework was constructed (in Chapter 2) as a guide to focus the fieldwork and to construct questions for the interviews. This framework is used as a starting point but flexibility is adopted in order to take note of:

- influences not recognised in the literature;
- interrelationships between variables (interrelationships may not be clearly known); and
- influences that may not have been defined clearly (for example, trust).

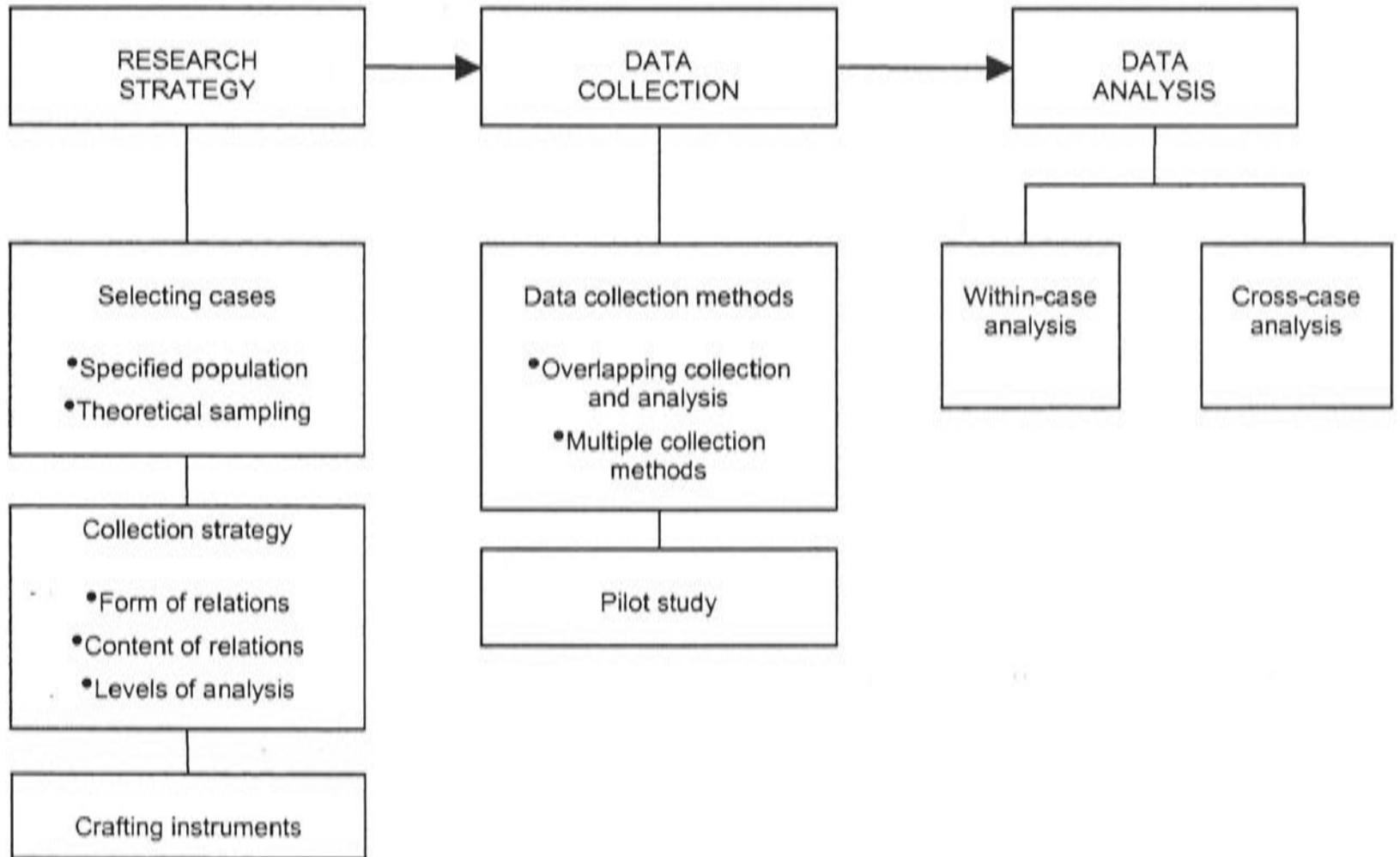
3.2 Research strategy

The research design takes into account the theoretical framework as the frame of reference for data gathering. The purpose is not only to test the theories, but to use the chosen variables as a starting point for asking questions. The role of theory development, prior to data collection, is one point of difference between case studies and pure grounded theory (Yin 1994, 27). Yin (1994) emphasises that theory development as part of the design phase is essential, even if the ensuing case study's purpose is to develop theory.

The three main stages of the research design are shown in Figure 3.1. The first stage is research strategy. In this stage, methods for selecting cases were developed, the collection strategy was formulated and the collection instrument was crafted. The second stage is data collection. Triangulation of data and overlap of

data collection and analysis are discussed. A pilot study was conducted. Finally, data analysis considers the techniques for within-case and cross-case analysis.

Figure 3.1. Research design for the study of IORs



The case studies are based on a mix of quantitative and qualitative evidence and, hence, should not be confused with qualitative research. The research design incorporates elements of qualitative case study, with careful attention to past designs of studies relating to networks and business relations. Numazaki (1991) uses the case study method and network analysis techniques to study social relations among large businesses in Taiwan. He adopts a historical approach to observing how business relations are formed. He also takes a structural approach to examining how the whole system is shaped and why it took that shape. Numazaki's first point of

analysis is the social relations within the Taiwanese business community. In contrast, this study takes the business relations between two firms as the first point of analysis, without regard to social relations in the first instance.

The research design is driven by the research question: How and why do Chinese firms engage in IORs with other firms? The main objective is the understanding of the external relations of a business. The four elements of the research strategy are: the choice of sampling units, the content and form of relations, the levels of data analysis and the design of the data collection instrument. These four elements are discussed in the following sections.

Theoretical sampling

A case study does not represent a sample in the statistical sense, where an inference is made about a population on the basis of data collected. Rather, the objective in this research is analytical generalisation, where a previously developed theory is used as a template with which to compare the empirical results of the case study. In this sense, the objective is to expand and generalise theory (Yin 1994, 31).

Case studies, consequently, are generalisable to theoretical propositions and not to populations or universes (Yin 1994, 31). In this research, sampling is guided by the search for contrasts, a requirement in order to classify the analysis and achieve the saturation of emergent categories (Glaser and Strauss 1967). The aim is not to strive for a representative sample but to identify purposive cases that represent specific types of a given phenomenon. This sampling strategy allows the researcher to study the range of types rather than determine their distribution or frequency (Minichiello et al. 1995, 13).

The goal of theoretical sampling is to choose cases that are likely to replicate or extend the emergent theory (Eisenhardt 1989, 537). Multiple cases, therefore, are not analogous to multiple respondents in a survey (Parkhe 1993, 34). Multiple cases are considered as one would consider multiple experiments, that is, following 'replication' logic. The logic implies that each case predicts similar results (a literal replication) or produces contrasting results but for predictable reasons (a theoretical replication) (Yin 1994, 45-46).

The Philippines is the focus because no such study has been done. Chapter 1 has outlined the important studies on Chinese economic activities. Several scholars have investigated the economic position of the Chinese in the Philippines (Hicks and Redding 1982; Palanca 1995; Yoshihara 1985). Limlingan (1986) attempted to explain their success by referring to their business strategies but did not study their networks. Roman et al. (1996) studied Chinese firms in Manila, looking at their internal management controls rather than external relationships. Omohundro (1981) conducted a detailed and illuminating study on Chinese business and culture in Iloilo, a small province south of Manila.

The three criteria for case selection of Chinese owned firms in the Philippines were size, age, and industry. The ranking of the top 5000 corporations of the Philippines was used as the size cut-off (no case firm ranks below this, except for the pilot study). The researcher obtained a mix of manufacturing and service businesses to search for contrast. Previous studies have mainly focused on Chinese trading firms, particularly those that are small-scale in size (Armstrong and Yee 2001; Menkhoff 1991; Menkhoff and Labig 1996; Omohundro 1981).

Larger companies offer a more diverse range of activities to study than small firms. Their management structures tend to be more complex. As revenues

increase, these companies are better able to employ outsiders in management positions. This ability affects their networking behaviour. Another requirement was that the firms chosen needed to have been operating for at least five years. The age of the firms is meaningful because the history of a company's development is significant in understanding how and why it has certain relationships. It also becomes possible to investigate changes in strategy and business relations over time.

Content and form of relations

In conjunction with choosing the appropriate sampling units, an analyst must decide what specific network linkages to investigate. These linkages between businesses have both content and form.

Content refers to the substantive type of relation represented in the connection (Knoke and Kuklinski 1982). Hakansson and Snehota (1995, 26) identify three different layers of content within a business relationship. These are activity links, resource ties and actor bonds. Activity links refer to the technical, administrative or commercial activities of a company that can be connected to those of another company. Resource ties connect the various resources (technological, material, knowledge) of two companies. Actor bonds join actors and influence how two actors form their identities in relation to each other.

Relational **form** refers to the properties of the connections between pairs of actors (dyads) that exist independently of specific contents (Knoke and Kuklinski 1982). For example, the content of the relationship with a supplier is made up of the supply of raw materials to the firm as well as any financing component. Relational form simply refers to any equity ties, licensing agreements and other connections that might exist between the firms.

Levels of analysis

The third element of the research strategy is the level of analysis of business relations. For this research, the effects of a business relationship are investigated by taking into account three levels: the dyad, individual company and third parties (Hakansson and Snehota 1995, 27). These case studies, in effect, employ an embedded design because multiple levels of analysis are present within a single study (Eisenhardt 1989, 534).

The primary level of analysis is the dyad: the one-to-one relationship of the case study firm to another firm. Some questions that are explored are:

- what resources are exchanged between the two companies?
- what activities do they share in common?
- what novel combinations of activities emerge as a result of their business relationship?

A second level of analysis is the function for the individual company. What are the costs and benefits of the relationship for a particular company? Finally, the effects on third parties, such as the case study firm's competitors, are also investigated.

Crafting instruments

An interview guide was prepared based on Larson (1992) (Appendix A). The three sections of the guide cover questions on the form and content of relations. The interviews were focused on the issues central to the research objective, but the type of questioning and discussion allowed for greater flexibility than does the survey-style interview. The interviews are characterised as semi-structured interviews, which ask each subject the same questions but not necessarily in the

same order. At the initial stages of the interviews, the researcher asks broad, open-ended questions about the nature and history of the subject's firm. In contrast, structured interviews are taken strictly to mean that standardised questions are carefully ordered and worded and each research subject is asked exactly the same question, in exactly the same order as all other subjects (Minichiello et al. 1995, 63-65). The guide was tested in a pilot study (SS Sawmill).

The interview guide served as a list of the general issues to be covered. However, the guide did not always determine the order of the conversation. For instance, in two case study interviews, the research subjects interviewed the researcher first and asked questions about her background.

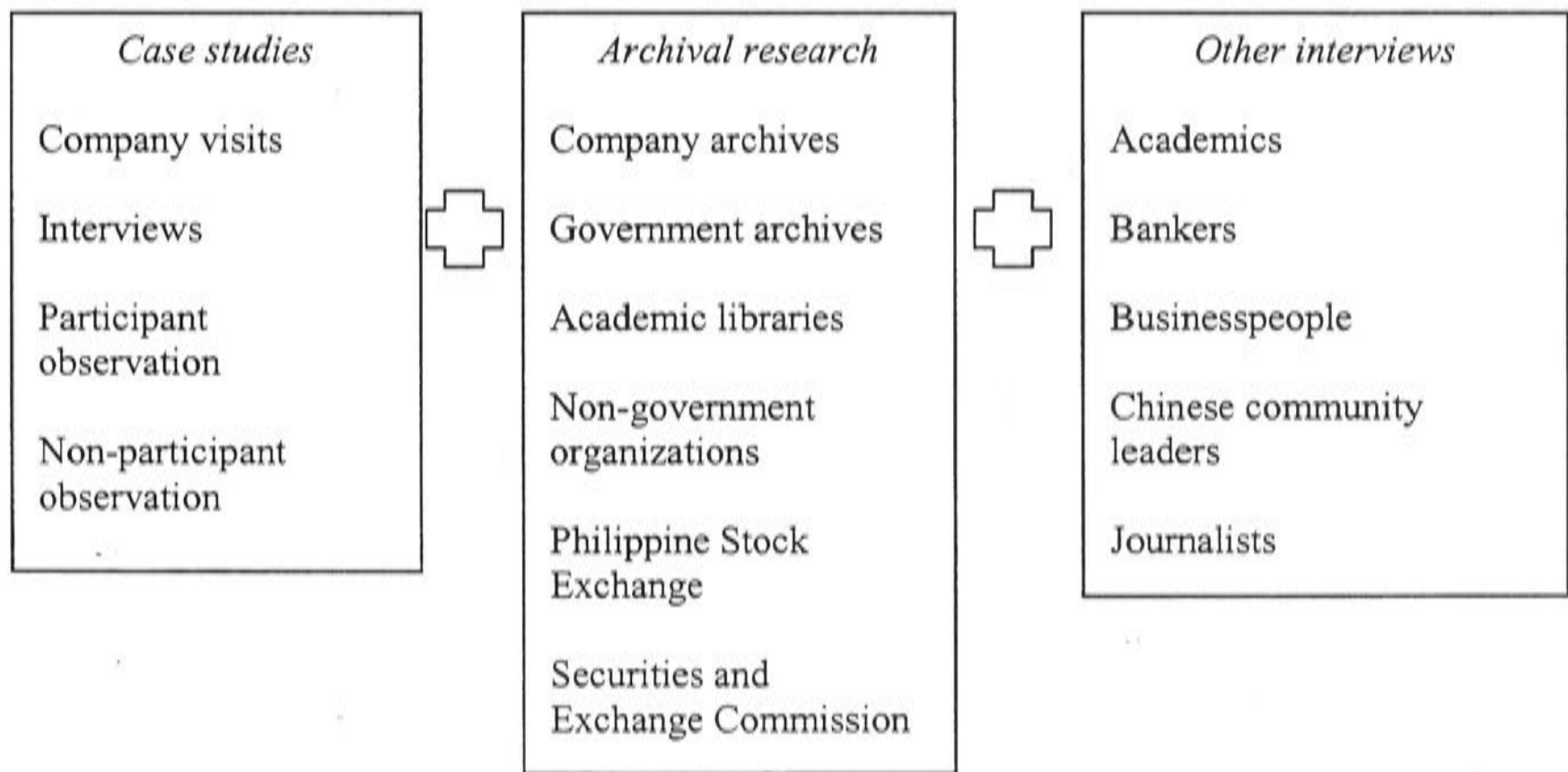
3.3 Data collection

The three data collection methods used in this research are interviews, observations, and archival sources (Figure 3.2). In order to test for convergence, interviews must be triangulated with multiple data sources (Parkhe 1993, 23). These other sources include archival records and observation. The three methods are combined in the same study to highlight different dimensions of the same phenomena, to compensate for the shortcomings of each method and to validate the findings by examining them from several vantage points (Minichiello et al 1995, 14; Parkhe 1993, 23).

The case studies were constructed using input from the three data collection methods. The quantitative data consisted of company financial statements, which were principally sourced from the Philippine Securities and Exchange Commission and the Philippine Stock Exchange. The Annual Handbook of the top 7000 corporations in the Philippines was used as a cross-reference for the financial statements. Archival corroboration involved cross-referencing to databases, news

clippings, and other reports in the media. Ultimately, case studies stress the holistic examination of a phenomenon and they seek to incorporate environmental components from the larger context to which these matters may be related (Jorgensen 1989).

Figure 3.2. Triangulation of data for the case studies



Interviews

Initial interviews in the field were with academics in Manila, in particular those connected with the Asian Institute of Management, University of the Philippines, De la Salle University, Ateneo de Manila University and the University of Asia and the Pacific. After about a month in the field, permission was granted to conduct a pilot study in a sawmill factory in the city of Bulacan, approximately thirty kilometres south of Metro Manila. Interviews were conducted with the factory's chief accountant, sales manager and general manager. In the course of visits, observations of the premises were also undertaken. The chief accountant kept

in close contact with the researcher because she was keenly interested in the study and became a good resource for verifying business information.

Details of the case study firms are discussed in Chapter 5. The firm names were all replaced by generic titles. For example, MM Textiles was used to represent the firm in the textile industry. Names of respondents were also disguised. However, facts relating to the firm's background and current operations were not altered (such as financial statistics, firm location and business activities). Anonymity was requested by the informants from the case study firms because all of their companies were currently in operation. They were also providing information on critical suppliers and customers as well as the firms' operating strategies.

The main location for participant observation was MM Textiles' head office in Manila. In addition, the researcher was also able to visit its two other factory sites in Bulacan as well as the joint venture knitting factory in Manila.

Two case studies on Chinese firms and an interview with a Chinese-Filipino joint venture company were completed in Manila before going to Cebu. The researcher gained access to FF Food and MM Textiles through her family network. The pattern of using one's personal connections to gain access to interviews was repeated in Cebu. A former student provided the introduction to JJ Chemical. A friend furnished a list of the ten largest Chinese-owned businesses and the names of the CEOs. The researcher contacted each one and gained access to three. These were GG Shipping, SS Shipping and KK Stores. Interviews were also conducted with representatives from other companies, but data were insufficient to construct case studies. These companies were a shipping company and a food processing factory.

Local bankers, academics and other business informants were also consulted. The President of the Cebu Chamber of Commerce became a good resource. Government agencies such as the National Economic and Development Authority and the Cebu Investment Promotion Center were also visited and key managers were interviewed. Frequent visits were made to the University of San Carlos and the University of the Philippines (Cebu) to use their libraries and interview academics.

Chinese community leaders were helpful and members of the non-government organizations *Kaisa Para sa Kaunlaran* and the Philippine-China Resource Development Center were also interviewed. The research libraries of the Philippine Stock Exchange and the Securities and Exchange Commission contained valuable statistical information.

In all the case interviews, the researcher used the funnelling technique to control the flow of information. This is a process of questioning in which questions of a general and broad nature were asked at the start of the interview. These initial questions, listed in the first section of the interview guide, were designed simply to start the informant thinking about the issue in general terms (Minichiello, et al 1995, 84). Then, as the participants engaged in conversation, the interviewer guided the informant's attention towards more specific topics by using questions that focused on precise issues in section II of the interview guide. Finally, the interviewer asked specific questions directly about the issue being examined (section III of the interview guide) (Minichiello, et al 1995).

The researcher often used the statement: 'Tell me about how your business got started' as a way to open the conversation. By asking informants to reflect upon the historical development of their business, the researcher injected a time element into the conversation. This approach also aimed to meet another objective of

gathering data, namely to discover important milestones in the firm's history. The informant's narrative about how his or her business grew (or declined) proceeded in this manner. Milestones were recorded and used as reference points for questions about who and what the respondent thought were crucial to success or failure during that particular event.

Permission to record was requested at the beginning of each interview. Half of the interviewees granted this permission. Interviews were conducted in three languages: English, Filipino and Hokkien Chinese. The researcher transcribed the interviews at the end of the each interview day. Transcripts in Filipino and Chinese were translated into English by the researcher at the field sites. The company names and interviewees were all disguised at the request of the informants.

Participant and non-participant observation

Whereas interviews and questionnaires elicit responses from the subjects, the researcher can also gather data without asking questions of the respondents by observing them in their natural work environment (Sekaran 1992, 215). The researcher can either be a nonparticipant observer or a participant observer.

As a nonparticipant observer, the researcher collects data without trying to become part of the organizational system (Sekaran 1992, 216). For example, the researcher might sit in the corner of an office and watch and record how various customers and suppliers interact with the owner.

As a participant observer, the researcher enters the organization, actually becoming part of the team (Sekaran 1992, 216). For instance, she may enter the organization in the role of an employee and observe the dynamics of customer and owner interaction.

Participant observation is well-suited to studying processes, relationships among people and events, continuities over time as well as the immediate socio-cultural context in which human existence unfolds. It is especially useful for scholarly problems where there are important differences between the views of insiders as opposed to outsiders (such as ethnic groups and labour unions) (Jorgensen 1989, 12). The world of everyday life is, for the methodology of participant observation, the ordinary, usual, typical, routine or natural environment of human existence. This methodology aims to provide practical and theoretical truths about human existence.

At the site for participant observation, MM Textiles' head office in Manila, the researcher was able to assist in tasks such as word processing and answering the telephone calls as well as sales assistant duties. It was a good opportunity to observe the daily comings and goings in the office and the many problems and situations that came up. There was a constant stream of suppliers, delivery people, customers, staff and other visitors to the site. Occasionally, the researcher served as a receptionist, which gave her a good chance to engage in conversation with people who were waiting to see someone in the company.

In addition, by making field visits to the case study 'sites', the researcher created opportunities for direct, or non-participant, observation. Observations on relevant behaviours or environmental conditions served as yet another source of evidence in a case study (Yin 1994, 86).

By going to the sites, the researcher was able to observe the firms' manufacturing and other business activities. The condition of buildings or work spaces indicated something about the climate of the organization. Similarly, the location of respondents' offices provided information about how accessible they are

to others. Some managers did not have a closed office and instead occupied a desk within an open-plan work space. Others had a private office away from the rest of their staff.

Period of data collection

The period of data collection was from 1994 to 1998. Interviews in the field were conducted over ten months (June 1996 – March 1997), first in Manila (June-August), then four months in Cebu (September-December), then back in Manila (January to March). The researcher was fortunate to have been able to live with two business families, one in Manila and the other in Cebu. The Manila family was involved in the textile industry while the Cebu family was engaged in real estate development and agricultural commodities trading. The researcher was also able to gain access to the Manila family's business as a participant observer for the two periods of her stay in Manila.

Preliminary findings were presented at a conference on Overseas Chinese Business Networks at the University of Malaya in Kuala Lumpur, Malaysia. Experts in the field were consulted in Singapore, Philippines, Australia, and Malaysia.

Strengths and weaknesses

A particular advantage of an 'insider' doing research on the ethnic Chinese is that the insider is able to gain access to a secretive community. On the other hand, a criticism of insider research is the perceived bias in data gathering and interpretation. The goal and aim of objectivity is to enable knowledge to be shared. The criticism of bias can, therefore, be addressed by providing systematic evidence of the actual research methods used to collect and analyse data so that there is some possibility of replication (Minichiello et al 1995, 184).

Although the insider may be more attuned to the informant's meanings, this in itself could present a problem. The insider must guard against assuming a taken-for-granted stance toward the informants' meanings, languages and concepts. The danger is that the researcher might not probe for details that indicate different interpretative schemes being used by the informants. To retain the integrity of the phenomena, the ethnic researcher must attempt to straddle her insider's perspective with her outsider's stance (Minichiello et al 1995, 184).

The researcher was aware of this dilemma and addressed it in all three phases of the research design: strategy, data collection and analysis. First, she interviewed a cross section of the business and non-business communities, including bankers, journalists, academics, community leaders and representatives of non-government organizations. These informants are of Filipino, Spanish and Chinese descent. This approach enabled cross-verifying of responses to certain questions and impressions about ways of doing business. Second, the data sources are triangulated and research methods are also well-documented. Finally, the data analysis method applies principles of grounded theory. This approach searches for theory and does not assume concepts and constructs from the data prior to analysis.

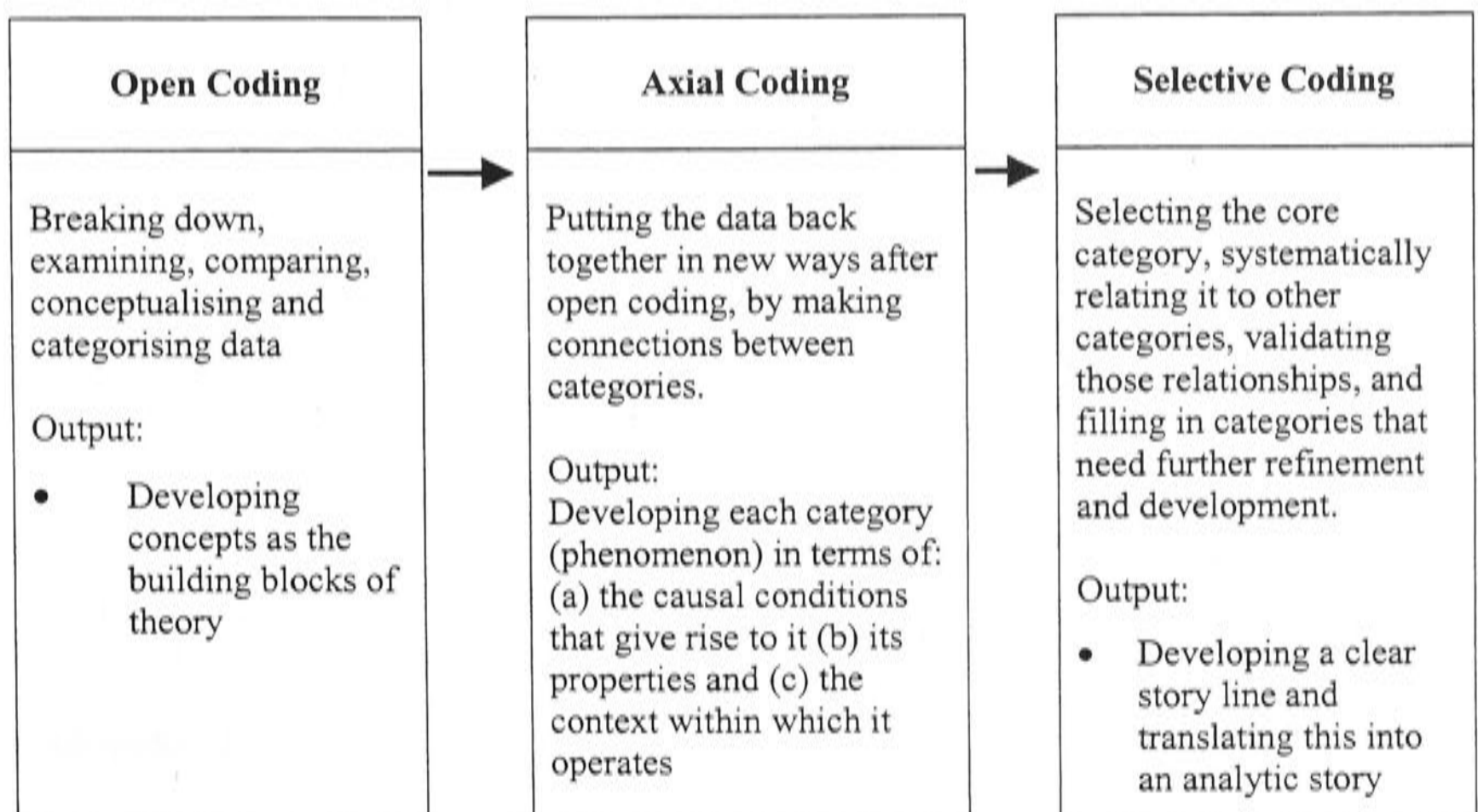
3.4 Data analysis

The procedure for data analysis closely patterns the grounded theory approach (Strauss and Corbin 1990). Broadly, the analysis emphasises coding and finding patterns. The three goals for coding are to: (1) make sense out of each collection, (2) look for patterns and relationships both within a collection, and also across collections, and (c) make general discoveries about the phenomena one is researching (Seidel, Friese, and Leonard 1995, E5).

The focus of data coding is conceptual specification. The approach used to analyse interview data is based on methods used in grounded theory. Grounded theory is based on a concept-indicator model, which directs the conceptual coding of a set of empirical indicators. The latter are actual data, such as behavioural actions and events observed or described in documents and in the words of interviewees and informants (Strauss 1987, 25).

Table 3.3 summarises the three steps in data coding. The first step in the process is open coding, defined as the process of breaking down, examining, conceptualising and categorising data (Strauss and Corbin 1990, 61). The interviews are analysed very closely: line by line and even word by word. The aim is to break down and conceptualise the data. The procedure involves transferring interview transcripts and field notes to the Ethnograph software, then performing line by line coding.

Table 3.3. The three steps in data coding



The second step, axial coding, moves to a more explanatory level. The aim is to produce pattern codes. Finally, selective coding allows the analyst to take another step up. The aims are to sort the codes into classes and categories and find patterns.

Open coding

The initial type of coding done for this research project is open coding (Strauss 1987, 28). It is done by scrutinising the field note, interview, or other document very closely: line by line, or even word by word. The aim is to produce concepts that seem to fit the data. It is the breaking down and conceptualising of data (Strauss and Corbin 1990, 63).

Open coding is grounded in the data on the page as well as on the analyst's experience, including her knowledge of the technical literature (Strauss 1987, 29). This grounding in both sources of data gets the researcher away from too literal an immersion in the materials (documents, field notes, and interviews) and quickly gets her to think in terms of explicit concepts and their relationships. In a sense, it is a 'conceptual stepping back' that forces the analyst to break the data apart analytically and leads to grounded conceptualisation.

The researcher created a 'start list' of codes prior to coding. Table 3.4 provides some examples. These codes are structured according to the theoretical framework. This structural order makes the codes easy to memorise and use. It also facilitates the retrieval and organization of material.

The next step is to define the codes. Clear, operational definitions are indispensable, so that they can be consistently applied by a single researcher over time (and by multiple researchers, if needed) (Miles and Huberman 1984, 60).

Table 3.5 presents an excerpt of definitions from the list of codes shown in Table 3.4.

Finally, line by line coding is performed using the Ethnograph software. Table 3.6 shows a page from a case study. Each line is numbered and limited to 40 characters. At this point, each line is analysed.

Table 3.4. Illustration of a list of codes

Company characteristics	CC
CC: Industry CC: Core business CC: Stage of development CC: Ownership	CC-IND CC-CB CC-SD CC-OW
Objective of relationship	OB
OB: Efficiency OB: Asymmetry OB: Reciprocity OB: Growth OB: Learning	OB-EFF OB-ASY OB-REC OB-GR OB-LRN
Interorganizational relationship	IOR
IOR-Nature IOR-Duration IOR-Partnership IOR-Joint venture IOR-Subcontracting	IOR-NAT IOR-DUR IOR-PSHIP IOR-JV IOR-SUB

Table 3.5. Definitions of selected codes from Table 3.4

Company characteristics	CC
Industry CC-IND	Specific industry or industries that the company operates in
Core business CC-CB	Core business of the company, as stated by CEO, literature; where majority of revenue is derived
Objective of relationships	OB
Efficiency OB-EFF	Forming interorganizational relationship prompted by efficiency reasons: usually least-cost alternative
Reciprocity OB-REC	Forming interorganizational relationship to pursue common or mutually beneficial goals or interests.
Interorganizational relationship	IOR
Duration IOR-DUR	Indication of how long the IOR has been in existence
Subcontracting IOR-SUB	Subcontracting relationship between the firms

Table 3.6. An example of open coding using a page from the Ethnograph software

M: In terms of marketing, is it your responsibility?	160 161		
A: Marketing is a joint effort. They have the international connections.	163 164 165]	10R - MKTG
M: So this arrangement seems beneficial for both parties.	167 168		
A: Well, there are good points but there are also bad points. You know how the Japanese are, they are quite shrewd in business, you have to be very careful.	170 171 172 173 174]	10R - CONSEQ
M: This means that if they can...	176		
A: I'm sure that in the first five years, they make a lot of money, because they handled all the marketing. Because we had no knowledge about activated carbon, we did not know how to sell. That was our first exposure to activated carbon. So for the first five years, it was a learning stage for us. So the first five years all marketing was done by the Japanese. So I'm sure they made a lot of profit.	178 179 180 181 182 183 184 185 186 187 188 189 190]	10R - LEARNING
M: Because they controlled the price?	192 193		
A: They had control of the price, the payment goes to them first, then they give us an LC. Of course, they put a mark-up on that already. Right now, it's equal between us.	195 196 197 198 199 200]	10R ASYMMETRY
M: It's already been more than twenty years.	202 203		
A: Twenty one years. So as I said the first five years is a learning stage for us.	205 206 207]	10R LEARNING

A code, then, is an abbreviation or symbol applied to a segment of words – in this case, a sentence of transcribed field notes – in order to classify the words. Codes are categories. They derive from the research questions, key concepts, and important themes. They are retrieval and organizing devices that allow the researcher to spot quickly and then cluster all the segments relating to a particular question, concept, or theme. Clustering then sets the stage for analysis (Miles and Huberman 1984, 56).

Given a working set of reasonably clear codes that describe the phenomena and events that are depicted in transcribed field notes, how can the researcher move to a second, more general and explanatory, level? The first step, open coding, is a process of summarising segments of data (Miles and Huberman 1984, 67). The next step is axial coding.

Axial coding

Axial coding produces pattern codes. These codes group the summaries of data produced in the first step into a smaller number of overarching themes or constructs. Axial coding has two important functions in this research. First, it reduces large amounts of data into a smaller number of analytic units. Second, it helps the researcher build a cognitive map for understanding what is happening.

Axial coding generates four summarisers: themes, causes/explanations, relationships among people, and theoretical constructs (Miles and Huberman 1984, 68). Table 3.7 provides examples of pattern codes derived from the data. Even during the initial fieldwork, the researcher is looking for threads that tie bits of data together. For example, if two or three informants say independently that personal ties are not really important when choosing business partners, this suggests to the

researcher that this may be an important variable to check out. This gets her to consider other factors that may account for choosing partners.

Table 3.7. Examples of pattern codes produced from axial coding

Themes:

PATT (pattern): Selection of business partners seems to depend to a great extent on previous experience with the person or firm, whether directly or indirectly.

Causes/explanations:

SITE-EXPL (informants' explanations): Price is not the only factor for entering into IORs. Other factors cited include access to limited supplies and sharing knowledge.

Relationships among people:

NET (personal network): The businessperson's personal network (strong ties) appears to be separate from their business network, but occasionally will overlap.

Theoretical constructs:

CHANGE (over time): Long-term business relationships change over time. They may become weaker or stronger.

Selective coding

In this final step in coding, the researcher is sorting codes into classes and categories. She is asking, 'What things are like each other? Does this specific thing belong to a more general class?' The analysis is taking another step up, trying to locate the event or activity in a more abstractly defined class (Miles and Huberman 1984, 243).

Glaser (1967) characterises this step as 'subsuming particulars into more general classes'. It is a conceptual and theoretical activity in which the analyst shuttles back and forth between first-level data and more general categories. They

evolve and develop through successive iterations until the category is 'saturated' (new data do not add to the meaning of the general category) (Miles and Huberman 1984, 223).

Practically, the researcher used the Ethnograph software as an aid to selective coding. Ethnograph was used as a tool to facilitate the analysis of data collected. Files consisting of interview transcripts and field notes were created and subsequently coded (Table 3.6). This software enabled the 'sorting and sifting' of data through its search function. It was then possible to compare and contrast the data by searching for coded segments.

For example, the researcher noted specific statements by informants, such as:

- 'They gave us access to overseas markets for our products.'
- 'In the first few years of the relationship, we learned a lot about the manufacturing technology.'
- 'During times of scarce supply, our supplier can give us preferential treatment because we have been doing business with them for a long time.'

These statements can be subsumed into a more general class: There is a specific resource **need** being met by the firm's relationships with other firms, a variable that turns out to be very important in explaining the decision to enter into long-term relationships or to 'do it themselves'.

Finding patterns

As analysis proceeds, the researcher needs to formalise and systematise her thinking into a coherent set of explanations. Field research typically has both a descriptive and an exploratory function. The researcher wants to depict the local

context and what happens within it and to disclose the reasons that determine why things happen the way they do (Miles and Huberman 1984, 132).

Table 3.8 is the 'analytical story' of the process of networking as derived from the field data. Table 3.9 presents a stylised diagram representing the process. The three chapters that follow (chapters 5, 6 and 7) use the diagram to organize the discussion.

Table 3.8. The networking process – the analytical story

An organization faces a series of dynamic opportunities and constraints from its environment. What external resources does it need? How does it go about acquiring those resources?

The main story seems to be about how and why businesses have certain relations with other firms. Crucial relations change from time to time as the needs of the company change. A firm's need for resources, information and technology, for instance, changes as it moves through different stages of its development. Smaller companies may need access to partners that are different from larger companies' needs.

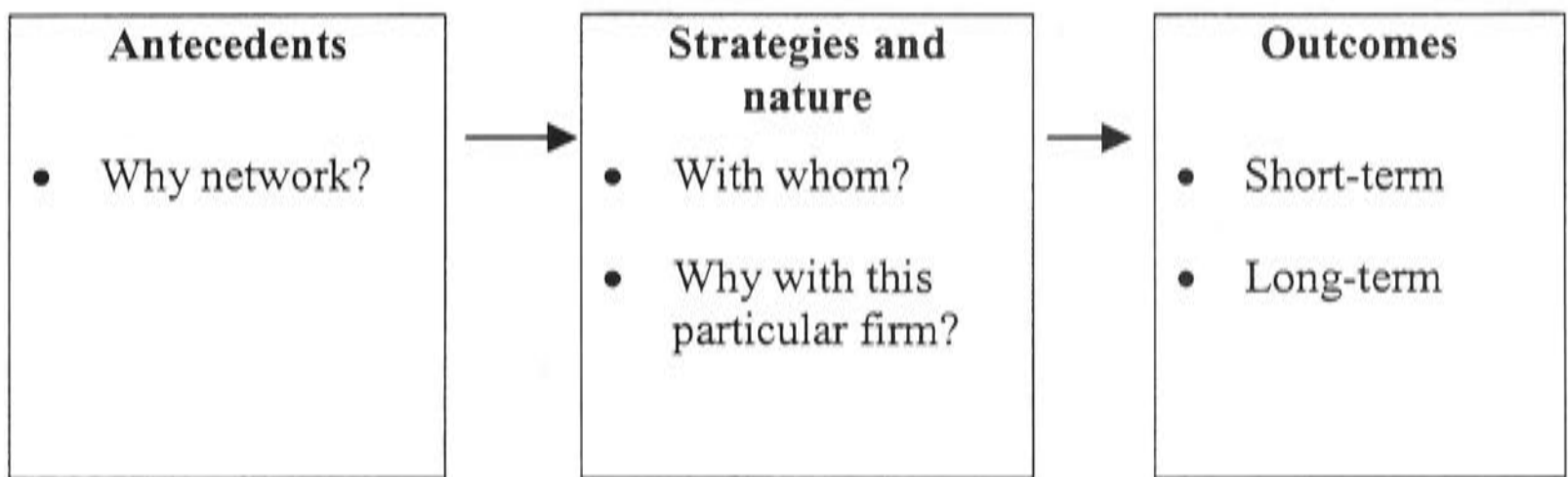
What determines whether a company decides to undertake an activity on its own or engage with outsiders (internalisation vs. subcontracting)? This decision affects the kind of action it will take vis-à-vis outsiders, for even if it decides to internalise, dependence on outside firms may still occur (e.g. raw materials, finance, equipment). The firm undergoes a process of assessing, taking into consideration its own competencies and resources. It may also evaluate the cost and benefit of particular decisions and take into account its own attitude towards external relations.

How does a company choose its business partners? In other words, what are the antecedents to business ties? Firms used several criteria for choosing a business partner, including the partner's business reputation and ethnic background. The relationship that results is the firm's interactional strategy and can be characterised by the extent, depth, and intensity of the tie.

If it is assumed that arm's-length transactions are pursued solely on the basis of price, then what are the consequences of embedded ties?

Who is important to the company at different stages of its development? Why?

Table 3.8. A diagram depicting the process of networking



The next chapter presents the context of Chinese business activities in the Philippines. The chapter covers two main categories from the theoretical framework: (a) government policy and (b) history and cultural traditions.

Chapter 4

The Development of Chinese Business

In the analysis of the changing economic roles of the Chinese, the historical development of institutions cannot be ignored, as business relationships have developed in the context of a number of supporting institutions, such as the legal framework, financial structures, and the form of entrepreneurship (Sako 1992). To understand the behaviour of an organization one must first understand the context of that behaviour.

The objective of this chapter is to provide both a series of snapshots of Chinese economic roles in Philippine history and a moving picture in terms of analysing changes in these roles over time. It is argued that political and economic policies of government administrations are of unquestionable significance in shaping patterns of so-called alien enterprises (Yambert 1981). The moving picture will also highlight the opportunities for and obstacles against business and economic development. In essence, this chapter covers two major elements of the theoretical framework (Figure 2.2): (a) government policy and (b) history and cultural traditions.

The discussion is organized according to the changing political periods in the country. It traces the development of Chinese business in the Philippines, beginning with Chinese settlement during the Spanish occupation and the formation of a unique system of credit arrangement and economic organization. During the American era, Chinese were predominantly traders, though a small number

embarked upon the manufacture of soap, shoes, and cigarettes. After the interruption of the Second World War, the Philippine government began a program of economic nationalism, with the aim of restricting alien (mainly Chinese) involvement in economic activities. A more outward-oriented outlook emerged during the 1960s, followed by a period of liberalisation and decentralisation in the 1980s through to the 1990s and 2000. Case interviewees were in strong agreement in acknowledging two events as turning points in Chinese business development: (a) the enactment of the Retail Trade Nationalization Law in the late 1950s and (b) the granting of citizenship to aliens in 1975. The chapter also addresses the question of the identity of the Chinese in the Philippines.

4.1 Humble beginnings

The Chinese have been trading with the Philippines since the thirteenth century (Fenner 1985; Omohundro 1981; Wickberg 1965). Merchants frequented the archipelago to exchange porcelain, pottery, silk and bronze for Philippine products (Yoshihara 1985). However, it was not until the Spanish occupation that they settled there permanently (Fenner 1985).

Spanish arrival in the Philippines in the 1560s expanded business opportunities. Ship owning merchants in Fujian province profited from the newly developing Manila Galleon trade between the Philippines and Mexico. Chinese goods were shipped to Manila, there to be loaded for markets in Mexico. On the return voyage, silver was brought to Manila, whereupon traders took it to China in repayment for the luxury goods they had brought (Wickberg 1965).

Early migration

The Chinese, known to the Spanish as *sangleys* (from the Hokkien word *sengli*, meaning 'trade'), began to migrate to the archipelago after the Spanish

arrival. Mostly originating from Fujian province, they were predominantly from the vicinity of the cities of Amoy (now Xiamen) and Jinjiang, formerly known as Ch'uanchou (Amyot 1973). In the mid-1840s, the size of the Chinese community stood at 5,736, representing no more than 0.14 per cent of the total Philippine population (Wickberg 1965).

From around the early 1830s, Spain's policy toward Chinese immigration and settlement underwent a fundamental revision. Basically, the change was from a policy of limiting new immigration and restricting the activities of Chinese already in the country to one of openly encouraging immigration, easing restrictions, and providing attractive opportunities for profit. In the 1903 census the Chinese population appeared as 41,035, slightly over one per cent of the total Philippine population. The tremendous growth in the size of the community was brought about by increased immigration, which generally assumed two forms: coolie-broker and kinship-based (Wickberg 1965).

Coolie-broker immigration developed after 1870 in response to the demands of foreign business houses in the Philippines. Coolie immigrants might have initially worked as part of labour gangs, or perhaps as *corredores* (house-to-house vendors). In the latter case, there was some hope of improving one's condition. A *corredor* working for a *cabecilla* (wholesale merchant) could often save enough money over a few years' time to enable him to open a *chucherias* (variety store) or textile shop of his own, often in partnership with another *ex-corredor*. Or a newcomer might be used by his *cabecilla* as a stock clerk, with an opportunity to move up the business and eventually, having learned what he needed to know, to go out on his own (Wickberg 1965). The coolie-broker system was also used widely in Singapore, where it was known as *kheh-tau* (Hwang 1976).

Kinship immigration appears to have followed a general pattern not only in the Philippines but also in Singapore and Malaya (Hwang 1976). Once a Chinese had established a foothold in the Philippines and achieved a modest measure of success, he sent for, or else returned to China and brought back, a teen-aged son or nephew. Eventually, other relatives, usually adolescents, came over in the same way, until a kind of fragmentary family – usually minus females – existed in the Philippines. Younger members could be used as agents or operators of branch stores. Otherwise, they might be kept in the original family store and apprenticed as clerks or, with sufficient educational background, used as bookkeepers (Wickberg 1965). Those who had migrated under the kinship-based system were initially dependent on their kinsmen for employment and financial aid. Others who came as free immigrants also sought help from their kinsmen and relatives from time to time (Hwang 1976).

Three broad economic systems were identified after the establishment of Spanish rule over the archipelago (Wickberg 1965). The first was the 'Western' economy, whose major interest was speculation in the Manila Galleon trade. The 'native' economy was locally oriented and of a subsistence character. The majority of Filipinos were part of an agriculturally based socioeconomic system in which market forces had little relevance (Carroll 1965, 24). Finally, the 'Chinese' economy included maritime trading between China and the Philippines, artisanry and the provision of goods to the Spaniards (Wickberg 1965).

In the mid-nineteenth century, the restriction that forced Chinese to live in the vicinity of Manila was removed. The Philippine governor-general's decree of 1839 gave the Chinese 'complete liberty to choose the occupation that best suits them', whatever their place of residence (Wickberg 1965, 52). The doors to the

provinces were now wide open. They subsequently fanned out to all parts of the Philippines as buyers of crops, distributors for importers based in Manila, entrepreneurs, and craftsmen. In the process they added permanent stores to many local economies previously restricted to periodic markets (Doeppers 1972, 103-104).

In contrast to the 'old Chinese economy' (pre-1850), the 'new Chinese economy' during the Spanish period assumed new forms and extended its geographical reach (Wickberg 1965). Table 4.1 contrasts these two systems. At the end of the Spanish period, Chinese became, on their own account, importers of European goods and exporters of cash crops to world markets.

Table 4.1. Chinese economic roles during the Spanish regime

Old Chinese economy	New Chinese economy
<ul style="list-style-type: none"> • pre-1750 to 1850 • maritime traders • provisioners and retail dealers in urban settlements • distributors of Chinese imports in the areas adjacent to Spanish settlements • artisans in both Spanish settlements and native communities 	<ul style="list-style-type: none"> • from 1850 to 1898 • most important new activity was that of commercial agent, or middleman: <ul style="list-style-type: none"> • collected produce for export • acted as wholesalers of imported goods, distributing them in the provinces • processors of Philippine products

Source: Edgar Wickberg, *The Chinese in Philippine Life, 1850-1898*. (New Haven: Yale University Press, 1965), 63.

Credit arrangements and economic organization

Wickberg (1965) argues that three sets of preconditions made the Chinese successful in their role as middlemen during the Spanish period. First, they had the right combination of patience, adaptability, pioneering spirit, economic

sophistication and organization to be markedly successful distributors and purchasing agents. Second, liberalised travel and residence laws provided the Chinese commercial agents with needed access to the provinces. Third, they had long-term dependable financing and effective economic organization.

It was doubtful that there was much capital available within the Chinese community in the pre-1850 period. Few enterprises were sufficiently lucrative. One could borrow at six per cent from the Chinese 'community chests', but after 1755 these funds were not large. Outside the community, individual Spaniards provided venture capital to some Chinese in the middle and late eighteenth century. But there appeared to have been nothing systematic or organized about this practice. In the pre-nineteenth century there were no banks but during the second quarter of the nineteenth century a few private banking businesses were initiated in Manila. It is not known whether they lent to Chinese (Wickberg 1965).

One source of funds for the Chinese was the European and North American entrepreneurs in Manila, who gave advances to Chinese wholesalers to help them dispose of European imports and to buy up produce for export. Another source was the Banco Español-Filipino de Isabel II. European firms became guarantors for Chinese borrowers from the bank, forwarding their payments to the bank, and assuming responsibility for settlement with the bank in case the Chinese defaulted (Wickberg 1965, 69-70).

For Chinese dealers who concentrated entirely on distributing or retailing imports, obtaining goods on credit was more important than access to cash loans. A European or American firm usually advanced imported goods to Chinese dealers in an interesting credit system that worked as follows. A Chinese dealer would ask one of the merchant firms for a rather modest amount of goods on credit of perhaps three

to six months' term. As soon thereafter as possible, he made a token repayment of a portion of the debt, and then asked for a larger advance. Again, only part of this was repaid, and additional credit secured. The process continued in this fashion, so that some Chinese dealers were constantly in debt to foreign firms (Wickberg 1965, 70).

From the point of view of the Chinese, a system of constant indebtedness bound the creditor to him and ensured the future availability of credit on the assumption that only in this way could the total investment be regained. From the European merchant's point of view, this system was stable only so long as it was the only way to deal with Chinese middlemen, and so long as Chinese business defaults were kept to a reasonable minimum (Wickberg 1965, 71).

No less important than financing was economic organization. The most characteristic element of this was the *cabecilla* system. A *cabecilla* was usually a large wholesaler of imported goods and export produce. Ordinarily, he was established in Manila, where he dealt with the foreign business houses. He was apt to have several agents located in the provinces, running stores as retail outlets for the imported goods he had acquired, at the same time buying up crops for the *cabecilla*. The *cabecilla* assisted his agents by extending them a line of credit, all the while keeping this relationship confidential (Wickberg 1965, 72).

The *cabecilla*-agent relationship offered a number of advantages to all parties concerned. The foreign merchant could be assured that by dealing with a *cabecilla* who had numerous agents, his imported goods would receive the broadest possible distribution. A wide network of purchasing agents would funnel Philippine produce to him in return. To the *cabecilla*, this system provided a broad scale for his operations. The agent, too, found this system advantageous. Usually he had neither the capital nor the access to credit to start his own business. These he could

get from the *cabecilla*, who started him in business, kept him supplied with whatever he needed, and provided a sure outlet for the produce the agent bought (Wickberg 1965, 74).

The system was also beneficial to consumers and producers. The agent's store, most often a general merchandise store called *tienda de sari-sari*, was established in market towns. Unlike the periodic markets held in these towns once or twice per week, the Chinese *sari-sari* store was open all the time. Another consumer advantage was the readiness of the Chinese to offer credit to his customers. From the producer's point of view, the Chinese store was also an improvement over previous marketing systems. As early as the 1780s producers of export crops had been receiving cash advances from agents of the Royal Philippine Company and *mestizo*² (Filipinos of mixed-blood) wholesalers. The Chinese storekeeper continued this practice. Because he also had something to sell, a producer who needed supplies rather than cash could barter with him, which would take the form of credit at the Chinese store instead of cash advances against crops (Wickberg 1965, 74).

A system similar to the *cabecilla* was also observed in Java around the same period (Willmott 1960). Chinese middlemen in Java not only supplied urban centres with food but, as native production was accommodated to an export crop economy, they also transported local produce to bulking and shipping centres for eventual export as well as distributing imported manufactured products throughout the whole economy.

² The term *mestizo* is broadly used to refer to Filipinos of mixed Malay and other blood. They are products of intermarriage of the Malay Filipinos with the Chinese, Spaniards, Americans and other foreigners (Reynolds 1964, 3).

In the years after 1860, Western imports continued to be funnelled through the Manila *cabecilla* system, but prominent Chinese in Cebu City established their own export *cabecillas*. The *cabecilla* based in Cebu City dealt directly with the representatives of the leading foreign commercial houses, accepting cash advances in order to collect goods from the countryside and deliver them to the firms. Thus, the Chinese *cabecilla* system created a commercial link between the port and the countryside (Fenner 1985).

The tax figures for the Cebu Chinese community in 1896 not only provide a more precise picture of the occupational nature of the community but also indicate the wide range of economic activities present in the port area (Table 4.2). In contrast to the majority of the immigrants who were labourers, a small number of Chinese had become artisans and merchants.

In the late nineteenth century, Chinese began to carry on new sets of economic functions in the Philippines as well as elsewhere in Southeast Asia. Though European settlements often were little more than trading ports and *entrepots* for transshipment of luxury goods, their inhabitants required food and urban services that the Chinese provided. Seaborne trade in precious commodities remained their principal occupation, but the Chinese also devoted themselves to artisanry and local level trade. Their roles as local middlemen represented a change from their previous position as long distance traders (Yambert 1981, 184). Chinese commercial middlemen, or *compradors*, occupied a position subordinate to the big European companies of the colonial era in Southeast Asia. Since the end of colonial rule, the economic roles of the Chinese have been changing and they have been able to diversify their occupations and economic strength in the Philippines, as in the rest of the region (Mackie 1992).

Table 4.2. Tax figures for the Cebu Chinese community, 1896

Taxpayer Classification	Percentage of Chinese	Occupations
First class	2%	Owners and operators of stores that sold textiles, thread, silk, books, or European luxury goods
Second class	5%	Operators of small textile stores that sold piece goods, operators of hardware stores, pharmacists, candle-makers, bakers and blacksmiths
Third class	1.5%	Grocers, silversmiths, shoemakers, carpenters, tanners and manufacturers of soap
Fourth class	5%	Owners of candy shops, slaughterhouses, furniture shops or Chinese restaurants
Fifth class	86.5%	Unskilled labourers, performing the heavy manual work on the docks or wharves

Source: Bruce Fenner, *Cebu under the Spanish Flag: 1521-1896*. (Cebu City: San Carlos Publications, 1985), 112-113.

To summarise, the Chinese in the Philippines were able to expand their economic influence because of three factors: liberalised Spanish policies, new opportunities offered by the new export crop economy, and Chinese business methods. Of the three, the last was perhaps the most decisive, as liberalised Spanish policies and new export products offered new opportunities to various groups, not only the Chinese (Wickberg 1965).

4.2 The American period (1898-1941)

At the close of the nineteenth century, the majority of Filipinos were part of an agriculturally based socioeconomic system in which, for those below the landlord

class, market forces had little relevance. In 1902, only sugar milling and cigar and cigarette manufacturing employed more than 10,000 workers each. Factories and larger workshops in all other manufacturing industries together employed less than 25,000 (Carroll 1965). The Chinese were starting to make their presence felt in manufacturing during the American era, but were second to the Americans in business investment. The economy went through a growth and decline cycle, but positive economic policies of the American administration had a beneficial impact on business activity.

Economic development

The growth of the Philippine economy was attributed to its increasing integration into the Western marketplace, a process that began in the mid-19th century and was strengthened in the early 20th century by free trade with the United States. A number of policies of the American government influenced the economic environment of the Philippines in general. Policies were introduced that instituted the rule of law, emphasised capitalist doctrines, implemented economic reforms, promoted infrastructure projects, and tolerated organizational mobilisation. In other words, the overall policy settings of a level playing field and private enterprise benefited all players, Chinese included (Wong 1994).

The development of Philippine manufacturing since 1902 through to 1939 was characterised by (a) the bulk of investments going to export-oriented industries, most of which were regionally concentrated in Manila, (b) sugar emerging as the leading industry, and (c) a scale of production that was limited to the household level of operation (Valdepeñas and Bautista 1977). Up until the 1920s, manufacturing in general was confined to small shops that produced barely enough to meet the immediate and local wants of the inhabitants. From a total value of

about 2 million Philippine Pesos (PhP) in 1900, exports rose to over 128 million PhP in two decades (Bureau of Commerce and Industry 1924). Throughout this period, traditional exports such as sugar, abaca, tobacco and coconut products comprised 76 per cent to 93 per cent of the total export value (Valdepeñas and Bautista 1977).

The Chinese community was smaller than elsewhere in Southeast Asia, both in absolute terms and in relation to the indigenous population. Its provincial homogeneity and the concomitant dominance of the Hokkien speech group were not found elsewhere in Southeast Asia. Lineage, hometown, surname, commerce, trade, cultural, and political associations created a network of social and economic relationships among the Chinese (Wong 1994). Their business activities in manufacturing, commerce, finance, and transport are discussed below.

Chinese business investment

Chinese investment in manufacturing was mainly in rice milling and liquor (Shozo 1939). In industries such as tobacco processing and footwear making, investments and production capacity were small (Wong 1994). Although they were not permitted to engage directly in the cultivation of rice, the Chinese were extremely important in the milling and marketing end of the rice industry. Another area of involvement was the lumber industry (Jensen 1975). As early as 1901, Chinese operated 21 out of 46 lumber mills. In 1935, there were 204 lumber yards, out of which 148 were owned and operated by Chinese (Alip 1974). They also participated in the desiccated coconut, Manila hemp, and sugar industries (Jensen 1975). There were also entrepreneurs involved in smaller-scale businesses such as candy factories and bakeries, leather production (mainly preparation of raw hides and skins), cigar box manufacturing, soap making and aerated water factories (Bureau of Commerce and Industry 1924).

Foreign trade in the Philippines mainly involved exporting agricultural products in a raw or semi-raw form and the importation of manufactured goods. The main trade was carried on through a small number of large commercial houses, most of which were American. Chinese constituted the most important agents in retail distribution in the country. Cotton textiles have been the single largest import of the Philippines, and the Chinese were the most important retailers of textiles. It has been observed that they always kept prices just a little below those prevailing in non-Chinese shops, but rarely attempted to cut each other's prices (Jensen 1975).

The Chinese commercial structure during this period has been characterised as a tight network, embracing everything from traders down to village general stores and peddlers. The storekeepers who lived in the villages and the itinerant peddlers who made regular rounds started by selling Filipinos the necessities of life. These were usually imported goods or Chinese manufactured products. Being in constant contact with Filipinos, they extended them considerable credit. This was not limited to sales on credit, but included small cash loans. Repayment was received in kind, such as rice, coconut oil, vegetables, or chicken. These goods were then supplied to exporters or consumers. Therefore, profit was made by supplying goods to both Filipinos and middlemen (Shozo 1939).

Flores (1987b) asserts that during the 1920s and 1930s, Chinese merchants excelled most as retail traders. Humble *sari-sari* stores directly served the localities, while various specialty stores (dry goods, rice dealers, grocery shops) enlivened the *calles* (or streets) of colonial Manila. Among the large hardware houses of the American years were the Yutivo Sons Hardware founded by Don Jose Palanca Yu Ti Vo and the older Mariano Uy Chaco Hardware. Chua Farruco and Don Mariano Velasco Chua Chengco operated the biggest Chinese bazaars in the city. Their

merchandise ranged from Viennese furniture to galvanised iron for roofing and fine Chinese silks. Rivals in the alcohol trade were Don Carlos Palanca of La Tondeña Distillery and Lim Chay Seng of Disteleria Limtuaco (Flores 1987b).

While still a young man, Dee C. Chuan had become known as the 'lumber king'. He operated a large sawmill, possessed logging concessions in the provinces, and was the country's single biggest lumber exporter. By the time he was thirty years old, he was elected president of the Chinese Chamber of Commerce, the youngest president in the Chamber's history. A year later, in 1920, he spearheaded the group that founded the China Banking Corporation (Flores 1987a). Another bank started by Chinese capitalists was the Mercantile Bank of China (Shozo 1939). It was unfortunate that whereas the China Banking Corporation was able to successfully weather the financial crisis of 1931, the Mercantile Bank of China succumbed to the Depression (Jensen 1975).

The Chinese had their own vessels for inter-island navigation, but the scale was not significant. Most shipping was combined with trading concerns (Shozo 1939). By 1937, the Chinese Consul-General estimated the total investments of Chinese at 201 million PhP (Table 4.3).

Another prominent Chinese businessman during the American era was Guillermo Cu-Unjieng, who founded the Yek Tong Lin Fire and Marine Insurance Company in 1906. Don Benito Siy Cong Bieng led the Chinese community as Chinese Chamber president for nine years. His business was primarily in import-export trading. The Li and Go clans, both from Fujian province, were among the pioneers of the modern lumber industry (Flores 1987b).

Table 4.3. Total investments of Chinese in the Philippines, 1937

Areas of business	Amount invested (in million PhP)
Retail merchandising	50
Wholesale merchandising	30
Lumber	20
Banking and other financial institutions	10
Cigars and cigarettes	5
Distilleries	5
Soap and candles	1
Real estate and other investments	80
TOTAL	201

Source: Irene Jensen, *The Chinese in the Philippines during the American Regime: 1898-1945* (Ph.D. diss., Ohio State University, 1975), 129.

Americans were also active in the business sphere. Three foreign groups dominated the manufacturing of soap: American, Swiss, and Chinese. Americans also controlled the Manila hemp industry and desiccated coconut exports. In mining, 37 per cent of total assets were owned by Americans. Before the outbreak of World War II, they had invested approximately 200 million PhP in sugar, coconut, abaca plantations, mining, lumber operations and public utility enterprises (Jensen 1975).

The Chinese were quick to recover after World War II. Many Filipinos complained that Americans discriminated against them by granting the Chinese credit immediately after the war. The head of a large business firm in Manila agreed that all the banks in the Philippines showed favouritism towards Chinese and Americans immediately after WWII, but maintained that in the light of his own experience this was merely sound banking. His firm, in business in the Philippines for about fifty years, had done 70 per cent of its 75 million PhP business with

Chinese and Americans, losing less than 25,000 PhP in bad debts in the process. But in the remaining 30 per cent of the business that had been done with the Filipinos, about 200,000 PhP in bad debts had been lost, despite the fact that the firm had screened the Filipinos much more closely than it had the Chinese (Appleton 1960).

4.3 Osmeña, Magsaysay, Garcia and Macapagal Administrations (1945-1965)

Three political periods since independence are presented. The first is one of electoral democracy that was marked in the 1950s and 1960s by a growth in factory manufacture and industrial entrepreneurship, aided by state protection (Pinches 1996). The second period, rule under Marcos, is associated with 'crony capitalism', the expansion of export industries and the growing importance of state technocrats. The third period, under Aquino, Ramos, Estrada and Arroyo, is characterised by the partial dismantling of 'crony capitalism' and a more liberal economic environment.

Inward-oriented industrialisation

Shortly after the Second World War, the Philippine government embarked on an import-substitution process, first under a system of foreign exchange and import controls, later behind a substantial tariff wall with liberal tax concessions for investment activities. Termed the 'decade of controls' by Carroll (1965), the period 1950-1960 saw policies utilised to favour Filipino over alien manufacturers and one's friends, relatives, and political supporters over all others. The system provided an abundance of opportunities for the 'graft and corruption' in the relationships between government and business that have been a most prominent feature of life in post-war Philippines (Carroll 1965).

Industrialisation by means of protection for import substitution began in 1949 when the government imposed import and exchange controls. This stimulated

domestic production of consumer good substitutes partly because imported raw materials and capital goods needed by these industries were obtained at artificially low prices in peso terms. The overall high level of protection created a bias against agriculture and export-oriented industries, leading to import substitution and capital-intensive development (Cabalu 1993).

In addition to providing these incentives, the Philippine government exerted itself in making credit available to prospective industrial entrepreneurs. The policy of favouring Philippine citizens over foreigners – and, informally, native-born over naturalised citizens - in the distribution of the various forms of government assistance tended to increase the incentives for the favoured groups (Carroll 1965). A major industrialisation policy had been that of granting subsidies to ‘new and necessary industries’. The term ‘new’ had been interpreted as industries that had not been commercially exploited in the Philippines before the Second World War. The term ‘necessary’ referred to industries that contributed to industrial and economic development. New industries were not only protected from the competition of imports of finished manufactures, but were also heavily subsidised by tax exemption and foreign exchange allocation. The number of products that had been approved for tax exemption by the middle of 1958 amounted to more than two thousand. By mid-1958, over 700 firms had been granted tax exemption (Table 4.4). Wide administrative discretion was inevitable in assessing qualifications for new and necessary industries (Golay 1961).

Filipino and qualified Chinese entrepreneurs were not slow in responding to incentives and opportunities such as these. They seemed to have developed a form of entrepreneurship far more political in its methods than that which appeared at

Table 4.4. New and necessary industries granted tax exemption, end of June 1958

Nationality of firm owners	Number of firms
Filipino	429
Chinese	144
Filipino-Chinese	107
American	22
Filipino-American	45
Filipino plus mixed nationalities	45
Unidentified	28
Firms not including Filipinos	6

Source: F. Golay, The Philippines: Public Policy and National Economic Development (Ithaca, NY: Cornell University Press, 1961), 252.

similar stages of development in the Western nations (Carroll 1965). Indeed, the growth rates in manufacturing were relatively high in the 1950s and early 1960s. The sector's share in total output increased from 7 per cent in 1946 to 25 per cent in 1960. Industrial growth in this period was mainly oriented towards the domestic market and assisted by high rates of effective protection (Vos and Yap 1996). In the late 1960s, however, manufacturing was a lagging sector, with a 4.8 per cent annual growth rate between 1962 and 1968, compared to 5.3 per cent for net domestic product (Lindsey 1976).

In the relative absence of interest from the landed elite, the manufacturing sector of the 1950s remained open to those from humbler origins. Yoshihara (1985) found that the Chinese who entered import substitution came primarily from amongst the merchants, with a few who were artisans or financiers. Among Filipinos, the entry patterns were more varied, with import-substituting

manufacturers getting their start in trading, agricultural processing, management of other enterprises, the professions and government service (Yoshihara 1985, 124-34). It was during this period that one of the case study firms, MM Textiles, began its operations. Jose Yu and his father saw the opportunities in manufacturing textiles to substitute for imported products. They were also hindered from continuing with their trading business due to the restrictive effects of the Retail Trade Nationalization Law, to be discussed later.

In the early post-war era, three old Chinese business families who branched out into the assembly and distribution of transport equipment were the Cosetengs with Honda Motorcycles, the Lees with Mercedes Benz limousines and the Yus with General Motors cars and trucks (Flores 1987c). At the beginning of this period, the Chinese comprised almost two per cent of the total population, were homogeneous and closely-knit, lacked a large proletarian sector and were predominantly located (50 per cent) in Manila (Cariño 1998).

Economic nationalism

Anti-Chinese legislation has been practised since Spanish times. At times the Spaniards tried to restrict Chinese immigrants to farming or labouring, but no matter where they started the Chinese soon found their way into commerce. Eventually, the Spaniards discovered that the most profitable policy was to permit the Chinese to operate, but to tax them heavily (Appleton 1960). A major discriminatory act under U.S. Administration was the Bookkeeping Act of 1921, which required merchants doing business in the Philippines to keep accounts in English, Spanish or a local dialect (Alip 1959). With the establishment of the Philippine Commonwealth in 1934, the pressure for anti-Chinese legislation increased. The Commonwealth Constitution itself contains provisions excluding

Chinese from owning land, exploiting Philippine natural resources, or operating public utilities (Appleton 1960).

A major policy goal of the Magsaysay administration (1953-1957) was an acceleration of economic nationalism in the narrow sense of wresting various lines of economic activity from Chinese control. The major legislative move in this direction was the Retail Trade Nationalization Law of 1954. If fully implemented, the law aimed to dispossess all aliens presently engaged in retailing in the Philippines within one generation (Golay 1961). Alien firms in the retail trade tended to be relatively large (Table 4.5). Some Chinese reacted by moving out of retail into wholesaling or manufacturing, while others used dummies or placed their businesses in the names of their Filipina wives. Still others took their capital out of the country and invested it elsewhere, particularly Hong Kong (Appleton 1960). A similar pattern has been observed in Indonesia. There the Chinese extended business into areas untouched by mounting government restrictions and so have become involved in construction, processing and small-scale manufacturing (Yambert 1981, 193).

President Carlos Garcia issued the Filipino First Policy on January 25, 1960, aimed at allowing Filipinos to obtain major and dominant participation in the national economy (Areño 1997). Other areas of economic policy in which economic nationalism has been evident were that governing the exploitation of natural resources and the assembly and marketing of agricultural products. Only citizens of the Philippines or corporations having at least sixty per cent Filipino ownership were permitted to develop agricultural, timber, and mineral lands. A bill providing for the

Table 4.5. Retail trade by nationality of trader, 1948

Nationality of trader	Number of establishments (thousands)	Per cent of total	Value of assets (million PhP)	Per cent of total	Gross sales (million PhP)	Per cent of total
Filipino	113.6	90	213	67	467	61
Chinese	12.1	10	93	29	295	38
Other	0.4	-	11	4	10	1

Source: Frank Golay, *The Philippines: Public Policy and National Economic Development* (Ithaca NY: Cornell University Press, 1961), 323.

nationalisation of trade, milling, and warehousing of rice and corn was passed in 1960 (Rice and Corn Industry Nationalization Act), aiming to eliminate alien middlemen from the assembly and marketing of agricultural crops. The bill provided that aliens presently engaged in retailing and wholesaling rice and corn could continue in business for two years and in milling and warehousing three years (Golay 1961).

In banking, the Monetary Board ruled that naturalised citizens were forbidden to own any portion of newly established banks. The intent of the ruling was to construct a legal barrier against Chinese, since the bulk of applicants for naturalisation was of Chinese descent (Hutchcroft 1993). This ruling was eventually relaxed in 1965 and 20 to 30 per cent ownership by naturalised Filipinos was allowed.

An important aspect of Filipino economic nationalism has been the reluctance of the Philippines to promote economic assimilation of aliens. Philippine

naturalisation policy was strict and reflected a determination to prevent any abuse or misuse of acquired citizenship. There were numerous requirements for naturalisation, including the length of residency in the country, minimum value of real estate holdings, language competency and schooling of children. As an illustration, consider the case of a Chinese applicant whose nine children attended government approved schools in the Philippines as required by the naturalisation laws, except for one who lived in China and was attending an English school. Failure of the one child to meet the schooling requirement was enough to defeat the application of the petitioner (Golay 1961). Many Chinese businessmen found ways to survive without Philippine citizenship. Some used the names of relatives who were Philippine citizens for registering the business; others changed their line of business while some transferred their investments elsewhere.

The Chinese outside Manila

In a study of the Chinese in three Philippine provincial cities (Dagupan, Dumaguete and Davao), Doeppers (1972) gives us a glimpse of Chinese business outside Manila. The Chinese consistently dominated the retail trade in Davao, Dagupan and Dumaguete cities. Dry goods stores were principally run by Chinese, which, according to Doeppers, was the result of a historical situation that dated from the early nineteenth century or even earlier when the Chinese became the distributors of cloth manufactured in England.

Hardware stores throughout the country were typically run by ethnic Chinese. This position was an outgrowth of the historical relationship between the Chinese distributors and the English, American, and Japanese manufacturers of tools, pumps and engines (Doeppers 1972).

In these three provincial cities, business and residential location of the Chinese was virtually synonymous. In all cases documented in the three cities, Chinese lived above or in their place of business (Doeppers 1972, 133).

Profits by Chinese merchants in Capiz were deposited in Chinese-owned banks in Manila. The ability to periodically borrow large amounts within a short period of time made it practical for the Chinese to operate within the sphere of Chinese banks (Yengoyan 1983, 119).

Minority within a minority

The Cantonese formed the principal minority group within the Philippine Chinese community. In provincial cities, they were principally found as bakers, cooks, managers of restaurants and grocers. The average Cantonese social standing in provincial cities, as in Manila, tended to be lower than that of the Hokkien. The big Chinese businesses in commodities, logging, distributing, and retailing were Hokkien. Nevertheless, while Cantonese in various cities have been successful in generally modest businesses, a few Cantonese have achieved considerable success (Doeppers 1972; See 1988).

Trade, employment and business patterns moulded different lifestyles among the Hokkien and Cantonese immigrants. Most Cantonese were in the service trades and worked as craftsmen. They were dominant in the restaurants, hotels and laundries in Manila's Chinatown district. Many of them worked as cooks, waiters, typesetters, tailors, bakers and carpenters (See 1981).

The Cantonese went to particular cities because of specific contacts. The typical young Cantonese migrant described by Doeppers (1972, 119-120) immediately begins to learn one of the 'Cantonese' occupations (e.g. cooking and

restaurant management) while in the employ of a cousin in Manila. Doeppers writes:

After a decade or more the immigrant learns of an opportunity to manage a restaurant business in a provincial city for a different cousin. Having saved for years, he accumulates and borrows sufficient capital to open his own restaurant and a small second floor hotel. If he has no sons, he sends to Manila for a nephew to come carry some of the burden of work. This pattern of migration, occupational training, and system of family contacts has been often repeated (Doeppers 1972, 119-120).

4.4 Outward oriented industrialisation (Marcos Administration, 1965-1986)

Late in the 1960s and in the following decade, there was a shift towards a more outward-looking strategy. Under Marcos, the administration tried to pursue a policy of greater export-orientation and liberalisation. These policy goals were undermined, however, by the availability of cheap foreign loans that Marcos used to fuel a 'debt-powered' strategy of growth (Rivera and Koike 1995, 1). Pricing and regulatory interventions by the government fostered rent-seeking activities by special interest groups (also known as Marcos 'cronies') (Cabalu 1993). The main source of growth was external in origin, mainly through a massive loan inflow. The existing protectionist regime was further bolstered when non-tariff barriers became more restrictive. Monopolies in various sectors of the economy (such as coconut and sugar trading, beer, construction, and large department stores) were enjoyed by Marcos's closest associates. By 1983, a balance of payments crisis led to the suspension of the trade liberalisation program initiated by Marcos (Rivera and Koike 1995). The economy went into recession and the years following 1983 saw a massive outflow of private sector foreign exchange holdings (Vos and Yap 1996).

AA Plastics' founder was encouraged to go into manufacturing in the 1960s. During this time, they were the only manufacturer of acrylic plastic in the Philippines and, with no foreign competition, controlled product pricing. AA's business flourished in this era, as did MM Textiles and JJ Chemical. AA and MM belonged to the import substituting industrial segment while JJ was involved in export.

Chinese economic position

Yoshihara's study of the top 250 manufacturing companies of the Philippines in 1968 classified these companies in terms of foreign and domestic ownership (Table 4.6). Of the 250 companies, 87 were foreign-owned and 163 domestic. Of the 163 domestic companies, 80 were owned by Chinese and 83 by Filipinos (Yoshihara 1985). According to Yoshihara, the most common entry pattern into import-substitution manufacturing was from trading. Chinese entrepreneurs in manufacturing were almost without exception merchants. Among Filipino companies, 3 were owned by government organizations, 48 (or 58 per cent) were family companies, and 32 were non-family companies. The proportion of family companies was greater in the case of Chinese companies. Of the 80 Chinese companies in the sample, 68 (or 85 per cent) were family companies.

Japanese investment in the Philippines increased significantly during this period. Total investment increased from 0.40 million USD in 1970 to 12.90 million USD in 1972 and 62.59 million USD in 1975 (Tsuda 1978). Among the leading Chinese business partners of Japanese companies were Alfonso Yuchengco, Patricio Lim and Emerson Coseteng (Table 4.7).

Table 4.6. Ownership of the top 250 manufacturing companies in the Philippines, by nationality, 1968

Industry	Number of firms			Percentage of firms		
	Filipino-Chinese	Filipino	Foreign	Filipino-Chinese	Filipino	Foreign
Food	15	25	21	24.6%	41.0%	34.4%
Beverages	3	3	2	37.5%	37.5%	25.0%
Tobacco	9	1	2	75.0%	8.3%	16.7%
Textiles	17	12	5	50.0%	35.3%	14.7%
Pulp and paper products	5	3	2	50.0%	30.0%	20.0%
Rubber products	4	0	3	57.1%	0.0%	42.9%
Chemicals	6	10	25	14.6%	24.4%	61.0%
Petroleum products	0	0	4	0.0%	0.0%	100.0%
Non-metallic mineral products	3	10	3	18.8%	62.5%	18.8%
Metals	11	8	8	40.7%	29.6%	29.6%
Machinery, equipment and components	3	3	7	23.1%	23.1%	53.8%
Transport equipment	3	3	2	37.5%	37.5%	25.0%
Electrical appliances	1	4	3	12.5%	50.0%	37.5%
Other	0	1	0	0.0%	100.0%	0.0%
Total	80	83	87	32.0%	33.2%	34.8%

Source: Kunio Yoshihara, *Philippine Industrialization* (Quezon City, Philippines: Ateneo de Manila University Press, 1985), 38-39.

Table 4.7 Leading Chinese-Filipino partners in major Japanese-Filipino joint ventures, 1976

Leading partners	Firms with connection to leading partners	Japanese partner firm
Alfonso Yuchengco	Pan Malayan Insurance	Mitsubishi
	Philippine Fuji-Xerox	Mitsui
	Rizal Commercial Banking Corporation	Sanwa
	Super Industrial (Hi-Dai'ei; Hi-Daiwa; Hi-Eisai; House of Investments)	Sanwa
Patricio Lim	Filsyn	Sanwa, Mitsui
Emerson Coseteng	Mariwasa-Honda Porcelana-Mariwasa	Honda, Mitsubishi Toyota

Source: Mamoru Tsuda. *A Preliminary Study of Japanese-Filipino Joint Ventures* (Quezon City: Foundation for Nationalist Studies, 1978).

Alien Naturalization Law

A positive development for the Chinese community under Marcos was the passing of the Alien Naturalization Law. Under the mass naturalisation programme of 1974, Chinese were given the opportunity to apply for Filipino citizenship.

Eusebio Wu of JJ Chemical remarked:

This has changed the nature of finance. It's now easier to borrow money from the banks, because with collateral these institutions will lend you money quite easily. Larger sums can now be borrowed because of the real estate boom.

4.5 Liberalisation and deregulation (Aquino, Ramos, Estrada and Arroyo Administrations, 1986-2003)

After an initial spurt of manufacturing activity in the 1960s, industrial growth began to stagnate. Between 1961 and 1987, the proportion of total employment in manufacturing dropped from 12 to 10 per cent. In addition, the manufacturing sector's share in GDP barely moved between 1972 and 1988 (Rivera and Koike 1995).

In the post-Marcos era, starting with the Aquino administration and continuing under Presidents Ramos, Estrada and Arroyo, industrial reform has focused on liberalising, deregulating and privatising the economy. A major economic policy has included the privatisation of government-owned and controlled corporations (GOCCs). Several Chinese businessmen have taken advantage of the opportunities afforded by privatisation by investing in these GOCCs. PR Holdings, controlled by Lucio Tan, bought a majority share in Philippine Air Lines in 1992. The country's largest ship repair facility was privatised with the majority of equity purchased by a consortium which included Henry Sy. John Gokongwei Jr. has obtained a stake in the country's largest oil exploration company, Oriental Petroleum and Minerals Corporation (Rivera and Koike 1995).

A complementary policy pursued by the Ramos administration was the liberalisation and deregulation of key sectors of the economy, including telecommunications, energy, banking and shipping. The leading Chinese businessman in telecommunications is John Gokongwei Jr. (Digital Telecommunications Philippines). In the energy sector, the Lopez and Gokongwei families have jointly invested in power generation. The banking sector was opened to more foreign participation and the inter-island shipping industry became

accessible to new operators and investors. Greater trade liberalisation will see tariff reduce from levels of 30 per cent to less than 10 by year 2004 (Rivera and Koike 1995).

Liberalising policies presented both opportunities and threats to the case firms studied. Initially, most saw these policies as detrimental not only to profits but even to their own survival. Several had been beneficiaries of protectionism in the past. The manufacturing businesses, AA Plastics, MM Textiles, and JJ Chemical, benefited from tariff rates imposed on imports competing with their product lines. The two shipping companies were for many years protected from new entrants to the industry due to government regulation. KK Stores was also protected from foreign competition by restrictions on the foreign ownership of retailing businesses.

4.6 The Philippine financial market

The Philippine financial system has a strongly dualistic nature, in which an important informal financial market segment coexists with the formal banking system. Informal money-lenders fund, at relatively high cost, small businesses and household firms which have little or no access to the formal banking system. Large private corporations are the preferred borrowers of the highly-concentrated formal banking system (Vos and Yap 1996).

A 1957 ruling of the Monetary Board forbade naturalised citizens from owning any portion of newly established banks. In other words, all new banks were required to have 100 per cent natural-born Filipino ownership. Since the vast bulk of applications for naturalisation were of Chinese descent, the intent was quite clearly to construct legal barriers against ethnic Chinese ownership of banks. While these regulations may have temporarily obstructed greater ethnic Chinese involvement in the banking sector, they continued to enjoy a major stake in the

banking system (Hutchcroft 1993). A former Central Bank Governor, Gregorio Licaros, observed that the 'average Filipino banker is in the banking business not for banking profits; he uses his bank for allied business' (quoted in Vos and Yap 1996, 108). Certainly in the 1960s, ownership of a bank became among the surest means of securing credit for the other components of the diversified family conglomerate, and most major business families flocked to the industry. These families set out to obtain bank licenses and commercial banking became something of a fad in the 1960s. The families that flocked to banking included both those of old landed wealth and those that had been involved in the import-substitution industries of the 1950s. Among the Filipino and Spanish mestizo businessmen who invested in banks were Ramon Aboitiz, Gonzalo Puyat, Salvador Araneta, Antonio and Jose Madrigal (Hutchcroft 1993, 260).

In subsequent years, many ethnic Chinese entrepreneurs were able to acquire significant ownership stakes in other, already existing, commercial banks (Hutchcroft 1993). These include Henry Sy's investments in China Bank and Far East Bank, Gokongwei in Far East Bank and Philippine Commercial International Bank (PCIBank) and Yuchengco in Rizal Commercial Banking Corporation. In 1999, the Gokongwei and Lopez families sold their stake in PCIBank for 31.6 billion PhP (835.9 million USD) to the Equitable Banking Group and the state-run pension funds (Government Security and Insurance Service (GSIS) and Social Security System (SSS)). Equitable Bank is headed by the ethnic Chinese tycoon George Go. Go is said to be a friend of former President Estrada, but Equitable Bank was founded in 1950 by his father Go Kim Pah. George Go became President of the bank in 1988 when it had resources of 8.1 billion PhP (383 million USD) at the

average exchange rate that year). Ten years later, assets had grown to 109.1 billion PhP (2.8 billion USD) (Lopez and Espinosa-Robles 1999).

It does not come as a surprise, therefore, that the three largest companies among the case studies have strategic investments in banks. SS Shipping, GG Shipping and KK Stores have equities in Chinese-controlled banks and representatives of these three families sit on the boards of directors.

The interlocking interest of banks and corporate enterprises have been systemic problems which have required Central Bank and government intervention to bail out ailing financial institutions, often at substantial macroeconomic costs (Vos and Yap 1996). One characteristic of the Philippine banking system is rampant favouritism. The favour or disfavour of those oligarchs currently holding state office is a major determinant of the relative success or failure of particular banks. Favoured treatment, it should be noted, is not imperative to the success of a commercial bank, but in instances where banks have enjoyed mercurial growth, one is nearly sure to find special favours, granted through special relations with prominent officials (Hutchcroft 1993).

The case of Allied Bank is particularly illustrative of the success that comes from favourable access to the political machinery. The bank's founder, Lucio Tan, a Chinese-Filipino, was a well-known associate of Marcos. Hutchcroft (1993) asserts that by 1980, thanks to extensive support from Marcos in gaining tax, customs, financing, and regulatory favours, Tan's Fortune Tobacco Co. had become the country's largest maker of cigarettes. His bank, Allied Bank, was among the most favoured commercial banks in the allocation of rediscounting and foreign exchange swap privileges. Moreover, it had privileged access to government-guaranteed foreign loans. Allied Bank, of course, is only one of many examples of banks that

ended up in crony hands and only one of many examples of how private banks received special favours from the Central Bank and the presidential palace.

Determining what constitutes a 'Chinese' bank can be problematic, for no bank can claim to have only Chinese customers, nor are there any banks that are wholly managed by Chinese. The conventional definition is that these are banks where the majority of the equity is held by ethnic Chinese (Go 1995, 86). As of 1996, ten of the thirty four commercial banks were classified as 'Chinese' banks (Table 4.8).

Table 4.8 Value and ranking of Chinese-owned banks among all private domestic banks, 1996 (in million PhP)

Bank	Total assets	Rank	Total loans	Rank	Total deposits	Rank
Metropolitan Bank	170	2	109	1	104	2
Rizal Commercial Bank	72	7	49	8	48	7
Allied Bank	58	10	37	10	35	9
Equitable Bank	47	11	28	11	31	10
China Bank	37	12	26	12	24	12
Philippine Bank of Communications	19	20	13	17	12	19
Westmont Bank	14	23	10	21	12	18
Banco de Oro	13	25	9	22	10	23
Philippine Banking Corporation	12	27	9	24	8	22
East West Bank	4	41	2	39	2	34
Total (as a percentage of total private domestic banks)	446 (41.8%)		292 (42.6%)		276 (39.8%)	
Total private domestic banks	1066		686		693	

Source: *Businessworld* (12 August 1996), 30.

The clientele of 'Chinese' banks is not limited to Chinese clients just as Filipino-owned banks do not deal only with Filipinos. The important considerations

are (a) where the management controls lie and (b) where the benefits go. Chinese-controlled banks accounted for 41.8 per cent of total assets of the private domestic banking sector as well as 42.6 per cent of loans and 39.8 per cent of deposits in this sector (Businessworld 1996). In turn, the private domestic sector accounted for 69.1 per cent of the assets of the total banking system (Table 4.9).

Four Chinese-owned banks figured in the top ten banks of first quarter 1999 (Table 4.10). These banks were Metrobank (majority owned by George Ty), Equitable Bank/PCIBank (George Go), Rizal Commercial Banking Corporation (Yuchengco), and Allied Banking (Lucio Tan).

4.7 Government-business relations

What is the nature of the involvement of government in markets and, conversely, the nature of the involvement of business in political life? In Southeast Asia, business-government interaction generally reflects the pervasive importance of patrimonial or clientilistic links between government figures and business people (MacIntyre 1994). The Philippines is said to have the most decentralised political system in the region, with the economic policy machinery routinely hijacked by powerful business interests (Hutchcroft 1994).

The Philippine state apparatus has been continually choked by an anarchy of particularistic demands from, and particularistic actions on behalf of, those oligarchs and cronies who are currently most favoured by its top officials. Some will have obtained highly coveted loans or import licenses while others will have enjoyed a stake in a cartelised industry protected by highly discretionary state regulations. The case of government involvement in the financial markets was illustrated in the previous section. It was because of the weak institutionalisation of the state

Table 4.9 Philippine banking system composition (assets, loans and deposits), 1996 (in million PhP)

	Total assets	Share of total (%)	Total loans	Share of total (%)	Total deposits	Share of total (%)
Total private domestic banks	1066	69.1	686	73.1	693	72.3
Total government banks	289	12.2	151	10.8	214	5.3
Total foreign banks	188	18.7	101	16.1	51	22.4
Total banking system	1543	100.0	938	100.0	958	100.0

Source: *Businessworld* (12 August 1996), 30.

Table 4.10 Top ten banks according to assets, first quarter 1999 (in billion USD)

Bank	Total assets
Metrobank	6.6
Equitable Bank and PCIBank	6.2
Philippine National Bank	5.7
Bank of the Philippine Islands	4.7
Land Bank of the Philippines	4.7
Citibank	3.8
Far East Bank and Trust Company	3.4
United Coconut Planters Bank	2.7
Rizal Commercial Banking Corporation	2.6
Allied Banking Corporation	2.2

Source: Antonio Lopez and Raissa Espinosa-Robles, 'The bank that could', *Asiaweek* (May 28, 1999), 90.

apparatus that personal favour and disfavour of those currently in power was a critical determinant of business success and failure for some (Hutchcroft 1994). The cronies during the Marcos administration came from the newer, non-landed capitalists whose initial entry into manufacturing was facilitated either by access to loans from government institutions or to special licenses and import privileges from political connections (Vos and Yap 1996).

Hutchcroft (1994) uses the terms 'booty capitalism' to refer to the case of the Philippines where rents were generally grabbed by groups with an economic base outside the state. This is differentiated from bureaucratic capitalism, where rents are most commonly grabbed by a bureaucratic elite based inside the state.

With their history as trading immigrants to the country, the Chinese-Filipino capitalists were rarely oligarchic in their social origins, but some Chinese had developed sufficient personal or business ties with the Marcos family and its associates to qualify as cronies. Among the Chinese-Filipino capitalists in manufacturing, two Marcos cronies stand out: Jose Yao Campos, who monopolised the distribution of pharmaceuticals in government hospitals, and Lucio Tan, who built his powerful diversified conglomerate around the cigarette industry. A powerful bloc of support for Lucio Tan lies in a grouping of about 27 legislators in the lower house of Congress who represent the tobacco-producing provinces of the Ilocos region. Since the 1960s, Tan's tobacco and cigarette business has served as the major buyer of the tobacco products of the Ilocos region (Rivera 1997). Some of the Chinese-Filipino capitalists, through their equity linkages with government financing institutions, controlled firms that monopolised particular sectors. An example was the Lim group of Filsyn that monopolised the processing of polyester (Rivera 1994, 121).

Chinese businessmen have often used former leading public officials in various roles in their companies (Rivera 1997). George Ty of Metrobank had as co-founders of the bank Pio Pedrosa, former finance secretary, Placido Mapa Sr., former secretary of agriculture, and Emilio Abello, an influential former ambassador. Alfonso Yuchengco's Rizal Commercial Banking Corporation had as original partners the Antonio Floirendo family whose patriarch was a logging

magnate and one-time senator of the Philippine republic. Finally, Lucio Tan hired as his top managers former well-placed military generals.

4.8 Chinese economic profile

Using data from 1980, Hicks and Redding (1982) conducted a study of the top 259 corporations (Table 4.11). While Yoshihara (1985) limited his sample by considering only the companies that were engaged in manufacturing, Hicks and Redding included the largest 259 in terms of revenue, regardless of company activity. The two samples are, thus, not directly comparable. However, it is still possible to highlight some common patterns. There appears to be no noticeable difference in the proportion of ownership. In Yoshihara's study, ethnic Chinese owned 32 per cent of the manufacturing companies, while the Hicks and Redding study showed 33.2 per cent of Chinese ownership of the top 259 companies. The two most significant sectors in the Hicks and Redding study were the manufacturing sector, to which 140 out of the 259 largest companies belonged, and the commercial

Table 4.11 Ownership of the top 259 companies in the Philippines by ethnic background, 1980

Industry	Spanish	Filipino	Chinese	American	Other	Total
Manufacturing	14	53	47	18	8	140
Commercial	2	34	32	3	3	74
Mining	-	6	2	2	3	13
Services	1	9	1	1	2	14
Utilities	1	7	3	2	-	13
Agriculture	-	3	1	1	-	5
Total	18	112	86	27	16	259
Percentage	7.0%	43.2%	33.2%	10.4%	6.2%	100.0%

Source: George Hicks and Gordon Redding, "Culture and corporate performance in the Philippines: The Chinese puzzle," in *Essays in development economics in honor of Harry T. Oshima*, ed. Philippine Institute of Development Studies (Manila: Philippine Institute of Development Studies, 1982).

sector, which accounted for 74 corporations. In terms of manufacturing, Chinese-owned companies predominated in tobacco, textiles and garments, vegetable and animal oils, food and beverage, paper products and basic metals. In the commercial sector, Chinese owned the majority of companies in machinery supply, general retail and chemical-based products.

The third major study to investigate the share of Chinese in top corporations utilised 1990 data and included the top 1000 corporations (Palanca 1995). Table 4.12 shows that the Chinese share in the top 1000 corporations in the Philippines was 35.9 per cent in 1990. There has been an expansion into the finance and services industries, such as real estate, banking and insurance by Chinese as well as other ethnic groups. In manufacturing, Chinese were dominant, in terms of the number of firms, in industries such as textiles and leather, wood products, paper and publishing, paints, rubber and steel products (Table 4.13).

Table 4.12 Comparison of the three ownership studies

	Yoshihara	Hicks and Redding	Palanca
	Top 250 manufacturing companies, 1968	Top 259 corporations, 1980	Top 1000 corporations, 1990
Filipino-Chinese	32.0	33.2	35.9
Filipino	33.2	43.2	34.8
Foreign	34.8	23.6	29.3

The Chinese business hierarchy

The ethnic Chinese operate business of all sizes, from small to medium and large-scale enterprises. If one were to imagine a hierarchy of business people, then

Table 4.13 Ownership of private firms in the Top 1000 corporations of the Philippines, by ethnic background, 1990

Industry	Number of firms			Percentage of firms		
	Chinese-Filipino	Filipino	Foreign	Chinese-Filipino	Filipino	Foreign
Agriculture, fishery and forestry	6	7	4	0.6%	0.7%	0.4%
Mining and quarrying	2	12	5	0.2%	1.2%	0.5%
Manufacturing	170	124	169	17.0%	12.4%	16.9%
Utilities	0	2	1	0.0%	0.2%	0.1%
Wholesale and retail	124	77	41	12.4%	7.7%	4.1%
Construction	4	14	8	0.4%	1.4%	0.8%
Transportation, storage and communication	3	22	11	0.3%	2.2%	1.1%
Finance, insurance and real estate	37	67	40	3.7%	6.7%	4.0%
Community, social and related services	8	19	8	0.8%	1.9%	0.8%
Others	5	4	6	0.5%	0.4%	0.4%
TOTAL	359	348	293	35.9%	34.8%	29.3%

Source: Ellen Palanca, 'An analysis of the 1990 top corporations in the Philippines: Economic position and activities of the ethnic Chinese, Filipino and foreign groups', in *China, Taiwan and the Ethnic Chinese in the Philippines*, ed. Ellen Palanca (Quezon City: Philippine Association for Chinese Studies, 1995), 67.

at the top level would be the so-called 'six taipans'. They are considered the most prominent businessmen of the 90s era. Having a net worth of at least 1 billion USD each before the Asian financial crisis in 1997, they were brought together to accompany former President Ramos on his official visit to China in the early 1990s. They represent the upper echelon of the Chinese business hierarchy and most did not come to prominence until the 1970s. They include John Gokongwei Jr, Henry Sy, Alfonso Yuchengco, Andrew Gotianun, George Ty and Lucio Tan. While Yuchengco was born in the Philippines and Ty in Hong Kong, the rest were born in Fujian, China.

John Gokongwei Jr began his business career in Cebu. In 1954, he established a corn starch factory in Metro Manila. He listed the foods and oils division Universal Robina Corporation on the Philippine Stock Exchange in 1994 and J.G. Summit in 1993. J.G. Summit functions as the holding company for a group of companies engaged in branded consumer goods, textiles and garments, real estate development, hotel management, banks, power generation, cement, petrochemicals, telecommunications and printed circuit board manufacturing. He has engaged in joint ventures with numerous foreign companies, among those are with Marubeni in petrochemicals and Nissin Foods in noodles and biscuits (Young 1994).

Shopping mall magnate Henry Sy opened a small shoe store in the late 1940s and his first Shoemart department store in 1958. His holding company, SM Prime Holdings, was listed in 1994 and develops commercial shopping centres. The initial public offering of SM Prime Holdings allocated 10.95 per cent to foreign investors and 6.55 per cent to domestic investors. He has also diversified into banking, real estate, cement manufacturing, shipbuilding and repairs, and entertainment (Young 1994).

Alfonso Yuchengco's business group is the oldest among the taipans and stems from the inheritance of his father's pre-World War II lumber and insurance businesses. His listed holding company, House of Investments, is organized into five main groups: manufacturing, construction, agribusiness, finance and insurance, and services and trading (Young 1994). He has several joint ventures with foreign companies, including a cement plant with Nissho Iwai and polyethylene manufacture with Nissho Iwai and Maruzen.

Andrew Gotianun began a consumer finance company in 1955 and then expanded into banking. Filinvest Land was listed on the stock exchange in 1993 to engage in the development of residential property. Filinvest Development is the family's holding company with interests in banking and financial services, infrastructure investments and manufacturing (Young 1994). Gotianun also has a 20 per cent share in a 1.5 billion USD consortium that developed the Fort Bonifacio area in Manila.

Born into a poor immigrant family from Fujian, Lucio Tan was at various times a janitor, chemist and trader. He now has a controlling interest in approximately 48 companies, ranging from farming, brewing, tobacco and banking interests to real estate, textile and packaging. His companies control 60 per cent of the local cigarette market, a major share of the live hog market, and are dominant in chemicals, beverages, banking and hotels. Tan has also acquired substantial international holdings, including banks in the U.S. and Canada, a shopping centre in Guam, tobacco and steel companies in Papua New Guinea and one of Canada's largest carpet manufacturers (Young 1994).

4.9 A question of identity

The Chinese community in the Philippines is smaller than elsewhere in Southeast Asia, both in absolute terms and in relation to the indigenous population (Wong 1994). Estimates have ranged from 600,000 to 1,000,000 (Wickberg 1992, 45). Suryadinata (1996) estimates the Chinese population in the Philippines to be 850,000, or 1.3 per cent of the total population, as of 1990. Furthermore, the provincial origin of migrants to the Philippines is more homogeneous. Approximately 85 per cent of the ethnic Chinese community in the Philippines today can trace their origins to southern Fujian. Ninety per cent of these Fukienese

originated from Jinjiang, Nan-an, and Hui-an *hsiens* (townships) of Quanzhou prefecture (See 1981). In Dumaguete, for instance, the Fukienese community stems principally from a dozen villages in Heshan. In Dagupan, most Chinese come from Jinjiang county and in Davao, Fukienese Chinese originate from Nan-an county and Cantonese Chinese from Taishan (Doeppers 1972).

The homogeneous origin of the Chinese migrants to the Philippines means that there are few regional or language differences except for the Cantonese minority. Instead, clan associations emerge as one of the most prominent kinds of organization while *tongxianghui* (hometown associations) are formed on the basis of southern Fujian villages. Recent years have seen the development of alumni and class associations. Classmate ties are intimate personal relationships with quasi-kinship features in the Chinese social world (See 1988).

In a study of the Chinese during the American period, Wong (1994) identified a minority who had acquired Philippine citizenship while the majority were still Chinese citizens. This situation was subsequently reversed after Marcos allowed the Chinese to apply for Philippine citizenship in 1975. Notwithstanding the difference in citizenship status, both groups share common denominators that characterise them as ethnic Chinese. Among these denominators are Chinese descent, varying degrees of Chineseness, and a self-identification of themselves as Chinese and being regarded as such by others. There are three features of Chineseness. First, Wong observes that though some have Christian names, all have Chinese names. Second, ethnic Chinese know a Chinese language. Since the vast majority originates from Fujian province, the *lingua franca* within the community is the Hokkien dialect. Third, the proliferation of Chinese schools and newspapers helps spread Chinese culture across the community (Wong 1994). Charles

McCarthy (1974) defines an ethnic Chinese as someone with a measure of Chinese immigrant parentage who is sufficiently influenced by Chinese culture, can use a Chinese language, and observes Chinese customs enough to rightly call himself, and to be regarded by his neighbours, as Chinese.

Is it still relevant to speak of the Chinese in the Philippines as a distinct ethnic group? In this context, it is useful to distinguish an 'ethnic group' from a 'culture' (Omohundro 1977, 148). An ethnic group has a boundary, which is consciously maintained by cognitive criteria, while a culture is a complex of traits and institutions which characterise it at one point in time. The continuity of an ethnic group is, therefore, easier to define than that of a culture, which lacks a boundary. For example, cultural change has certainly been occurring among the Chinese in Iloilo City. Language, manner of dress, religion and even the role of women have undergone modification. Nevertheless, an ethnic group persists and the cognitive criteria for membership remain. Chinese birth, facility in Hokkien, conscious affiliation with Chinese organizations, and a commercial occupation all assure one of a place in the community (Omohundro 1977, 152; Yoshihara 1985).

The evolution of the Chinese from itinerant traders and seafarers to sojourners and later residents of the Philippines was a long process (See 1997). The ethnic Chinese today are mostly university graduates and most have had more wide-ranging contact with Filipinos than the older group. While identifying themselves as Filipino-Chinese and using Hokkien in the home, many feel affection for the city or town they live in and their Filipino neighbour (Doeppers 1972). It is argued that the Chinese who are born in the Philippines are not 'Chinese who live in the Philippines' but rather 'Filipinos of Chinese descent' (See 1997). The majority of the local-born are young Chinese with no first-hand experience of China. Most of

them are articulate both in Filipino and English and are graduates of local universities. They are a 'deculturated' Chinese group, Westernised in ideology but not really assimilated to the Filipino culture. Not very many work in the government bureaucracy, while the well-educated may work in the corporate world. The majority either work in the family businesses or venture into new trades (See 1988).

4.10 Conclusion

The preceding analysis of the historical development of Chinese business activities in the Philippines covered their early migration pattern, economic roles, and the various government policies that have influenced business. Two general trends can be observed. One is the changing economic roles of the Chinese in the Philippines while the other is a seemingly unchanging approach to economic organization.

Wong (1994) asserts that the Chinese were both a product of and a contributor to the growth process of the Philippines during the early 20th century. As McVey (1992) remarks, a population group that is assigned a business role in society will come to emphasise business values.

Several transformations in Chinese economic roles were observed: first they were long distance merchants dealing with luxury items, then many became artisans and local middlemen supplying urban centres with services and subsistence items. Later, they acted as intermediate traders with the dual function of conveying native produce to export houses while distributing imported manufactures locally (Yambert 1981). The 1896 tax survey serves as an invaluable snapshot of the occupational composition of the Chinese in Cebu. A movement into secondary industry and the professions occurred in the 1980s and 1990s.

The transition from being *coolies*, peddlers, small shopkeepers and *compradors* during the Spanish occupation to *taipans* in the 90s and 2000s is dramatic, but one should not forget that this period spans several centuries. Expanding markets, foreign capital inflows, new technologies and the growth of urban middle classes created the environment in which business could take off (Mackie 1992). Differences in operations can be attributed to historical, social and political factors rather than just ethnicity. The modern Chinese business enterprise is characterised by family-based ownership, large scale operations and management based on a mixture of kinship and professionalism. The large-scale firms usually started with family ownership, but grew in size and gradually transformed into a Western-type of public liability company under the control of one or several related families (Hwang 1992).

While the change in economic roles is dramatic, what appears to have changed very little is the Chinese approach to economic organization, in which elements of adaptability and flexibility feature prominently. For instance, the source of financing may change, but the nature of financing has not. The earlier dependence on European and American importers as well as Spanish banks has been replaced by reliance on Chinese and American banks. Japanese partners are also becoming increasingly important. While *taipans* have substantial holdings and wealth, none are important global players. However, many have made large foreign investments in China, Guam, the United States and Hong Kong.

This chapter not only provided a historical snapshot, but also traced the changing nature of Chinese business and the interaction of government policies and business activities. An underlying theme is the uncertain environment in which Chinese business operates. This uncertainty stems from different government

administrations' approaches towards the Chinese and the resulting fluctuation in public policy, including economic policies and regulation of direct foreign investment and industries such as banking and retailing.

Finally, the question of the identity of ethnic Chinese in the Philippines was addressed. There is no simple definition of 'Chinese-Filipino' and no single identity within the Chinese community. While it is possible to identify the Chinese as an ethnic group in the Philippines, See (1997) points out that there is a contrast in how the different generations of Chinese perceive themselves. While first-generation Chinese may perceive themselves as Chinese who live in the Philippines, See (1997) contends that most of the next generation have become Filipinos of Chinese descent.

Having set out the context in which Chinese business operates, the next three chapters examine in detail the case study firms' networking behaviour. What are the antecedents to interorganizational relationships (IORs) (Chapter 5)? What is the nature of IORs that are formed and what is the role of trust (Chapter 6)? What are the short-term and long-term outcomes of IORs (Chapter 7)?

Chapter 5

Antecedents of Exchange Relations

Every organization exists in a specific physical, technological, cultural, and social environment to which it must adapt. No organization is self-sufficient; all depend for survival on the types of relations they establish with the larger systems of which they are a part.

(Scott 1992, 20)

The previous chapter discussed the macro environment of Chinese business in the Philippines and covered the economic and political context. This chapter continues to the intermediate environment, which links the organization and its macro environment. Also termed 'organizational domain', it includes the claims that an organization makes with respect to products or services provided and populations served. These claims immediately relate it to a number of other organizations - suppliers, customers, competitors - that affect an organization's behaviour and outcomes (Scott 1992, 126). Each unit in the intermediate environment facilitates the acquisition of resources from the environment or the distribution of products and services to the environment (Hodge and Anthony 1988, 69). The next section introduces each of the case study firms. The discussion then proceeds to consider the IOR process as derived from analysis of the fieldwork data.

5.1 Introduction to the case studies

There are eight main case studies, including a pilot study of SS Sawmill. A ninth case is that of China Construction, a mainland China-based company chosen to gain the perspective of a partner firm. As previously noted, company names are

disguised to preserve their anonymity, which was a condition for the granting of access and interviews. The cases are roughly divided between the manufacturing and service sectors and also roughly divided between Manila and Cebu-based firms (Table 5.1).

Table 5.1. Case studies according to industry and location of headquarters

	Manufacturing	Services
Manila	<ul style="list-style-type: none"> • AA Plastics • MM Textiles • SS Sawmill (Pilot) 	<ul style="list-style-type: none"> • FF Food • China Construction (foreign partner)
Cebu	<ul style="list-style-type: none"> • JJ Chemical 	<ul style="list-style-type: none"> • KK Stores • SS Shipping • GG Shipping

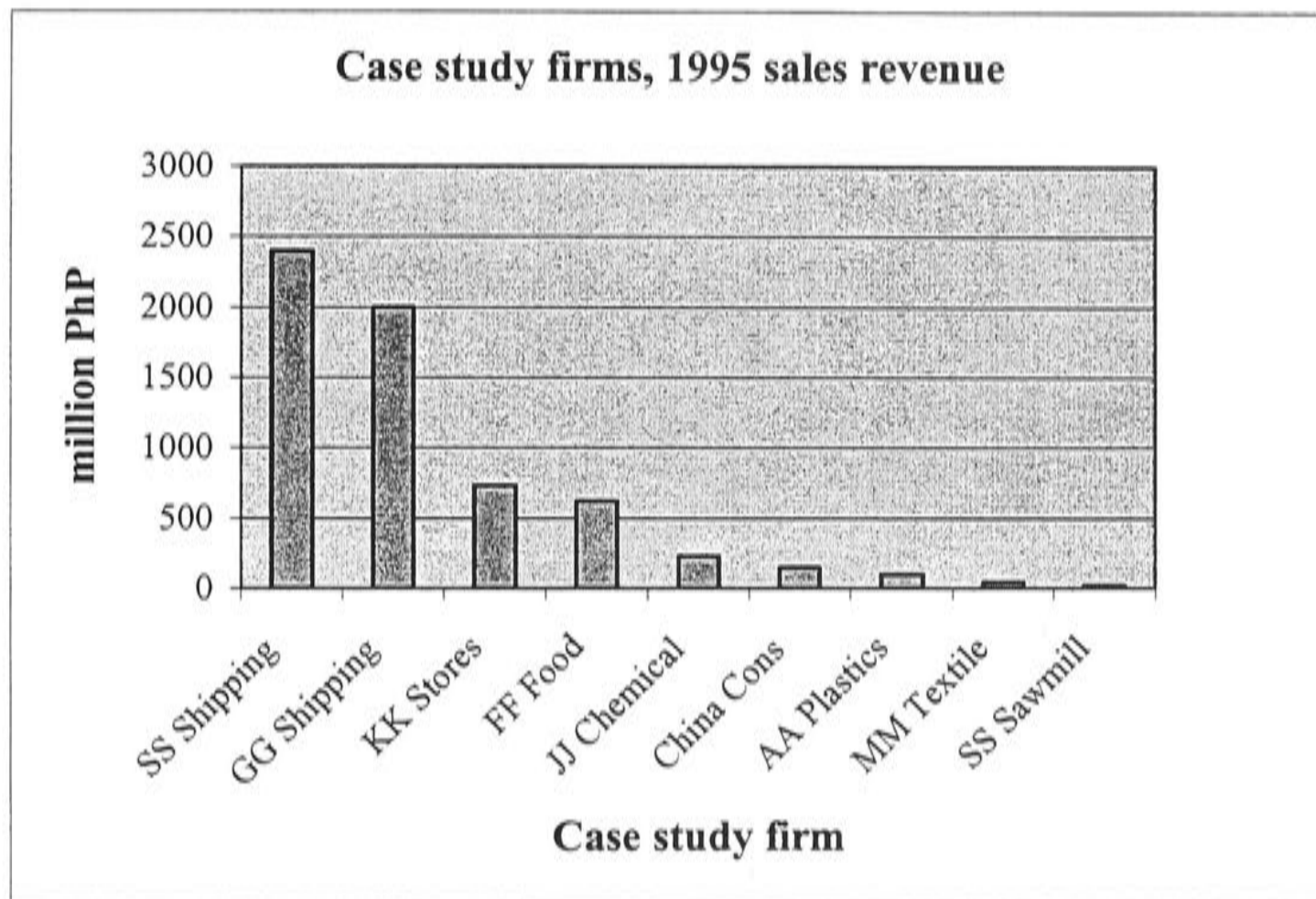
Firms are ranked according to the size of their revenues in Table 5.2. The last column indicates their asset size. A graphical representation of this ranking is presented in Figure 5.1. A brief description of each case study firm is then given.

Table 5.2. Revenue, assets, ranking and year established of the case study firms

	Year established	Rank in top 1000	Sales revenue, 1995 (in million PhP)	Assets, 1995 (in million PhP)
SS Shipping	1949	Top 150	2400	4300
GG Shipping	1970	Top 200	2000	2200
KK Stores	1936	Top 500	730	370
FF Food	1986	Top 600	620	330
JJ Chemical	1960	Top 1200	230	110
AA Plastics	1968	Top 2000	100	80
MM Textiles	1956	Top 4500	40	70
SS Sawmill (pilot study)	1966	n/a	20	40

Source: Securities and Exchange Commission, *Philippines 5000* (Manila: Securities and Exchange Commission, 1998).

Figure 5.1 Case study firms ranked according to sales revenue



AA Plastics

Founded in the late 1960s by three Chinese partners, AA is engaged in the manufacture of acrylic plastic. One of its original partners was a Taiwanese Chinese who provided the equipment and technology while the other two were Filipino-Chinese businessmen who contributed capital to the venture. AA has benefited from being a first-mover in the industry. As the only manufacturer of acrylic plastic in the Philippines and one of the few in Southeast Asia, it enjoyed consistent sales growth well into the 1980s. Not only did it dominate the domestic market, but its exports encompassed Southeast Asia and extended to the Middle East. Another crucial advantage stemming from its dominance of the domestic market was its power to set domestic prices.

The company's product, acrylic plastic, is used mainly for advertising displays, such as illuminated shopfront, signage and advertising boards. Point of

purchase displays can also be made from this material and the plastic is also able to substitute for glass in certain applications, such as in tabletops. It is much lighter than glass and does not shatter upon impact.

By the early 1970s, the three original partners had gone their own way. One returned to Taiwan and another started his own business in a completely different industry. The remaining partner brought in his eldest daughter Wilma to help him run the company. Soon after taking over from her father as General Manager in 1994, she was faced with a difficult challenge when the Ramos government began to liberalise imports of plastic products. While remaining confident that local competitors would not be able to match AA's quality, the company faced a more serious threat from competing plastic imports from Taiwan and Malaysia.

In the earlier years, when AA was the sole manufacturer in the country, the challenge was to master the production technology and consistently produce quality goods. With current competition seemingly focused on price, the impetus has become the improvement of product distribution and international competitiveness.

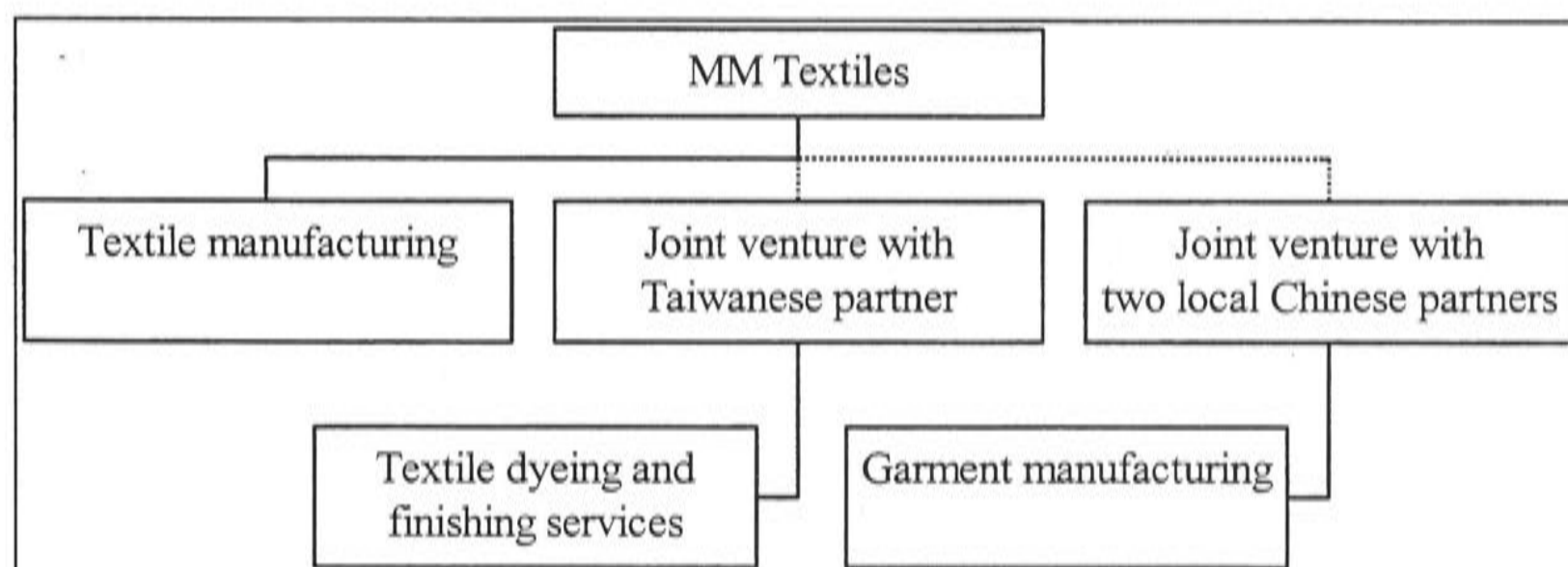
MM Textiles

MM Textiles was incorporated in the late 1950s and since then has achieved consistent sales growth by diversifying into upstream and downstream businesses. It was founded by Yu Eng Lit, a Chinese migrant from Fujian province who worked as a storekeeper for a textile merchant when he first arrived in the Philippines. After he had accumulated enough savings to start his own business, he became a retailer selling textiles imported by Chinese wholesalers.

When his two sons eventually joined the business, Yu Eng Lit sold his shop and went into the manufacture of textiles. His sons' engineering degrees enabled the

company to improve its production efficiency and keep up-to-date with the latest production technologies. The rapid growth of the company was attributed to the addition of two new businesses: textile dyeing and finishing in 1992 and garment manufacturing in 1993. Realizing that integrating the finishing process for textiles meant higher value-added for their products, the Yu brothers engaged the services of a Taiwanese consultant to set up the textile dyeing operation. Its entry into garments manufacturing enabled it to serve a new set of customers, mainly retailers such as boutiques and department stores as well as being a subcontractor to garments exporters. MM has three main business lines and employs 400 people (Figure 5.2).

Figure 5.2. MM Textiles' business activities



SS Shipping

With a fleet of 17 ships consisting of ten passenger/cargo and seven cargo vessels, SS Shipping ranked among the country's top five shipping companies throughout the 1990s in terms of assets and revenues. With its head office in Cebu City, the company's principal business is to provide inter-island passenger and cargo liner services in the Philippines.

SS Shipping was incorporated in 1949 to transport passengers and products to and from Cebu. During the 1950s and 1960s, the founder and his son expanded and modernised the company's fleet. By the late 1970s, the company decided to change the emphasis of its operations from conventional break-bulk operations to containerised cargo operations in response to the perceived growth in inter-island trade and travel activity. In the early 1990s, the company raised funds through an initial public offering on the Philippine Stock Exchange.

KK Stores

KK Stores credits its beginnings to the family matriarch, Constancia Tan. Widowed at an early age, she began to engage in the general merchandise business in the early 1930s. Her second son Mark recalled, 'When we started, everyone in the family helped out. We did not use any outsiders, doing the manual labour ourselves. At that time prices were very cheap, sales reached ten pesos every day. Life was very hard but everyone was united.'

When World War II came, the store closed. After the War, the five Tan brothers (Solomon, Mark, James, John and Robert) sold flour and bread. It was not until 1947 that KK Stores was revived. They kept prices low and the store well-stocked. Third son James narrated, 'After the war, our eldest brother shipped two fluorescent light bulbs from Manila. They were installed in front of the shop so that passers-by would notice. Every evening, the other shopkeepers used pale light bulbs. Our store was bright as day; this became our unique feature. Passers-by could not help but stop, go inside the shop to have a look, and always ending up buying something.'

In the 1960s, KK expanded by opening other branches. The family also invested in real estate, banks and restaurants. The business was divided in the late

1970s. Each of the five brothers decided to control their own business group. Each group has its own set of department stores, supermarkets, movie theatres, and food shops. They operate independently, but taken together the whole group comprised 24 department stores and had annual retail sales of approximately 300 million USD in 1990. In the early 1990s, it was estimated that the group's department stores and supermarkets had a total combined floor area as big as the entire Cebu downtown area.

GG Shipping

The founder of GG Shipping arrived in the Philippines as a young man in the early 1900s and began his business career as a general merchant in the southern Philippines. As a merchant, he would load his goods on 50-ton sailboats and travel from island to island buying and selling agricultural products.

He later chose Cebu City as his permanent residence and established a trading firm with his brother. He organized GG Shipping on his own in the late 1970s and managed the company with the help of his sons. One of the largest shipping companies in the Philippines today, the company generated revenues of 2.4 billion PhP in 1995. As one of his sons, now CEO of the company, remarked, 'We have the support of the Chinese business community.'

FF Food

'Where East Meets West' is the concept behind the founding of FF Food. Its image is the fusion of two restaurant concepts: the Chinese noodle restaurant and the Western fast food outlet. Commencing operations in the mid-1980s with one outlet located in the commercial centre of Makati, FF has grown to about 140 outlets in 1997 and 200 at the end of 2000.

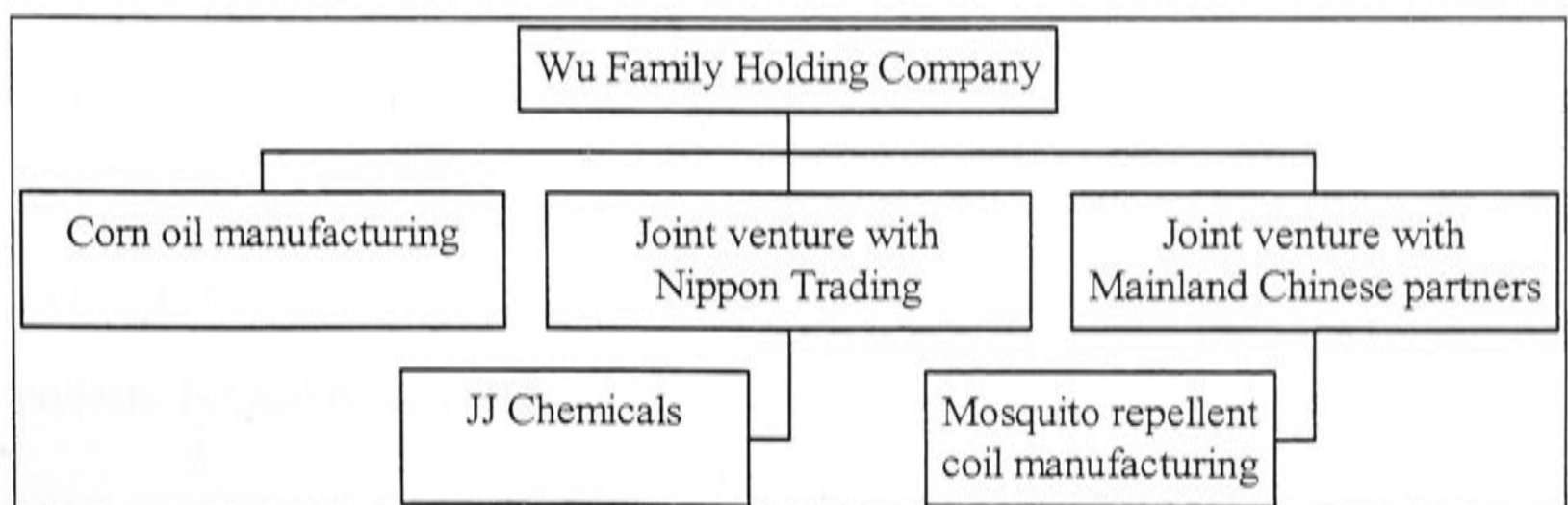
The company's franchising program started in 1989 and marked the beginning of its expansion into provincial markets. For FF, franchising is the preferred route as it enables the company to grow without unduly straining funds. By 1997, FF Food outlets were found in all parts of the archipelago, from Baguio and Dagupan in the north to Cebu City and Iloilo in Central Visayas, and Davao and General Santos City in Mindanao.

JJ Chemical

Mr. Honorio Wu, the founder of JJ Chemical, started his business career on a small scale in the late 1940s, raising pigs and poultry on small plots of land. His father had come to Cebu from Fujian, China and went into the sari-sari store business. When his father passed away, Honorio went into different ventures. He established a corn mill because he realised that the staple food in Cebu and the surrounding region was corn and not rice. Later on, he expanded into corn oil manufacturing.

The current manager of JJ Chemical, Honorio's younger brother Eusebio, attributed the family's success to their ability and character. He emphasised that 'We always saved everything we earned and expanded the business. Hard work and thriftiness are two important elements in anybody's business success.'

Figure 5.3. JJ Chemical's business activities



SS Sawmill (pilot study)

The company was established in 1966 with four partners, one managing and the others silent. By 1988, the partners were in conflict; the managing partner was retained and the others had to bid for shares in the company. Only two of the original partners remained: the managing partner ended up holding 75 per cent and another family 25 per cent.

The managing partner's family has always been in the lumber industry. His father, uncles and cousins are all involved in the industry, due to the fact that when his father arrived in Philippines, he settled in a logging area in Agusan. The manager also owned a plywood shop in Manila, which his wife and two sons managed.

China Construction Company

China Construction Company (CCC) is a Chinese state-owned enterprise headquartered in Beijing, China. It had a total of 200,000 employees globally in 1997 and had been operating in the Philippines since 1990. The country general manager, Mr. Jiang, had previously been assigned to Brazil, Bangladesh, Pakistan, Singapore, Hong Kong and the Philippines.

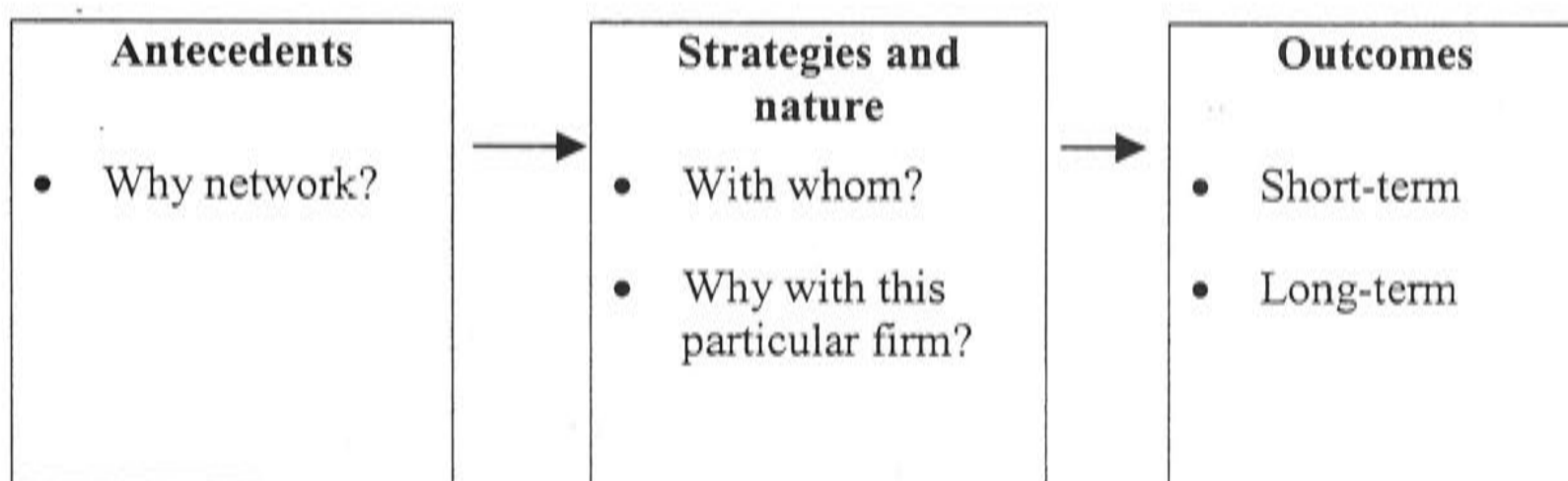
CCC was involved in four major highway projects in the Philippines and planned to expand into real estate development and reclamation projects. Its projects were both foreign and locally funded. Wholly foreign funded projects did not need a local partner, but, by law, the locally funded projects had to have a minimum of 60 per cent local equity. Partners were taken on a per-project basis, with a defined contract for each. Initially, it had Filipino-Chinese partners for projects, but had recently taken Filipino partners as well.

5.2 The IOR process

This section discusses the process of interorganizational relationships (IORs) as derived from the qualitative analysis of the case studies. The diagram depicting the process of networking as derived from the analysis in Chapter 3 is reproduced here (Table 5.3).

This chapter considers the antecedents to forming an IOR. An organization faces a series of dynamic opportunities and constraints from its environment. What external resources does the firm need? How does it go about acquiring the needed resources?

Table 5.3. A diagram depicting the process of networking

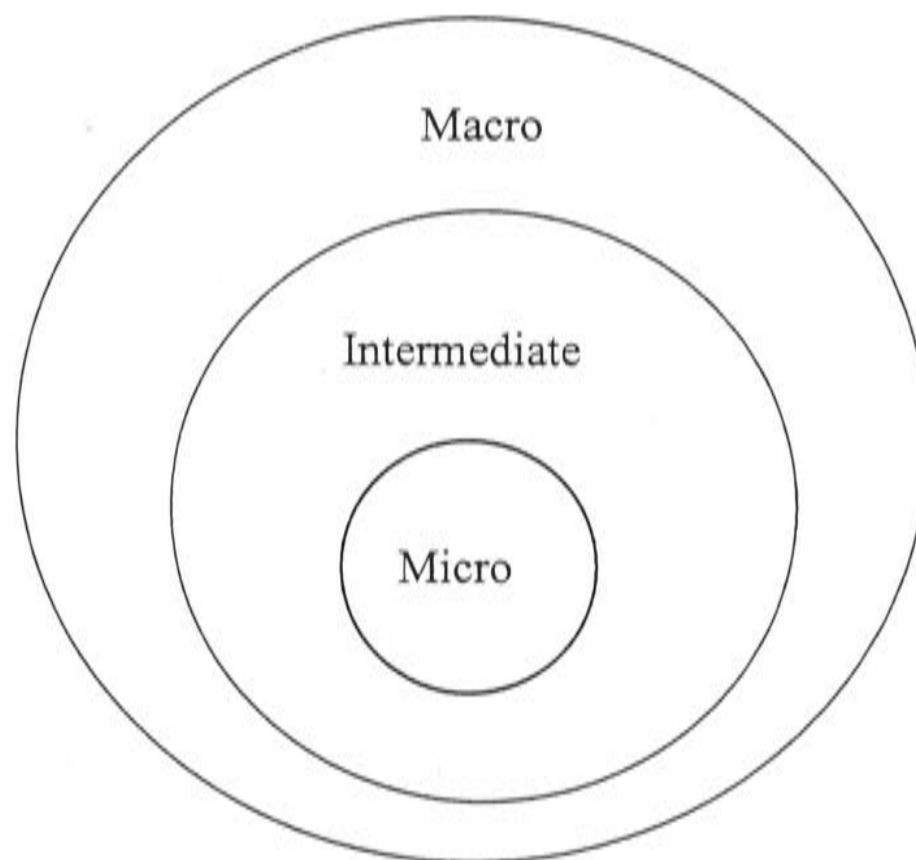


The external resource needs of a firm, and the way that it meets these needs, are influenced by a number of factors. These factors include the firm's existing competencies and resources, the transaction costs and risks associated with different alternatives and the firm's attitude towards external relations. Section 5.3 discusses these considerations using Porter's (1980) five forces framework.

The organization in its environment

An organization's interaction with its environment may be conceptualised using micro/intermediate/macro environmental distinctions (Hodge and Anthony 1988). The micro environment represents the organization itself, including its mission, people, resources, procedures and product or service produced. The intermediate environment encompasses those systems that span the boundaries between the organization and its general, or macro, environment. Figure 5.4 depicts the interaction of these three environments while Table 5.4 gives examples of the factors operating in each of the three levels.

Figure 5.4. Micro-intermediate-macro environment



Source: B.J. Hodge and W. Anthony, *Organization Theory* (Boston: Allyn and Bacon, 1988).

Table 5.4. An organization's micro-intermediate-macro environment

Micro environment	Intermediate environment	Macro environment
<ul style="list-style-type: none"> • Goal and work system • Resources • Skills 	<ul style="list-style-type: none"> • Suppliers • Buyers (distributors, brokers, agents) • Service units (including financial services) 	<ul style="list-style-type: none"> • Economic <ul style="list-style-type: none"> • Performance • Policy • Financial market • Political <ul style="list-style-type: none"> • Policy making • Government-business relations

Source: B.J. Hodge and W. Anthony, *Organization Theory* (Boston: Allyn and Bacon, 1988).

Several elements within its intermediate and macro environment influence a company's business decisions. The macro environment includes the economic, political and social side of the theoretical framework presented in Chapter 2. In general, the interviewees discussed the macro environment within a longer-term context, specifically in terms of analysis and reflection on overall changes within their industry. The intermediate environment was discussed in terms of more immediate concerns, for instance the effect of foreign competitors entering the market. The intermediate environment is also the direct source for resources.

5.3 Assessing the environment and evaluating needs

A business might ask itself these hypothetical questions: What strategies have we decided to follow and what are the corresponding resource needs for such strategies? What resources do we have and what external resources do we need to implement such strategies?

The first question in the analysis of the internal environment is: What resources does the business have? Nevertheless, steps subsequent to the assessing of internal resources, evaluating strategy and analysing external resource needs are, in reality as seen from the case studies, accomplished simultaneously.

An organization's intermediate environment consists of its suppliers, buyers, and service units (including financial services). The patterns arising out of the case studies portray these groups of organizations in terms of power differences, a categorisation similar to that of Porter's five competitive forces (Porter 1980). The forces that affect resource requirements are: (a) the threat of new entrants, (b) the bargaining power of suppliers, (c) the bargaining power of buyers and (d) the rivalry among the existing competitors. The fifth, the threat of substitute products or services, did not come up in the interviews.

The discussion of the findings is, therefore, organized in five categories:

- starting out in business
- threat of new entrants
- bargaining power of suppliers
- bargaining power of buyers
- rivalry among existing competitors.

Resources for starting a business

The two most important resources needed for starting a business are financial capital and technology. All the case study firms began as small businesses, whose initial capital came from the founders' own savings or the founding family's contributions. At this stage of their development, the capital needs were small. Most of these firms also started operations during the 1940s and 1950s. Many have moved

from their original activity and diversified into other areas. One of the founders of AA Plastics was operating a Chinese herbal medicine business. He then started a business in plastics manufacturing. Over a period of four decades, JJ Chemical assembled a set of business operations in unrelated areas: corn oil, activated carbon and mosquito repellent manufacturing.

Others started as traders and grew by moving into manufacturing. MM Textiles' founder started as a textile merchant, KK Stores' family began as small retailers and SS Sawmill's managing partner was a merchant who bought and sold lumber. These initial ventures did not require large amounts of capital but when the businesses moved away from trading as their principal business activity and towards manufacturing and other services, sources of finance outside the family became more significant. This change in financing requirements will be examined in this chapter and the next.

For its initial venture into manufacturing (corn oil), JJ Chemical purchased machinery from Japan to extract oil from corn and modified this technology to suit local Cebu conditions. It was eventually able to manufacture a local version of this equipment and sell it to other processors in the area. With the activated charcoal business, however, it neither had the technology nor was it able to purchase it. Hence, it decided to enter into a joint venture (JV) with a large Japanese trading company, Nippon.

While it had domestic competitors in the manufacture of its product, JJ had technical support from its Japanese JV partner to enable it to produce to the highest quality. It considered itself the leader in the local market, but was facing tough competition in the international market due to lower cost competitors from Vietnam and China. The crucial resource needed at this stage of development was

international marketing skills, which JJ did not have. However, JJ Chemical identified one of its strengths as having an efficient infrastructure in place to collect agricultural commodities in the Visayas and Mindanao regions. Its network of collection branches, together with sub-purchasing networks in the smaller towns, were considered by CEO Eusebio Wu as one of the most extensive in the country and represented a key resource.

Technology was needed by MM Textiles and AA Plastics in the early stages of business development. MM Textiles' entry into manufacturing involved the owner's two sons researching the technology needed to manufacture cotton fabrics. They were able to purchase textile machinery from Japan, and the eldest son went to train there for six months. For its fabric dyeing and finishing venture, the company was unable to purchase the equipment itself and accepted a Taiwanese partner who provided the equipment and technological skills.

AA Plastics' founder had no previous experience in manufacturing as he had assisted his father in the Chinese herbal medicine business. He felt that there would be little room for growth in the traditional herbal business and decided to enter the plastics manufacturing business with two partners. While he had sufficient capital to contribute to the venture, he knew nothing about the business and relied on the Taiwanese partner to provide the technological know-how.

Technology was needed because the case study firms were entering new areas. Most were moving from trading to manufacturing activities. IORs were used because they had no access to the technology. They were unable to purchase it, often because the other party was unwilling to simply sell it outright.

Start-up capital needs were not crucial in the case studies examined. This is because these firms started out in small-scale activities. The next four sections proceed to the next stages of business development, which include business growth and diversification.

The threat of new entrants

This section reveals the challenges that arise when new entrants come into the markets served by the case study firms. In the Philippine case, there were several causes for new entrants. Government deregulation policy was the most pressing issue for the case study firms, in particular as it related to investment by foreigners. In addition, favourable market conditions also attracted new entrants.

As part of the policy reforms discussed in the previous chapter, the Ramos government issued Executive Order 185 in 1996, which opened all shipping routes to additional operators to attract more investments into the industry. This encouraged the entry of new players into developmental routes, deregulated entry of new vessels into routes already served by franchised operators, and eased restrictions on vessel and voyage scheduling. Rates for passenger fares were also deregulated except for third-class passengers (Sun Star Daily 1996, SA1). These developments had a direct impact on the shipping companies SS and GG. Since they had previously operated in a highly regulated and protected environment, these liberalised policies pushed them to action. How did they respond to the threat of new entrants? SS Shipping decided to join forces with other firms while GG Shipping defended its market position alone.

With the threat from large and resource-rich competitors (including the Singapore Government), SS Shipping decided that it had to improve efficiency and service in order to survive. CEO John Ongseco said, 'We had to offer better

services yet keep control over our costs. If anyone requires sea transport, we want us to be the first name that comes into their minds.' Of the two shipping concerns, SS Shipping appears to be better-placed in terms of managerial skills to expand rapidly and react to changing market conditions. John Ongseco remarked,

We have a criterion that the company will be professionally run. What happened was that when we started we had five members of the family who had line functions, now there are only two. The rest are professionals. I got very good people, then I sent them to good schools for their Masters degrees and so on.

SS Shipping embarked on two different tactics to ensure its survival. First, it entered into a strategic alliance with two smaller competitors. John Ongseco explained that the objectives of being competitive and of realising economies of scale were foremost considerations for all three participants. It was simply unwise, he reiterated, to compete with each other along the same routes. Another objective was to be able to capture a bigger share of the cargo market. The three companies combined were already the biggest in the passenger market. The long-term strategy of the alliance was to become a global logistics company.

SS Shipping's second tactic was to list on the Philippine stock exchange. It took advantage of what was a buoyant capital market in the early 1990s to embark on an initial public offering, raising funds of approximately 2 billion PhP. The company had a projected revenue growth rate of 11 per cent.

Its competitor, GG Shipping, was managed by members of the Lim family, including CEO George Lim, his wife, two sons, his two brothers and their families. Speaking about the advantage of having family members to manage the company, George Lim said,

Look at this former shipping company, it was very big but the owner did not have his own people to manage it, so he hired people from outside. They robbed the company until it went bankrupt.

Like SS Shipping, GG recognised the need to improve efficiency, lower costs and upgrade equipment. GG accomplished this by relying on bank financing, partly through its equity investment in a Chinese-Filipino bank. When queried about the possibility of raising funds through a stock market listing, Mr. Lim did not show any interest in this approach. SS Shipping approached him when the former was considering the strategic alliance option, but Mr. Lim refused the offer. He reasoned that the cultures and approach to business of the two companies were different. If he joined the alliance, GG would lose its identity as a family-run organization.

The deregulation of the shipping industry thus brought different responses from these two shipping companies. Facing the same uncertain operating environment, they recognised similar resource needs, primarily those of finance and technology, but the two companies took completely different routes.

The retail trade sector is another area that the Philippine government deregulated. A Bill has been proposed to enhance competition in the domestic market, partly by allowing foreign equity into retail businesses. The proposed scheme allows for 100 per cent foreign ownership if the paid-in equity capital totals 100 million USD, and less than 100 per cent equity for capital less than 100 million USD. Two bills (HB No. 648 and 969) aim to decrease the required paid-in capital for foreign investments from USD 500,000 to USD 150,000. The amendment will also remove the prohibition of 100 per cent foreign ownership of industries engaged in import and wholesale activities (Businessworld 1995). In response to this, some

foreign retailers such as Wal-Mart from the U.S. have made preliminary investigations into the Philippine market. Others have entered into agreements with local partners in opening retail outlets such as shoes (Naturalizer and Rockport of the U.S.) and clothing (Esprit, Benetton and Liz Claiborne).

KK Stores was, for several decades, the dominant player in the Cebu department store industry. In 1995, the entrance of a Manila-based competitor (Shoemart) into the Cebu market caused KK Stores to rethink its business strategy. The new entrant constructed the first shopping mall in the city and initially forced KK to adopt a 'reactor' strategy (Miles and Snow 1978). In addition, the prospect of foreign entrants into KK's market looks certain.

Triggered by growth motives and the threat of new entrants, KK Stores decided to focus on its core competency. It also started to expand southward. CEO Wallace Tan envisaged the company as the pre-eminent merchandiser in the Visayas and Mindanao region. The company needed a reliable supply of goods but also highly skilled staff due to its rapid growth. KK Stores' core competency was in the merchandising business, as stressed by Wallace Tan. It was not interested either in subcontracting or the production of house brands. Several important aspects of research and development were therefore passed on to its suppliers. This was one key external resource which KK was dependent upon.

The perspective of a new entrant is provided by China Construction Company's entry into the Philippine construction market. The company had the technology, which attracted numerous prospective local partners. The company needed market information and local staff to succeed in the local market. Redding (2000, 49) observes that these alliances are occasioned by the 'fertile combination of needs that are complementary'.

Increasing power of suppliers

The increasing power of suppliers in the retailing industry had an immediate impact on the nature of business credit. KK Stores' CEO recalled

I remember before, in '86, we were able to get credit for most of the supermarket items; easily thirty days or ninety days. Right now almost fifty per cent of the items, especially Nestle, Philippine Refining Corporation, Colgate, those heavyweights, they can hardly give you credit anymore.

One reason for this shift was that demand for certain brand goods was increasing so that more and more retail outlets found it imperative to stock these items. There were even brief periods of shortages of products such as bathing soap and toothpaste. Suppliers responded not by increasing prices, but by shortening the credit period. This period declined by about half, from an average of thirty days to fifteen days. According to Wallace Tan, most supermarkets have had to pay in advance to obtain cash discounts. This discount became the profit margin. He said

We get a discount of four per cent [for cash advance], that's our margin. I believe if you pay COD [cash on delivery], it's two per cent; that's your margin. If you pay after fifteen days, which is the maximum credit period, you don't get anything, you have to sell at cost.

This shift in power has affected KK's financial needs and influenced the initial capital requirements for any other company wishing to start up in the industry. A more liberal credit environment decreased a firm's need for outside financing, for even if it sold at cost price, the generous credit period enabled one to earn at least some return on the sales proceeds that were parked in a temporary account. With tighter credit conditions, firms with inadequate working capital often found themselves having to borrow funds from banks to meet the payment terms of the now more powerful suppliers.

To start a business in the supermarket industry in the 1990s necessitated much more capital than several years previously. Mr. Tan estimated that it would take at least a hundred times more capital to go into the supermarket business now than when their business started (about fifty years ago). In the past, businessmen, whether Chinese or Filipino, would have been able to start a grocery business by using their own savings, borrowing from family and friends or pooling funds in a partnership. Because the capital amount needed in the 1990s was much greater, the traditional, more informal sources were no longer viable as a source of substantial financing. For existing and new businesses, financial resources have become a more crucial resource. What were the avenues for acquiring this capital? For KK Stores, the main source was still the banking institutions but it was considering listing on the stock exchange to raise funds.

Increasing power of buyers

In the textile industry, the bargaining power of MM Textiles' buyers has been increasing. According to Jose Yu, the CEO, this was caused in part by the increase in the number of entrants. One sign of increasing buyer power was the fact that most of the major department stores were passing on more and more of the costs associated with selling its merchandise to the supplier. In most cases, suppliers had to provide their own display shelves which were manufactured according to the store's specifications, as well as paying for a salesperson at the store. The department store segment of MM's buyer network has increased in popularity because of the change in the shopping habits of the urban population. There is an increasing preference to shop in more comfortable air-conditioned shopping malls where the department stores are located. Twenty years ago, Mr. Yu recalled, there were major shopping streets in downtown Manila. Shops along Avenida Street or

Divisoria sold a variety of goods and competed against each other. One street became known for textile goods, while another was known for craft supplies.

The three consequences of increasing buyer power are that: (a) costs of selling have increased due to department stores passing on inventory monitoring and stock display functions to the seller, (b) the terms of credit have lengthened to twice the previous terms and (c) stores have been purchasing more and more of the goods on consignment. The latter refers to the practice of stores ordering goods on credit and returning unsold goods after a certain period of time (usually 90 days). Costs to a supplier like MM included the credit period for the sold goods, inventory costs for unsold goods and the risk of returned goods becoming out-of-fashion.

Both MM Textiles and AA Plastics were experiencing increased pressure from foreign competition, as cheaper imports flooded the market due to decreased tariff rates. In the case of MM Textile, its aim was to manufacture for the domestic market. It did not export its textiles directly, but some garment exporters purchased material from them. Management had emphasised the technical aspects of production to the neglect of marketing. AA Plastics' CEO, on the other hand, acknowledged her weakness in international marketing skills. To remain competitive in the international market, the firm was seeking accreditation with the International Standards Office (ISO).

Rivalry among existing competitors

The increase in competition in the textile industry also exerted pressure on credit terms. 'Anyone with a few sewing machines can set up their home business,' Jose Yu, MM's CEO remarked, 'Somebody with a few million pesos can go into fabric manufacturing.' MM did not have a strong brand name, causing Jose Yu to reason that its products were not necessities in contrast to food or toiletry products.

He remarked that they were able to offer thirty days' credit terms to buyers a few years ago. The past two years have seen this term stretch out to sixty, and even ninety, days. These longer credit terms were the result of competitors in the textile industry trying to edge each other out by offering more attractive terms for buyers. There was also not much product differentiation. Some local manufacturers have attempted to establish their own brands or operate their own retail outlets but with mixed results. This situation has exacerbated MM's needs for financial resources, for it has to match its competitors' credit terms.

FF Food was established twenty years ago with one shop in the business district of Makati, Metro Manila. Jonathan Co's vision was for FF to grow to 200 stores by the year 2000 and to list the company on the Philippine stock exchange not long after that. The company had created a successful brand name and concept for the domestic fast food market but needed several key resources to expand the business. These resources included financial capital and access to property in strategic locations. It had expanded through a mix of both company-owned and franchised stores. Considerable financial resources were required to establish company-owned stores. The funds were traditionally sourced through the company's retained earnings and bank financing. The establishment of stores required either outright purchase of real estate property or entry into a long-term lease with the property owner. For franchised stores, prospective franchisees were put through a screening process to determine their suitability. Franchisees provided the capital and FF provided the business, technology and raw materials. As a smaller player in the fast food market, FF had to be more generous in its requirements of prospective franchisees. The major player in the market is able to stop granting franchises and open its own stores because of a successful listing on the stock exchange. FF could

not do this due to constraints on funds and on its access to store locations. As will be seen in Chapter 6, however, this constraint has resulted in benefits to FF.

FF had built a large manufacturing plant in Manila to manufacture its food products centrally. Using modern equipment, it manufactured noodles, bread, Chinese buns, sauces, and dumplings in its plant. These were fast-frozen and then delivered to the food outlets. It also sold noodles and sauces to the supermarkets.

The raw material supplies that FF needed were of a generic nature; what were more important to the company were the logistics and value-adding aspects of the supplier relationship. The dependence on suppliers to provide more value-added services allowed FF to decrease its investments in processing plants, storage warehouses, and even delivery vans. CEO Jonathan Co explained that he would rather subcontract most of the processing activities to the suppliers and adapt the just-in-time system.

5.4 Summary

Organizations are interdependent with environments in a number of senses (Pfeffer and Salancik 1978; Scott 1992). Environments directly affect organizational outcomes, which in turn affect subsequent perceptions and decisions. Moreover, environments supply the materials and ingredients of which organizations are composed (Scott 1992, 149).

The crucial role played by the environment in an organization's development is one of the patterns that clearly emerged from the case studies. It is both an influence on business and a source of resources. The environment influences a firm's strategic decisions. The repercussions of government policy were discussed in the previous chapter. Other firms in the market also affect a firm's decisions. For

some of the taipans discussed in the previous chapter, political favours conveyed some advantages to their business activities. The case study firms, however, did not recognise political influence as a crucial resource for them.

What would make it necessary for a business to seek IORs? This chapter has presented a model of how a business determines the need for external resources. Notable shifts signalled through the macro environment precipitate changes in the organization's strategy. A critical factor for the case study firms has been the government's changing policies towards the ethnic Chinese. The permission to apply for citizenship had far-reaching consequences for business development. With citizenship came the possibility of owning property in their own names and entry into industries reserved only for Filipino citizens.

The intermediate environment also triggered numerous events that influenced the firm's strategic direction. Porter's (1980) competitive forces model is a useful framework for analysing these triggers. These forces are more applicable to ongoing businesses. The special case of businesses starting up was also discussed. The resource needs of a business starting up and the subsequent stages of growth and diversification were distinctly different. Initial capital requirements for start-ups were not onerous and the technical needs were not complex.

The next stage for case study firms was their expansion into new areas. Because most of these activities involved manufacturing, technology requirements became more complex and were often unavailable in the Philippines. Many were also accessing new markets, either expanding outside the major Philippine cities or overseas. AA Plastics and JJ Chemical were two firms that were significant exporters. Table 5.5 depicts the competitive forces and summarises the strategic reactions and corresponding resource needs for the case study firms.

Table 5.5. Competitive forces, strategic reaction and resource needs

Competitive forces	Strategic reaction				Resource needs	
	Expand into new markets	Expand into new products or services	Upstream and downstream linkages	Seek alliance with others	Finance	Technology
Threat of new entrants	x	x		x	x	x
Increasing power of buyers			x		x	x
Increasing power of suppliers			x		x	
Rivalry between existing competitors	x	x			x	x

The organization-environment fit is a process as well as a state: the organization seeks to align itself with its environment and to arrange resources internally in support of that alignment. It has been argued that successful organizations achieve strategic fit with their environment and support their strategies with appropriately designed structures and management processes. Less successful organizations typically exhibit poor fit externally or internally or both (Miles and Snow 1984, 10).

The basic premise of resource needs analysis is resource dependence theory. The key to organizational survival, according to Pfeffer and Salancik (1978), is the ability to acquire and maintain resources. If organizations were in complete control of all the components necessary for their operation, then this problem would be quite simple. However, no organization is completely self-contained: rather it is

embedded in an environment consisting of other organizations. The organization depends on those other organizations for the many resources that they themselves require. How do organizations acquire resources from their intermediate environment? The next chapter turns to this question.

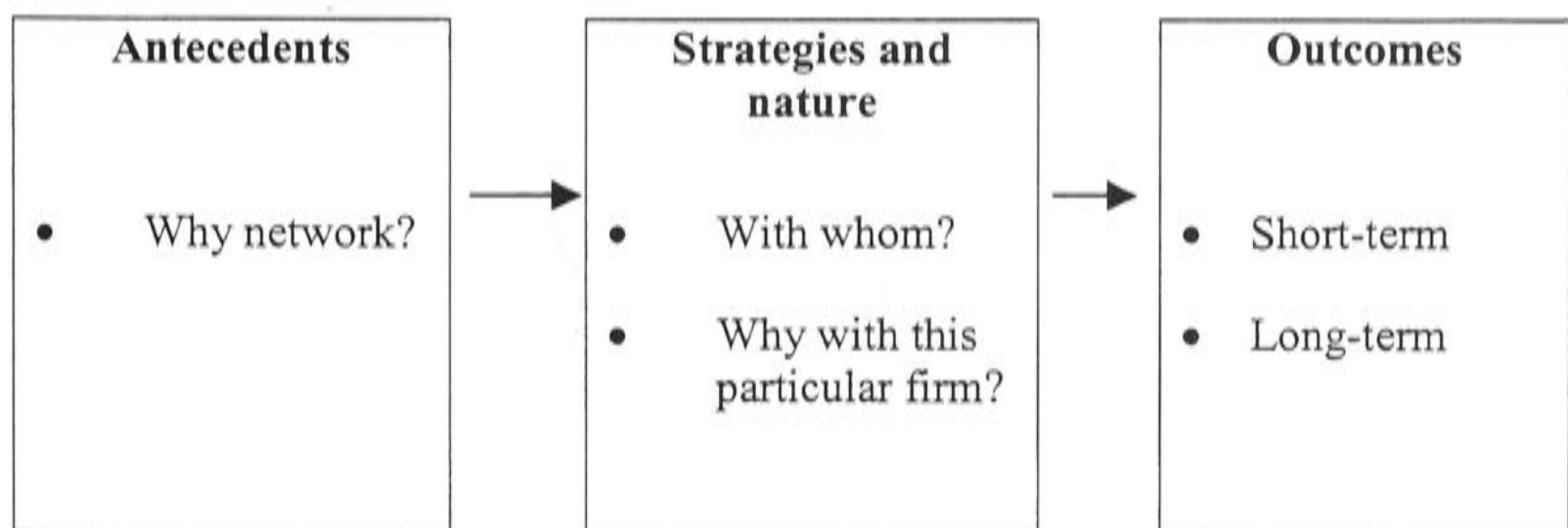
Chapter 6

The Strategies and Nature of Business Relations

This chapter aims to answer two main questions: 'With whom do Chinese firms enter into relations?' and 'How do they choose who to do business with?' In addition, three supplementary questions will also be addressed: Does trust matter? Does reputation matter? Do asset specificity and small numbers bargaining come into consideration?

In terms of the diagram depicting the process of IOR formation, this chapter proceeds to the second stage: strategies and nature (Table 6.1).

Table 6.1. A diagram depicting the process of networking



Kay (1993) refers to a firm's 'architecture' as one of the primary sources of its distinctive capabilities. By architecture he means the network of relational contracts within, or around, the firm. This study is primarily concerned with the firm's external architecture, or its relationship with suppliers, customers and other

external agents, rather than its internal architecture, or its relationship with employees.

How do Chinese companies manage their need for exchange relations? In the grounded theory tradition, the process of managing is an action/interactional strategy that is composed of two important elements (Strauss and Corbin 1990). First, strategy is processual and evolving in nature. The discussion in this chapter accentuates the process of evaluating business partners to highlight this process. Second, action/interaction is purposeful and goal oriented. In this case, these IOR strategies are undertaken to meet the particular company's need for resources and skills.

While the need for resources may initially determine the nature of relations with other firms, it must not be forgotten that relations continually unfold. Several factors influence the manner in which relations evolve. Among these are the expected and unexpected outcomes, or met and unmet objectives, after the relationship is undertaken. This aspect will be the focus of Chapter 7. For now, it is sufficient to keep in mind that the nature of relations discussed in this chapter is not static.

This chapter discusses the nature of relationships structured along two dimensions: activity links and resource ties (Hakansson and Snehota 1995). Activity links refer to the technical, administrative or commercial activities of a company that are connected to those of another. Resource ties focus on the various resource elements (which include technological, material or knowledge resources) that are shared between two companies (this is sometimes referred to as a dyadic relationship).

It comes as no surprise that all case study firms considered a few ties to be their most important, or core, relations. This finding is similar to Hakansson and Snehota's (1995) observations for Swedish companies. They discovered that most industrial companies had a few buyers (or customers) and suppliers that accounted for the major part of their total sales and purchases. These relationships were decisive for the performance of these firms. The ten largest customers and ten largest suppliers accounted for more than two-thirds of the total sales and purchases in two out of every three companies in the 100 Swedish companies studied.

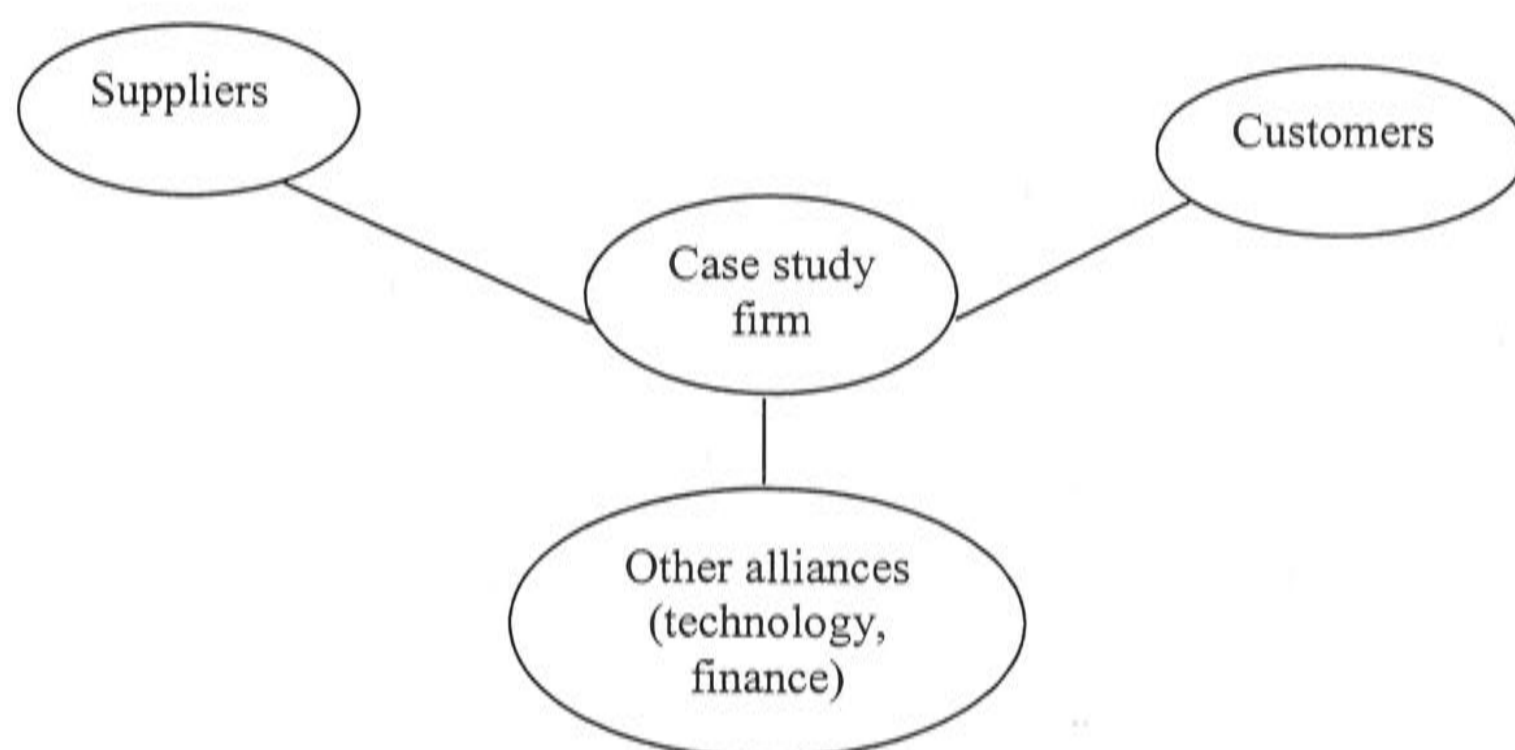
In this chapter, the firms' relations are discussed and organized in terms of the nature of their customers (or buyers) and suppliers, as shown in Table 6.2. These are arrayed according to Williamson's (1975) small numbers bargaining condition as a dimension for comparing cases. Well-defined customers (small numbers) versus diffuse customers are based on the nature of the company's principal business activity. For example, industrial companies such as MM Textiles have well-defined and easily identifiable customers while mass-market companies such as KK Stores have a widely diffused customer base.

Table 6.2. Case studies according to the nature of customers and suppliers

	Well-defined customers (small numbers)	Diffuse customers
Well-defined suppliers (small numbers)	<ul style="list-style-type: none"> • AA Plastics • JJ Chemical • MM Textiles • SS Sawmill • China Construction 	<ul style="list-style-type: none"> • FF Food
Diffuse suppliers	<ul style="list-style-type: none"> • GG Shipping (mixed) • SS Shipping (mixed) 	<ul style="list-style-type: none"> • KK Stores

Figure 6.1 is a graphical representation of the discussion of the case study firms and their IOR counterparts. The case study firm is the unit of analysis. The firm's relationships with each partner category (suppliers, customers and other partners) are described in the next section.

Figure 6.1 Case studies and IOR counterparts



6.1 Well-defined suppliers, well-defined customers

Companies that belong to this category mainly deal with industrial products. AA Plastics sells acrylic plastic products to industrial processors while JJ Chemical supplies industrial end-users and intermediate processors. MM Textiles manufactures some consumer products (such as men's and ladies' shirts) but does not sell directly to consumers. It sells on a wholesale basis to retailers.

AA Plastics

Buyers. AA did not sell its products directly to end-users, but relied on five exclusive distributors for domestic distribution and four foreign trading firms for export sales. Domestic sales accounted for 70 per cent of its revenues. The

domestic distributors, in turn, sold the products to manufacturers of lighting and signage products, point-of-sale displays and other plastic products. AA was one of only two companies that manufactured high-quality acrylic plastic in the Philippines and had yet to meet a domestic manufacturer as a strong competitor.

No one distributor accounted for more than twenty per cent of AA's sales and all of them were related in one way or another to Chang Eng. His brother and sister owned one distributorship each. A sister-in-law was the third distributor while the fourth was a cousin. The fifth, while not a relative was a *compadre* (sworn brother) of Mr. Chang, as the latter is the godfather to one of the former's sons.

Long-term commitment between AA and its distributors was both desired and the reality, according to Wilma, General Manager of the company and Mr. Chang's only daughter. The average duration of the relationships was twenty years and Wilma expected these to continue indefinitely.

Transactions with distributors depended to a great extent on oral agreement and tacit understanding. No written contracts were used and all orders were placed over the phone. While the use of informal procedures affords flexibility, rapid response and low initial cost, it was not without its drawbacks. Wilma explained:

Sometimes it is difficult to do things over the phone. Like I would take an order, then the customer rings back and changes things. Or they might say, 'This is what we ordered but your company produced the wrong quantity.' We produce to exact specifications and if there is a misunderstanding like this, what am I supposed to do with our products?

Suppliers. AA had a long-standing relationship with a machinery company in Taiwan from whom it purchases machinery. AA also depended on this company for machinery parts and repairs from time to time. It did not require the equipment

supplier to provide regular servicing, however. So long as the machinery was installed properly and running smoothly, AA was able to perform the regular maintenance on its own.

Its major recurrent purchases were those of chemicals, the main suppliers of which were Chinese-owned trading companies. AA dealt with four trading companies. The chemicals required were all imported, with a standardised classification system for quality. The choice between purchasing from one supplier or another, therefore, hinged on two factors: the availability of the material and price.

The procedures followed for purchasing were as informal as the sales procedures. As a result, similar problems of misunderstanding surfaced. Wilma recounted one incident:

There was one time I asked for the price of a certain chemical from Robert [the sales manager for a Chinese chemical trader]. He told me it was 24 pesos a kilo. So I ordered a thousand kilos from him. When the invoice came it was for 28 instead of 24 pesos per kilo. The problem was that he said that he quoted the higher price to me, but I remembered agreeing on another.

Wilma hoped to address this problem by implementing the International Standards Office (ISO) standards. Conforming to ISO standards required most transactions to be put into writing. Therefore, there had to be written confirmation of orders, sales and delivery. Wilma remarked that convincing their suppliers and buyers to change their ways to conform to the new system would not be easy. Now, she gratefully acknowledged, buyers would have no choice but to complete purchase orders and suppliers would likewise have to send confirmed sales contracts after these standards were put into place. In addition, their production processes would have to be documented and quality control procedures put into writing.

Technology. Initial technology was provided by the Taiwanese partner because Chang Eng had no previous experience in this line of business. While this type of technology can now be easily purchased, this still entailed a large capital outlay. Such an outlay could not necessarily be justified because the domestic market was not large enough to sustain more manufacturers. This capital requirement functioned as a barrier to new entrants into the market. Rather, imports from Malaysia and Taiwan were AA's main competition.

Summary. The initial need for technology stemmed from the fact that Chang Eng had no experience in the manufacturing process of acrylic plastic. The current crucial network was the distributor network, both for domestic and international sales. Both sets of distributors were long-term associates and all local distributors were linked to the Chang family through strong ties. None of the domestic distributors had previous experience in the industry but the international distributors were established international trading companies.

JJ Chemical

JJ Chemical was a family company managed by Eusebio Wu, the younger brother of the founding Wu brother, Honorio. Important management positions in accounting, finance, marketing, human resources and planning were held by family members, including Eusebio's nieces and nephews. Johnny, Honorio's eldest son, was in charge of marketing. The company's major products were activated carbon, corn oil and mosquito repellent coils. It also operated a rice and corn mill.

Nippon joint venture. JJ Chemical's most important business relationship was with Nippon Trading Company, one of the largest trading companies in Japan. JJ has a joint venture with Nippon for the manufacture of activated carbon. How

this partnership began and why it has lasted for more than twenty years are two important issues to investigate.

According to Johnny Wu, JJ had been exporting coconut shell charcoal since the mid 1960s. Japan was one of the major importing countries and Nippon one of the largest buyers. It was Nippon that came over to Cebu in 1973 and proposed the joint venture. When this occurred, the two parties had been doing business together for almost ten years. However, this was not equivalent to stating that there was 100 per cent trust, only that the parties had a previous working relationship and knew each other's reputations. The implications of the difference between trust and reputation will become clearer in the section on trust. The Wu family managed the business in Cebu, with the assistance of one Japanese plant manager and three Japanese technical staff.

What were the motivations of each party? In the case of JJ Chemical, Nippon was their major buyer before the venture. Nippon had access to the technology to process coconut shell charcoal into activated carbon and wanted to find a local partner to manufacture the finished product in Cebu, since labour costs were cheaper than in Japan and the raw materials were abundant in the Philippines. The final agreement saw Nippon contribute fifty per cent of the capital, in the form of equipment and technology, while JJ contributed the other half, including the land and buildings on which the present manufacturing plant stood. The venture had already been in existence for twenty years and Johnny foresaw it continuing indefinitely, so long as both parties derived benefit from the arrangement.

Buyers. JJ and Nippon marketed the products together. In the early years of the venture, Nippon was responsible for most of the international marketing activities. 'They were more experienced in this area,' Johnny recalled, 'So for the

first five years it was really a learning stage for us. They did most of the marketing then, but now it's 50-50.'

Johnny was responsible for domestic marketing, selling the products to a mix of industrial customers, the majority of which were mining companies. These companies used activated carbon to remove impurities from mined gold, a less expensive and less polluting process than mercury. As part of his duties, Johnny travelled to mining sites across the Philippines to consult with the customers' technical staff. He saw this as an important way of cementing relationships with the customers; they not only shared information, but were also able to evaluate product performance together. Industrial customers had specific requirements and JJ tailored its production to their specifications. His visits enabled discussions about these requirements as well as any complaints about the product and suggestions for improvement. Competition in the industry was not based solely on price.

'You know, there are five producers of the same product in the Philippines, so we win or lose based on product quality. The gold mines say that our prices are a bit higher than others, but they still continue to buy from us because we can support them through our better quality control,' Johnny emphasised. 'We have more than twenty grades of carbon, depending on how the product will be applied. Sometimes our competitors fall short of supply, but we can guarantee our customers a steady supply. That is important too.'

How did JJ decide whether to sell to a certain company or not? Before JJ made a decision to accept or reject an order, Johnny and another manager paid visits to the buyer to meet and talk to the other party in person. Johnny explained that they preferred to go to the top level in order to know the management and their requirements before accepting a new order.

JJ Chemical relied on written contracts or oral agreements, depending on the situation. Its industrial customers were large companies with established operations, so there was a certain confidence on the part of JJ that these companies would honour their obligations. JJ Chemical considered the company's size and type of operation and prepared a written sales contract for each order. For some smaller companies or ones that preferred not to have written contracts (often for tax evasion purposes), orders were done verbally. In Johnny's opinion, however, a written contract would not be any good if the buyer refused to pay and set out to be deliberately dishonest. The company seldom resorted to legal action to solve problems in business, a finding similar to that for Taiwanese business (Tu 1991).

The problem that Johnny encountered with buyers was not default in payments, but delay in payments. Although sales contracts specified a credit period of thirty days, the buyers usually extended this to sixty and even ninety days. He didn't consider this dishonesty, but rather a case of 'bending the rules'.

Suppliers. JJ Chemical developed its own purchasing network by establishing numerous buying stations in key centres in the Visayas and Mindanao regions. According to Eusebio Wu, JJ's CEO, the best quality raw materials came from the Mindanao region because of the fertile soil. He often visited the buying stations as well as their branch office in Davao City, which served to coordinate all these stations in Mindanao. These stations were staffed by JJ employees, who were tasked with purchasing coconut shells from hundreds of farmers in the surrounding area.

While the price paid for coconut shell was an important consideration for farmers, JJ's long experience in the industry was another factor that affected the negotiations. The relationship established became important because the farmers

often had to be paid in advance. The farmers could then use the money to purchase tools and equipment, and the company was ensured of the supply when harvest-time arrived.

Finance. At the start of the venture, Nippon and JJ each contributed an equal share of the capital in equipment, land and cash. Now that the business was growing, finance was sourced from bank borrowings, not additional equity. When asked how they chose which institution to do business with, Johnny remarked that they compared the various terms and conditions proposed by different banks and chose the one which offered them the best terms. The company has established a certain reputation and credibility with the banking community and did not find it difficult to obtain needed loans.

Redding (1995) found that strategic alliances between Chinese firms in the Southeast Asian region and Western or Japanese firms demonstrated a valuable combination of: (a) Chinese enterprise in handling local labour forces, distribution systems and government relations and (b) Japanese or Western expertise in technology or world marketing. This is certainly the case with JJ Chemical. Nippon's expertise in technology and international marketing was combined with JJ's local labour force and raw materials procuring system. In addition, the taipans' alliances with foreign companies were highlighted in Chapter 4.

Chinese joint venture. The Wu family was involved in another joint venture, this time with some of the residents of Honorio's hometown in mainland China. This venture was formed in 1992 to produce mosquito repellent coils for the Philippine market. The circumstances behind the formation of this venture could not have been more different from that of its venture with Nippon. It began when Johnny's father, Honorio, returned to China in the early 1980s to invite people from

his hometown to invest in Cebu. Some of them decided to manufacture mosquito repellent coils and contributed machinery to the venture.

Mosquito repellent coils were a good product fit for the Wu family. The coils used a by-product of coconut shell charcoal as the principal raw material. However, five years later the venture had not even made a profit, which prompted Johnny to remark that his father entered into the business for sentimental, rather than profit, reasons. 'They [the Chinese partners] contributed machinery, but this was old and slow,' he said. 'This venture might be profitable for them, because they are managing it, but for our part we have not yet seen a cent.'

While it may seem odd that a successful business family would enter into a business that had little hope of making a profit, the maximum financial exposure for the family was at most five million PhP, which was not a big amount for them. The venture with Nippon was substantially larger and JJ had more at stake in ensuring its success. Upon closer scrutiny, the Chinese venture was more of a political rather than economic move. Honorio was a well-known local Chinese leader in Cebu and was also well-respected in his home town in China. The venture was seen to bring a certain prestige to the family while at the same time establishing a good reputation for them in China.

In summary, the most critical relationship for JJ Chemical was the joint venture with Nippon. For JJ, this venture was a source both of technology and access to international markets. The firm sacrificed profits in the first few years, realising that its partner was making a larger profit from the venture. The Wu family was determined to learn from this venture. It also took the opportunity to add value to the raw materials that they were previously exporting in an unprocessed state.

From Nippon's point of view, JJ's supplier network was a competitive advantage for the venture.

MM Textiles

MM's first product was textile fabric, when Yu Eng Lit and his sons were inspired to produce import substitutes. It now produced both woven and knitted fabric. Its joint venture was formed with two Chinese-Filipino young men. The family ventured into fabric dyeing and finishing in the early 1990s.

Buyers. MM's network of customers had gradually evolved during the last twenty years. Some were important in its earlier years of operation but less so today. Its first network of customers was composed of small retailers of textiles and variety stores within a limited geographical area. These were located around the Chinatown area in Manila, mainly on Rosario, Juan Luna and Divisoria Streets. The majority of stores were Chinese-owned and were all known to the Yu family from the days when the latter were textile traders themselves. Therefore, when they first set up their textile factory, the first customers were these Chinatown traders.

As the shopping patterns of the urban residents of Metropolitan Manila changed to reflect a shift towards department stores and shopping malls, MM's customer network for its garments reflected this shift. While the Chinatown merchants were not abandoned totally, department stores were accounting for an increasing share of total sales. From selling 100 per cent of its products to the wholesale and retail merchants of Chinatown at the beginning, Jose Yu estimated their share to be down to about 20 per cent. Department stores accounted for 30 per cent of sales, while sales agents contributed 50 per cent.

The basis for procuring orders from the department stores was the presentation of samples to their purchasers. One day a week was allocated to certain products. On Thursdays, for instance, MM's sales representative displayed their new garment samples to the purchasers at say, Landmark Department Store in Makati. There was no direct contact between owners of these businesses and the process was formal. The decision to make a purchase was, according to MM's sales representative, dependent upon the purchaser's knowledge of what styles were fashionable and the past sales history of the products. When the purchaser was unsure of the product, they may still place a trial order and treated it as a consignment purchase. In this way the department store bore no risk if the product did not do well. In a climate of intense competition among garment manufacturers, MM's sales representative said the message of the stores about consignment purchasing was 'take it or leave it'. If suppliers were unwilling to sell this way, competition was high and there were other suppliers to take their place.

MM Textiles had a network of about a dozen sales agents. They were not employed by the company, but operated independently and in competition with each other to sell the company's products to institutional customers. To illustrate, a certain hotel required the supply of linen and put out a notice for tender. Various firms and agents submitted bids for this requirement, including two of MM's sales agents. Product specifications were set out and the final decision was made on price. MM Textiles quoted the same price to both agents and it was up to them to submit their own bids after adding their own profit. In fact, they did not know that they were bidding against each other.

Suppliers. MM's purchases from suppliers can be divided into recurrent and one-off transactions. It had ten suppliers for its major raw material requirements.

The major raw material requirements included cotton and polyester yarn, chemicals and packaging materials. Cotton and polyester accounted for 80 per cent of the total annual purchases of its textile manufacturing division, while chemicals and dyestuff accounted for 90 per cent of purchases for its fabric dyeing and finishing division.

There were several suppliers of cotton and polyester thread in Manila, but their quality and price varied. The primary criterion for purchasing decisions was price, but MM did not purchase from companies with whom it was not familiar. The suppliers were Chinese-owned firms, with one exception. That exception was an Indian yarn manufacturing company that was relatively new to the market. Before MM decided to purchase from this firm, Jose Yu toured the manufacturing plant of the company and got to know the management. Quality was as important as the price, because inferior yarn caused increased costs during the manufacturing process. It took time to load the yarn onto the looms and poor-quality yarn often broke, disrupting the operation of the loom. Frequent starting and stopping of the loom resulted in time wastage and consequently higher labour costs.

Technology. Machinery and equipment were all imported either through a local agent or directly from Germany, Taiwan or Japan. Attendance at trade shows was one important avenue for learning about the latest manufacturing technologies. Jose Yu and his brother had good contacts within the textile industry and could find out what kind of machinery their competitors are using. How did they do this? A Filipino sales agent for machinery spare parts paid a visit to Jose Yu one morning while the researcher was present. The agent informed the researcher that in his spare time he ran a business buying and selling used machinery. He then proceeded to inform Mr. Yu about the used machineries that were available and their prices. He also inquired whether Mr. Yu was selling any of his equipment. This agent was a

fount of information regarding MM competitors' factory set-ups and the availability and market value of used machinery.

In the course of their business careers, Jose Yu and his brother have visited other textile manufacturers in the Asian region. On one occasion, while evaluating the performance of a certain machine from Germany, they were given the opportunity to visit a textile plant in Malaysia to observe how the equipment functioned. Jose Yu indicated that while this machinery had output estimates, it was always prudent to see it in action in tropical climates. MM arranged the financing of new capital purchases from local banks, in loans denominated in US dollars or Philippine pesos.

The company had no formal alliances with technology providers, but it regularly bought parts from two Japanese and two Taiwanese companies. The initial need for new manufacturing technology was through outright purchase of machinery. The suppliers of the new machinery provided technical training to the Yu brothers. Jose Yu and his brothers have trained in Europe, Japan and Taiwan.

Competitors. Cooperation between competitors is more common than is usually supposed. One example is the car industry. When an order is too large or difficult for a single firm to carry out, it may subcontract part of it to a firm with whom they would normally compete (Prahalad and Hamel 1990). This was observed in MM Textiles' case.

Such subcontracting was observed in the fabric dyeing and finishing business of MM Textiles. The company performed its own dyeing and finishing for its woven fabrics, but also accepted outside orders from other manufacturers for fabric finishing. An urgent order might come at a time when the plant was operating at full

capacity. When this occurred, MM did not refuse the order but accepted it and subcontracted the job to a competitor to fulfil. Sometimes the company revealed its identity to the competitor but other times it assumed a fictitious company name in the purchase order. However, the identity of the original buyer was always closely guarded.

In summary, this case illustrates the use of both strong and weak ties in forming IORs. MM's older buyer network has broken down because of declining sales. The newer network of department stores and boutiques represented formal contracting without particularistic ties. The most important information that the company sought was that related to the competitive environment, market prices for raw materials, and business news about its buyers and suppliers as well as the general business community. The main sources for this information were the family's social and business network as well as formal sources such as trade shows. The company's strategy for addressing declining sales in textiles was to diversify downstream into garments via a joint venture. When the garments business began getting highly competitive, it then diversified upstream into textile finishing.

6.2 Well-defined customers, diffuse suppliers

SS Shipping

SS Shipping was ranked in the top five companies in the shipping industry and in the top 150 corporations of the country, based on gross revenues, in 1995. The founder, John Ongseco, was born in the Philippines in 1910 and sent to China for a few years to study. His father operated a chartered boat service to transport cargo and passengers in Cebu. Unfortunately, he perished in a boat accident, leaving John to fend for his younger brothers and sisters.

During the Second World War, John bartered currency, dried fish, sugar and cigarettes. After the war, he started his transport business with one ship like his late father. By the 1950s, fifteen ships were flying his banner and, with continued vessel acquisition, SS was serving 24 domestic ports with a 1400 workforce by the early 1990s. Its total assets by this time totalled two billion PhP.

SS Shipping pursued a strategy of upstream and downstream integration by providing container facilities and services, as well as freight forwarding and trucking to provide customers wide access to a broad range of services. By introducing faster and more luxurious passenger vehicles, the company set a higher standard of quality for domestic water transportation and was able to attract a new set of customers who would otherwise not have considered using sea transport.

Freight revenues accounted for sixty per cent of total gross revenues while passenger sales accounted for forty per cent in 1994. The company's basic cargo service was a pier to pier service, with the shipper delivering the cargo to the company at the port of origin and the consignee collecting the cargo at the port of destination. The company, however, contracted for trucking services with more than twenty trucking companies, including its own trucking company, which enabled it to provide door to door, door to pier and pier to door distribution services as required by its customers.

All of the company's vessels were used in its cargo operations. The majority of the cargoes carried by the company from Manila to the provinces consisted of consumer items and finished goods, while the bulk of cargoes transported to Manila from the provinces comprised agricultural products and livestock.

Freight charges and passenger rates charged by inter-island shipping companies were established by each shipping company in reference to the tariff structure imposed by the Maritime Industry Authority (MARINA). SS Shipping's cargo rates were determined primarily by reference to the type of cargo carried (in accordance with MARINA classification), the distance of the route, and either the volume or the weight of the cargo to be carried, depending on which would result in a higher tariff. Trucking rates charged to customers were determined by reference to the Domestic Shipowners Association (DSA) prescribed rates.

The company's passenger ships offered a range of accommodation that typically comprised premium first and second class accommodation, and third or economy class. Passenger rates were determined by the class of accommodation and the distance to be travelled. First and second class rates for liners have been deregulated and the company was free to determine these rates. Third class, or economy rates, like basic cargo rates, must be set by reference to prescribed MARINA rates.

Buyers. SS had two sets of customers. The first consisted of industrial customers who availed themselves of its cargo services. This set was well-defined and each company was identifiable. The second set was composed of passengers and was a diffuse and numerous group. Cargo customers' choice of which carrier to use was based on routes and frequency. Long-time customers were granted credit, but new customers did not have this privilege. The company advertised in various media targeting the passenger segment, including newspaper, television, radio and magazine advertising. Sales and marketing were conducted through its network of branches and sales agencies, most of which were situated at ports serviced by the company's vessels.

Equipment suppliers. SS has historically purchased most of its vessels from Japanese shipowners. These vessels were generally between 11 and 20 years old when acquired and were then renovated and refurbished in the Philippines before deployment. The company financed approximately eighty per cent of its vessel acquisition costs through peso loans from local banks payable over five to seven years with interest at market rates.

The company has a technical tie-up with a Norwegian consultancy company to develop training programs for its officers and crew. This training venture was intended to provide employees with new skills, enhance their existing skills and keep them up to date with developments in national and international shipping.

The company owned and leased a variety of types and sizes of containers and other equipment for use in its cargo operations, including forklift and top loaders, yard tractors and trailers. As of the end of 1994, SS owned 78 per cent of the containers in use while the rest were leased. It believed the primary benefits of leasing a portion of its containers were (a) the ability to respond rapidly to changes in shipping demand and imbalances in trade routes and to meet seasonal needs and (b) the opportunity to expand trade routes and market share without making a long-term financial commitment. The company leased containers from eight lessors.

Strategic alliance. SS entered into a strategic alliance with two smaller shipping companies in the early 1990s. The decision was triggered by indications that the government would be opening the local shipping industry to foreign investment and, hence, greater competition.

One shipping company was owned and managed by a Chinese family and excelled at servicing short routes to and from Cebu. The other was owned and

managed by a Spanish family and was highly computerised. While the CEO, John Ongseco, admitted that the process of merging three companies into one was difficult, the benefits outweighed the teething problems. One of the problems of integration was the difference in the cultures of the organizations, John continued. However, the basic problem of the management team had been resolved, he revealed, with himself as CEO, and a representative each from the two other families as vice-presidents.

GG Shipping

In sharp contrast to the management style of SS Shipping, GG was a family owned and managed company. The company began as a partnership between two Lim brothers, Lim Po and Lim Wan, who were immigrants from China. The initial capital came from the profits that the two brothers had saved from previous businesses, in particular agricultural trading. In the early 1970s, the two brothers parted ways to form their own shipping companies with their own families. Lim Po, the older brother, started GG Shipping together with his two sons. George Lim, the eldest, is Executive Vice President and Chief Executive Officer of GG Shipping.

Finance. Finance for business operations and capital investment was generated internally and through banks. However, the family was seriously considering listing their company on the stock exchange. According to George, 'If you go public, other people invest [their money] so borrowing from the bank will be minimised.'

Shipping was a capital intensive business because a large amount of funds was required for the purchase of ships, according to Mr. Lim. An alternative to outright purchase was leasing but in the case of GG, they preferred to purchase all of

the ships with the aid of bank financing. They purchased used ships from overseas, particularly Japan and Eastern Europe.

Customers. GG Shipping has decided to concentrate on the cargo and passenger business and reduce the emphasis on their agricultural trading business. Shipping prices were set in reference to government guidelines, as discussed previously. Companies within the industry effectively competed on service and equipment. Mr. Lim believed that their advantage lay in their personalised service, as reflected in the way customers and guests were received in the office.

Due to their focus on passenger service, it became necessary to establish a wide network of ticket outlets around the country to make purchasing tickets convenient. These outlets were a mixture of company-owned and independent agencies. The decision as to which ownership structure to implement depended on whether GG had a suitable person in the area to manage the outlet. With an agency, GG incurred higher costs, in the form of commissions on sales. However, Mr. Lim said that it was easier to manage an agent. The agent earned income based on sales commissions, so there was an incentive for them to increase sales. This performance-based incentive encouraged the agent to conduct their own local marketing activities, such as advertising, in an attempt to increase turnover.

Staff. As to the management team, it was a different story altogether to SS Shipping. There was a clear preference for family members. The advantage of having their 'own people' (*zi ji ren*) managing the business, according to George, was that it speeded expansion. By 'own people' he meant family members exclusively. Without their own people, he continued, they would be cheated left and right.

George Lim believed that customers should have easy access to the officers of the company and designed the layout of their headquarters in Cebu City to reflect this outlook. The layout can be described as open and although there were private offices for the officers, all of them occupied desks in the main open area together with the rest of the staff. Desks were arranged in accordance with the organizational hierarchy: receptionists and clerks were placed in the front area while officers were closest to the back wall and furthest from the reception area. Mr. Lim explained that he encouraged this open type of layout to enable customers to have free access to anyone in the company. 'In fact,' he remarked, 'I try to answer my own telephone.'

Summary. GG's expansion and growth strategy was highly dependent on the availability of family members as trusted managers. This was in contrast to SS where only two family members were in the management team and no other family members were employed in the firm. George Lim characterised GG as a traditional Chinese family firm, efficiently and conservatively run. There was much emphasis on informality and accessibility of managers to buyers and suppliers, as the office layout anecdote illustrated. He also valued long-term ties and offered flexibility in payment terms to loyal customers.

6.3 Diffuse customers, well-defined suppliers

FF Food

From a single shop in 1985, FF Food had developed into a network of more than one hundred outlets by 1997. It started building its network of franchises in 1989. The company began as a partnership between two businesspeople contributing their own resources and skills. Jonathan Co had the experience and skills in running a Chinese noodle shop while Stephen Yu possessed substantial financial capital and experience in the fast food industry. Jonathan assumed the

position of CEO of FF Food while Stephen remained a silent partner. While acknowledging the importance of this initial partnership to business success, other relations were harnessed by Jonathan for subsequent growth. According to him, the firm's internal and external architecture were equally important in ensuring success in the marketplace.

Suppliers. Its relations with suppliers and franchisees were crucial in securing consistent growth. There were two general types of suppliers for a food outlet. The first consisted of equipment manufacturers and importers. The equipment was a mixture of locally manufactured and imported equipment. Freezers, for instance, were imported but other equipment such as deep fryers, burners, working benches and countertops were sourced from various manufacturers in Manila. Jude Ngo, a supplier of stainless steel counter and kitchen fixtures remarked that KK was their biggest customer, and that they have been doing business with each other for ten years.

When queried about the ethnic background of the owners of these companies, Jonathan was surprised to note that they were all from a Chinese background. 'Well, we did not deliberately choose the suppliers because of their background,' he remarked. 'Many of them I knew from when I was managing a Chinese restaurant. We buy from them because they can deliver the quality we require at the right price.'

The other type of supply for a food outlet was the raw material (food ingredients) needed to produce the menu items. A typical FF outlet offered a range of noodle and rice dishes, steamed buns and a small selection of desserts. The food ingredients were of a generic, non-asset specific nature. Chickens, for example, were sourced from the two biggest corporations in the Philippines, Magnolia

Corporation and Vitarich. 'Their quality is more or less the same,' Jonathan said, 'so it doesn't make much difference from which company we buy our chickens from. The price is what we consider.' This was, however, not the case with other types of food ingredients.

Suppliers of wheat flour, pork, beef, and seafood were mainly small and medium sized family owned businesses. Aling Emilia, a supplier of vegetables, recalled that she first sold vegetables to FF in 1985 when it had one outlet. The volume was a few kilos a day. Now, she delivered 2,000 kilos of different vegetables to the company each day. She happily declared, 'As long as they are growing, we are also growing. They are a very good customer. That is why I am loyal to them.'

This network of suppliers was gradually built up through personal referrals from existing suppliers. It was important to ensure that the company got the best quality products and, in the case of meat products, disease-free as well. Quality was a crucial factor as the company was embarking on a rationalisation of its purchasing system. As part of its strategic plan, it was passing on most of the food processing activities to its suppliers. Instead of delivering whole chunks of pork, Jonathan was experimenting with letting the suppliers cut the pork into specified sizes and marinating them. He explained that he was trying to adapt the Japanese just-in-time system to his business. 'In this way,' he rationalised, 'we don't have to hire so many people. We just farm out most of the activities to our suppliers. We don't even have to make big investments to expand our warehouse.'

Franchisees. At the outset, the two partners had already decided to use the franchising system as FF's growth strategy. As the main franchisor, FF not only received an upfront franchise fee, but generated on-going revenues from its royalties

based on the sales revenues of the outlets. Not all of its stores were franchises; about 20 per cent was company-owned.

Jonathan contrasted their approach to another local franchise business, FoodWorld. The latter's decision to build its own stores rather than franchising them was a function of its financial standing at a certain point in time. During periods when FoodWorld had abundant financial resources, it simply stopped granting franchises and built its own stores. The opposite occurred during times of low levels of financial resources. When it listed on the Philippine Stock Exchange, FoodWorld refused to grant new franchises for at least six months because it was flush with cash. In the case of FF, Jonathan viewed franchising from a different perspective. It was a function, Jonathan stressed, not of the financial standing of the company, but of its desire for growth. He illustrated this by an anecdote about one of its newest stores in Pampanga.

Florencio Ramos owned a piece of property in one of the most popular shopping areas of Pampanga and was scouting around for a food franchise. He approached FoodWorld but it had already stopped granting franchises at that time. Turning to FF Food instead, both parties reached an agreement whereby Ramos owned fifty per cent of the business and FF the other half. 'See,' Jonathan exclaimed, 'if we could not have reached a compromise, we would not be there. Now it is one of the highest grossing stores in the province and the only fast food franchise in that shopping complex. FoodWorld missed their chance.' For him, it was more important to seize the opportunity and be more flexible in negotiating.

Franchising is an example of the plural firm: it is both a hierarchy and a relational network. The choice of this mechanism is a function of the vagaries of circumstance, for example an idea for a new site or the need for cash or qualified

managers (Bradach and Eccles 1989). The franchised chain is not strictly a firm but a network of firms (Grandori and Soda 1995).

Internal architecture. While the main focus of this research is on the firm's external architecture, in the course of discussion Jonathan brought up the importance of his key employees. His core management team, all Filipinos, played a key part in the success of the firm. Aside from this core team, the company employed a large pool of casual labour in the food factory and food outlets. The length of the employment contract was less than one year. This practice allowed optimum flexibility in staffing, as the company was free to reduce or increase the numbers at short notice. The downside to this was the need to train new casuals on a regular basis.

6.4 Diffuse customers, diffuse suppliers

KK Stores

KK Stores' important external relationships included its set of customers, suppliers, and banking institutions. Wallace Tan, President and CEO, identified their core business as merchandising through the department store concept. In a typical store, one found departments such as ladies shoes, ladies wear, cosmetics, toys, kitchen items and so on. A supermarket was usually located on the ground floor of a multi-storey building owned by the company. Customers were characterised as being diffuse. Though its customers were an important set of partners, there was no one-to-one relationship between the two parties. KK classified its customers into broad socio-economic groupings, and tagged the A-B class as the upper class and the C-D class as the middle and lower (or mass-based) class.

Suppliers. Relations with suppliers had evolved by an interesting process, as a result of which the routines for transacting had been institutionalised. Mr. Tan's words were illuminating in this area:

Right now, in my position, I hardly know our suppliers because they are changing while most of those who were close to us, their children are taking over. Some of them merge, change...so I hardly know them anymore.

Not all suppliers were Chinese, but the majority were. According to Mr. Tan, most had dealt with the company for more than twenty years and some even for two generations. Suppliers were a mixture of foreign multinationals, Chinese and Filipino companies.

What was the nature of KK's relations with suppliers? KK's strategy was to focus its efforts on what it saw as its core competency, the merchandising of consumer goods. This strategy drove the company's actions with suppliers. It did not manufacture any of the goods it sold, unlike some competitors who had joint ventures with garments manufacturers and subcontracting arrangements for the manufacture of house brands. Mr. Tan affirmed that

We are concentrating on our core business. I feel that we are quite strong in retail and merchandising. We know our trade and we are quite efficient. When you go to manufacture, the focus is very, very different.

As a result, KK relied on its suppliers to provide market research and product development. He emphasised, 'What we don't do well, others can do better.' This arrangement was generally limited to fashion items, in particular ladies fashion and shoes. Suppliers had to keep tabs on what was happening in their particular product specialisation, domestically and internationally. They took note of new fashion

developments overseas and adapted those designs that they considered appropriate for the local market. The manufacturers subsequently presented their product offerings to the purchasing team of KK Stores, who in turn decided which items would be suitable for certain branches.

KK operated a large number of stores in the southern part of the Philippines, with department stores and supermarkets in Davao, Iloilo, Cagayan de Oro and Cebu. Mr. Tan stated with pride that they had developed a fine-tuned purchasing system. Each store possessed its own purchasing team, which focused on selecting items that it believed were suitable for its particular location. An example was cotton T-shirts. Two different KK stores in Cebu that were ten kilometres apart might order completely different mixes. The 'uptown' stores ordered larger sizes in pastel colours while the 'downtown' store bought smaller sizes in brighter colours. 'The skill of our purchasers has to be so specialised and fine-tuned to local demand because of the high cost of transporting goods from one location to another,' Mr Tan explained. 'Like our store in Davao, if they want to move stock here that has remained unsold for some time, it will cost five per cent (of the price). Mistakes can add a lot to the cost.'

Finance. In the case of the retailing industry in general and KK stores in particular, existing financial practices were a result of the interplay between buyers and suppliers and their relative strength or power. One of the significant changes in the last decade, according to Mr. Tan, was the increase in the initial capital required for business. 'In fact,' he stressed, 'it seems to me that the capital needed has increased by at least a hundred times more. So one can no longer depend on capital from one's friends or family or even suppliers' credit.'

A decade ago, most supermarket items could be bought on thirty or sixty days' credit. For retailers, goods were purchased on credit and so there was no immediate need to use the sales proceeds to pay the suppliers. These proceeds could then be used for other purposes, such as earning interest revenue by investing them in the money market. The current situation had changed dramatically. Now almost fifty per cent of supermarket items, especially well-known brands such as Nestle and Colgate, had to be purchased with cash. Some supermarkets had been known to pay in advance to secure a discount. That discount became the profit margin. For instance, a store might get a four per cent discount for paying in advance: that was its margin. Payment upon delivery translated to a two per cent discount. Waiting for fifteen days to settle the account, the maximum credit period, did not earn any discount. Stores found it difficult to make a decent profit margin because if they marked up on cost, customers would go elsewhere. A store in this situation had to very well sell at cost.

6.5 Strategies and nature of IORs

With whom?

The literature on Chinese business networks emphasises the predominance of ties with one's own family members. In contrast, this study uncovered something different. The case study firms' IORs with their strong kinship ties were the exception, not the rule. Nevertheless, a pattern emerged in terms of the nature of resource need and the choice of partners. Resource need was, in turn, influenced by a firm's stage of development and strategy. Initial capital was important for the firms investigated. The amount was almost always not very large, but the hindrance to a new business start-up was that it was unable to borrow from financial institutions. The new business did not have assets to serve as collateral, nor did it

have a track record to show the banks. Hence, the role of family and friends in providing initial capital was highly important. At the very least, one could use strong kinship ties to serve as loan guarantors or credit references. Controlling for industry, the stage of a firm's development affected the source of resources for the following reasons:

- The scale of resource need was normally small at the start-up stage.
- There was uncertainty at the start-up stage due to a firm's lack of reputation and performance record (hence, it could not access financial institutions). For these reasons, family ties were essential.
- The nature of resource need was different at different stages of development. Therefore, source of resources was also varied.

A person's *guanxi* is thus highly relevant in the discussion of the choice of business relationship, especially in the early stages. The term *guanxi* refers to relationships or social connections built on pre-existing relationships of classmates, people from the same native-place, relatives and superiors or subordinates in the same workplace (Yang 1989, 41). In Chinese societies, the most common shared attributes for building personal networks are locality (native place), kinship, co-worker, classmate, sworn brotherhood, surname and teacher-student (King 1994).

To characterise the Chinese approach to social relationships, Fei Xiaotong (1992, 65) used the image of 'ripples formed from a stone thrown into a lake, each circle spreading out from the centre becomes more distant and at the same time more insignificant'. Within this mode of association, the society is composed not only of discrete organizations, but of overlapping networks of people linked together through differentially categorised social relationships. Yan (1996, 4) discusses three local categories in each person's network of *guanxi*:

- A **personal core** of close relatives: one's immediate family and close agnates and affines such as siblings, first cousins and wife's siblings.
- A **reliable core** of good friends and less close relatives who can always be counted on for help. The distinction between personal core and reliable zone is not always clear cut, because best friends may be regarded as closer than relatives and thus enter into the core of one's personal connections.
- An **effective zone** of relatives and friends in a broader sense. This normally embraces a large number of people and is more open to recruitment.

In social network theory, the equivalent of *guanxi* spheres is the contrast between strong and weak ties. A person's acquaintances (weak ties) are less likely to be socially involved with one another than are his or her close friends (strong ties). Thus the set of people made up of any individual and his or her acquaintances comprises a low-density network (one in which many of the possible relational lines are absent), whereas the set consisting of the same individual and his or her close friends will be densely knit (many of the possible lines are present) (Granovetter 1983, 201-202). An added dimension is that the individuals are usually members of multiple social networks and their ties can connect clusters. Such cross-linkages give clusters access to external resources and provide the structural basis for coalitions. At the same time, internal linkages allocate resources within a cluster and provide the structural basis for solidarity (Wellman 1983).

On the surface, one can argue that business relations can be established with anyone at all. If there is a choice, and everything else is equal, one will indeed prefer to deal with a kinsman or a person with whom one has something in common, or with whom one is at least acquainted (DeGlopper 1972). Still, networks are not exclusive: rather, ethnic Chinese are using their ethnic identities and values for their own benefit. Investment in China is done for economic advantage rather than for

reasons of their ethnic affection (Chen 1996, 7; Yeung 2000, 83-84). Wong (1991) found that small factory owners in Hong Kong depended heavily on particularistic connections to get business orders. Highly personal methods such as introductions and recommendations by former employees, friends and relatives were used, and impersonal channels such as advertising and sales promotion were seldom resorted to. The case studies indicate that both personal and impersonal channels are used to obtain orders. This is reflected in all the cases, as highly competitive environments necessitate going beyond one's particularistic connections.

The findings of the present study accord with other studies on Chinese business activities in Southeast Asia. A study of small-scale entrepreneurs in Singapore found that local and international trade through kinship links are rather untypical of Singaporean Chinese traders. Only four out of twenty three trading firms surveyed maintained local or international trade relations with kinsmen (Menkhoff 1991, 16). This study of Singaporean Chinese trading firms found that dialect or territorial solidarities, kinship or family connections are not per se a strong basis for Chinese trading networks and external economic dealings. The majority of the overseas trading partners of the respondents were non-kinsmen. This finding is contrary to others who have tried to identify the underlying 'secrets' of Chinese business connections in terms of far flung, global family and kinship ties (Menkhoff 1991, 202). Likewise, Wong (1988) concludes that kinship does not play an important role in regulating the external business transactions of Hong Kong Chinese enterprises. It has even been suggested that kinship reciprocity may under some circumstances curb the autonomy and freedom of the transacting actors (Menkhoff and Labig 1996).

Personal ties can furnish some clues as to who a businessman's potential partners might be, but a firmer basis for analysis is one of this study's core concepts: resource need. Complementarity of resources is a predictor of network formation (Grandori and Soda 1995). This study takes the underlying economic transaction as the first point of analysis, rather than looking at the nature of a businessperson's ties as the first consideration. When an economic basis for an IOR has been established, how then do businesses choose with whom to transact? The next section deals with this issue.

Trust and reputation

Is trust a precondition for exchange? Or is it possible to engage in a transaction without the presence of trust? The companies in the study evaluated other firms in terms of the latter's reputation with a view to gauging initial trust or distrust. The reasons why companies may not have full trust in their business relations were because:

- A large number of important business relations were not with those with whom the businessmen had strong ties. Initially, they may not have had sufficient experience with their partners to evaluate trust.
- The choice of partners was not infinite (small numbers bargaining), but the situation of some choice is discussed below. This was because it was not always possible to choose partners whom they trusted, as in the case of JJ Chemical.
- It was possible not to have trust, but not possible to have IORs with strangers. 'One does not do business with people one does not know' (De Glopper 1972, 304). In cases of distrust, safeguards were built into the relationship.

How was trust evaluated? Interfirm trust is incrementally built as firms repeatedly interact (Gulati 1995, 92). Familiarity is a precondition of trust but not identical with it. The case of JJ Chemical's joint venture with Nippon highlights the

observation that trust is not necessarily a precondition for IOR. Reputation is. JJ's evaluation process hinged on three points of reference: a common tie, tangible evidence, and company reputation. Armstrong and Yee's (2001) study of ethnic Chinese business in Malaysia also found that an organization's reputation influences interaction between industrial buyers and sellers.

A common tie represented a similar point of reference between a company and another party. This can take the form of a reference from someone whom the businessperson knows. New buyers coming to MM Textiles' office always attempted to establish their credibility by introducing themselves in relation to someone MM Textiles' officers knew. All this was done in the hope of getting discounts on the prices and, eventually, establishing a credit line with the firm. MM's first customers were its former competitors in the textile trading business.

In order to gauge the reliability of a company, MM Textiles and SS Sawmill looked for tangible evidence such as the other party's shopfront or office premises and assets such as machinery, equipment and transport equipment. When MM Textiles' John Yu was setting up the company's first set of textile retailers, he would go to the Divisoria area almost every day. At the same time as he was trying to sell his company's products, he was also investigating his potential buyers and observing each store's location relative to its competitor, the shop size, and merchandise stocked.

The company's reputation, apart from owner's reputation, was another point of evaluation. Where were the sources of information for evaluation? This was where the businessman's social ties came into play, as he could obtain information about other businesspeople through business association meetings, as well as hometown meetings and social gatherings. John Yu was president of his hometown

association, as was his father before him. Often, John was the first person to know about the business difficulties of a member of the association, as the member would use the association as a source of financial assistance. It should not be assumed that one completely trusted one's *guanxi* sphere. Pragmatically, however, it was easier to evaluate the trustworthiness and reliability of one's strong ties.

Personal reputations and prior relations are important factors in explaining the formation of ties. Knowing the people and knowing their capabilities (firm reputation) are two prime considerations. The first is a social relations aspect and the second an economic aspect. Mutual economic advantage is necessary but not a sufficient rationale. An obvious incentive is the primary economic exchange, defined as the economic value of the annualised economic transaction. The more important economic dimension, however, is the growth of the transaction as an incentive. Within this second phase is a trial period which enables the development of trust. Two key dimensions within this trial period are the institution of rules and procedures that introduce into the exchange a predictable structure and a basis for performance and monitoring that provide stability and efficiency and the evolution of clear expectations within each alliance (Larson 1992). This second phase is the subject of the next chapter.

6.6 The essential network

The core group of crucial customers and suppliers to the case study firms is what this research terms the **essential network**. Larson's (1992) research into smaller companies found that they used a limited but dense network of exchange relationships as vehicles for growth.

What qualifies a partner to be included in this network? The first is the volume of business activity accounted for. In the case of buyers, it is the volume of

sales revenue. For suppliers, it is the total purchase volume. What about finance and technology partners? It is the importance of their contribution to the firm's strategic direction and growth. This group changes, however, as the business environment in which the companies operated changes. In the case of JJ Chemical, a customer (Nippon) became a joint venture partner. In another, MM Textiles, a certain group of customers declined in importance while another group took their place.

AA Plastics stood out because it was the only case study firm with its essential network composed of close family members. The firm's manager emphasised the strong trust that existed within the network, yet she was strongly pushing for improved formal documentation of transactions with suppliers and buyers. JJ Chemical's critical partner was with a foreign company and both parties had made asset-specific investments in the activated charcoal plant. A special factory was built to produce an industrial product that had specialised applications in cigarettes, water filters and minerals processing.

MM Textiles had an essential buyer network composed of agents, wholesalers, and its garments joint venture. The firm also used its competitors as alternate sources of services for textile finishing, a unique situation that can be explained through economic reasoning: the company desired to keep its customers happy even if this meant sharing some profits with competitors.

Both SS Shipping and GG Shipping's essential network were composed of industrial customers but SS had the added strength of an alliance behind it. FF Food had a key set of suppliers and it was increasing its dependence on them by assigning even more functions to these suppliers. Finally, KK Stores also had a key set of

long-time suppliers. It also relied upon certain financial institutions for capital projects such as shopping mall development.

The essential network is the sum total of a firm's strong bonds. Bond strength is defined as the 'capacity to withstand a disruptive force' (Easton and Araujo 1989, 101). This strength does not equate to longevity or complexity; these are surrogates for bond strength but not strength itself (Easton and Araujo 1989). The dimension of frequency refers to transactions and to the mobilisation of relations, and must be distinguished from the criterion of durability, applied to roles. Some role relations may remain latent for years without withering away (particularly those defined in close kin terms) whereas others, such as those of friendship, may call for continual mobilisation if they are to persist. Also, high frequency of contact does not necessarily imply high intensity in social relationships (Barnes 1972, 18).

Weak bonds can also be important in three types of situations. First, infrequent purchase: where there is no regular contact between organizations, it is likely that strong bonding does not exist. Nevertheless, key technical decisions made at a particular point (e.g. capital equipment decisions) may tie the organizations together for long periods, at least economically and technically, though other evidence of strong bonding is absent. This was the case for JJ Chemical.

Second, small volume purchases would tend to suggest weak bonding. However, where these purchases are essential in terms of technical features, quality or delivery, strong bonding can and does occur.

Finally, some firms choose not to develop strong bonds despite obvious contextual benefits from doing so. They may prefer flexibility to economy (Easton and Araujo 1989).

The entire core relations of the firms studied exhibited what Uzzi (1997) terms embedded exchange. Characterised by informal ties rather than explicit contracts, these relations exhibited thick information exchange of tacit and proprietary know-how. These companies' strategies manifested elements of satisficing rather than maximising on price, as there was a demonstrated reluctance to shift from one partner to another, except in cases where the product was of a generic, non-asset specific nature. However, the utility of these embedded relations, and the resulting depth of exchange and learning, were ultimately dependent on the company's ability to provide coordinating devices within the firm in order to promote knowledge and learning from the relationship. The next chapter discusses this issue.

Chapter 7

Consequences of Relations

The core concept that resulted from the data analysis is **resource need** as an impetus for forming interorganizational relations (IORs). Chapter 5 discussed the resources needed by the case study firms. Chapter 6 proceeded to elaborate on how the firms gained access to these resources. This chapter addresses two questions: What are the outcomes from access to resources? How do IORs change over time?

Outcomes of IORs are discussed in this chapter in terms of tangible and intangible benefits and costs. Tangible benefits are strategic and financial: generating additional profits, improving market share, and sustaining competitive advantage. Intangible benefits are learning or knowledge-based such as acquiring specific skills and competencies (Kogut 1988; Parkhe 1991) or simply learning how to learn from collaborations. Intangible outcomes are more difficult to quantify and usually manifested over a longer period of time. The discussion then proceeds to encompass opportunism within IORs. How do firms try to prevent or reduce the possibility of exploitation within their relationships? Finally, what changes are observed over time? Four important areas are examined: the level of trust, dependence and power asymmetry, cost reduction and quality issues, and exit (termination).

7.1 Tangible outcomes

The strategic importance of a network arrangement is that it allows a firm to specialise, enjoying the benefits of specialisation, focus and size. The other activities are then farmed out to members of the network. By farming out activities,

a firm can lower its costs for those activities it keeps inside, because it can reap economies of scale and develop distinct competences (Jarillo 1988, 36). The tangible outcomes from IORs are grouped under the four categories of (a) economies of scale, (b) economies of scope and synergy, (c) economies of specialisation and experience and (d) other factors.

Economies of scale

Economies of scale were manifested by the case study firms through achieving the same ends with fewer resources or producing the same unit at less cost. There are economies of scale in some interval of output if the average cost is decreasing there (Eatwell, Milgate, and Newman 1994). SS Shipping's strategic alliance enabled the company to achieve increased efficiency, as the CEO explained:

When you see a duplication or triplication of schedules nationwide among the three of us, we only have so much market. So even before the liberalisation, I'd already been talking to my colleagues.

After the alliance, the three partners operated at their combined volume with lower total costs. The savings came from three sources. First, the alliance was able to obtain leverage from suppliers due to greater purchasing volume. Second, instead of three separate sales branches in Cebu, their base of operations, these were combined into one. Similar streamlining was done for branches in other parts of the country. Third, they were able to cut their land-based workforce by half, from 1000 to 500 employees.

Networks capture economies of scale for their associated firms (Jarillo 1988; Johanson and Mattsson 1987). Strategic alliances are characterised as 'resource pooling coalitions' aimed at the provision of common services (Grandori and Soda 1995; Johannisson and Monsted 1997; Lorenzoni and Baden-Fuller 1995).

The strategic alliance of SS Shipping was also motivated by survival. The argument for the decision was that if these three companies could not compete with foreign entrants in terms of efficiency and service, then they would lose market share, eventually going out of business. Indeed, it can be inferred from Chapter five's resource needs analysis that survival was a long term goal for many firms' IOR decisions. Another outcome of IORs was that they permitted firms to widen their range of activities without increasing their size.

Economies of scope and synergy

Economies of scope can be the basis for the formation of agreements for the joint utilisation of equipment or know-how (Teece 1980). In this context, alliances allow organizations to extend their range without increasing in size (Redding 1994, 80). By forming cooperative relationships, companies are able to share equally in the costs and benefits of market research and development and gain expertise in other needed areas (Alter and Hage 1993). From a resource dependence perspective, small firms in Scandinavia use networks to complement their own limited resources (Johannisson and Monsted 1997). Another benefit is that IORs allow firms to avoid making investments in up-to-date machine tools (Jarillo 1988; Lorenz 1988).

The ability to forge upstream and downstream linkages was the first important outcome of extending a firm's scope of activity, but equally significant was the fact that IORs enabled firms' diversification to unrelated activities. MM Textiles entered into a joint venture to manufacture garments with two young businessmen whose fathers John Yu knew. This venture allowed MM to diversify into downstream activities by producing finished products for the domestic consumer market. In this case, it also permitted the efficient pooling of resources. Both parties contributed what were idle assets at that time to the venture. MM's

partners contributed a piece of property for the factory site. MM had about a dozen pieces of garment-manufacturing equipment (sewing machines, buttonholers), repossessed from a customer who had defaulted on his payments. Equally important was that the joint venture utilised raw materials (textile fabric) produced by MM. This reinforces Redding's (1994, 80) observation that Chinese firms' network alliances enable them to transcend the limitations of their own small scale.

Could MM not have established the garment business by itself? John Yu acknowledged that his firm was limited by managerial capacity, as there were not enough family members to spare to manage the new venture. Hence, the decision to network rather than internalise was not only taken on the basis of costs. The company left the management of the venture to its two partners, with one of John Yu's brothers being the company's representative to liaise with the partners.

JJ Chemical's joint venture with Nippon Trading was built on JJ's access to coconut raw materials and Nippon's access to technology and international marketing channels. The economic outcome was extremely positive, and JJ experienced excellent sales growth after entering into the venture. In its joint venture, China Construction (CC Construction) contributed technical know-how while a local partner was responsible for hiring local workers and arranging subcontractors. The former also contributed the heavy capital equipment.

If economies of scope enable organizations to pool resources and extend their range of activities, the third tangible outcome pertains to the benefits that accrue to an organization as a result of its concentration on and development of its core competency.

Economies of specialisation and experience

If a diversified corporation can be conceptualised as a large tree, then the trunk and major limbs are core products, the smaller branches are business units, and the leaves, flowers and fruit are end products. The root system that provides nourishment, sustenance and stability is the core competence. Core competencies are the collective learning in the organization and represent its ability to coordinate diverse production skills and integrate multiple streams of technology (Prahalad and Hamel 1990). The ability to concentrate on one's core competency is an important pillar supporting the economies of specialization argument in favour of business networking. Economies of specialisation and experience have been cited as an important factor in explaining why, even in the presence of significant interdependence, a network of separate firms may be superior to an integrated enterprise (Eccles 1981).

Firms in the network enjoy the added flexibility of not having fixed commitments to activities that are not essential to them (Jarillo 1988). Dunning (1995, 468) terms this a 'concentrate on critical competency' response. The flexibility and focus that result from networking rather than integration can be extremely powerful competitive weapons, especially in environments experiencing rapid change (Jarillo 1988). Networks are, therefore, 'lighter on their feet' than hierarchies (Powell 1990).

An important outcome of being able to enter into IORs is that this frees up an organization's internal resources and enables it to concentrate on its core activities. KK Stores deliberately pursued a strategy of concentrating on merchandising. By passing on the functions of product research and development to suppliers, Wallace Tan of KK Stores commented that 'this may be close to an ideal arrangement'.

Product manufacturers knew their industry best, he continued, having at their fingertips up-to-date information about latest fashion trends and product availabilities. By allowing suppliers to take on R&D, KK did not need to allocate resources to keep tabs on product developments in so many product areas, thus freeing resources to enable it to concentrate on its core competencies.

Price was not the only basis for exchange. A more important aspect of the relationship was the provision of value-added services by KK's suppliers. Could the company purchase similar products from other suppliers? Certainly for products which did not depend on brand appeal, the company could switch from one supplier to another. However, KK and its core suppliers exchanged more than the product; they exchanged intangible services as well. These included R&D and flexible payment and delivery arrangements. They also shared the advertising expenses and other selling costs (such as the cost of special display stands in the department stores).

John Ongseco saw the alliance of SS Shipping with the two other shippers as benefiting from the skill complementarity of the three participants. He remarked

We are good in the long haul, while Jim's company is good in the shorter runs. The Ramirez family contributed their skill in computerisation.

Furniture exporters in Cebu used an elaborate system of subcontracting with each firm specialising in a particular item. Rattan furniture, for example, could comprise different materials: wrought iron legs, leather arms, and so on. Different firms, many of these home-based, specialised in manufacturing these components and ensured good quality while keeping costs down (Tan 1996).

Other factors

Other outcomes in the firm's IORs provided competitive advantages to the case study firm by reducing costs or allowing access to certain resources. Corruption costs were reduced by CC Construction because it aligned with local companies. Many case firms' IORs allowed them access to credit, supplies and markets.

In the case of CC Construction, the joint venture with a local partner was a cost-effective way of dealing with corruption in the construction industry. From a political point of view, a local company would be charged less in terms of bribes and kickbacks than a foreign company, as the general manager of CC Construction explained.

Another benefit is preferential treatment in terms of product supplies. This occurred with SS Sawmill, who gave its five core buyers first choice of lumber. This kind of arrangement became quite valuable in times of supply shortage.

Wong's (1995) study of subcontracting in Singapore found a similar ranking of suppliers, with the higher ranked suppliers usually given higher order volumes and higher preference for new contracts involving higher value-added contributions. In times of business downturn, the lower-ranked suppliers tended to be affected first while the higher-ranked suppliers were better protected.

SS Sawmill's main log supplier gave price protection to the company as a wholesale distributor. If a supply shortage occurred, no special preference was given to various distributors. They competed among themselves on the basis of the amount of cash upfront that they could put forward. The analysis of resource needs in this study has identified suppliers as important business partners and preferential, ranking behaviour as another dimension of the supplier-buyer relationship.

Access to credit was another advantage that participants in an IOR benefited from. Credit was never given to strangers, but on the other hand not all regular customers had lines of credit. The previous chapter discussed the process of evaluating creditworthiness. The clear economic benefit from being able to purchase goods on credit was that the buyer was able to (a) do a bigger volume of business and (b) use proceeds of his own sales somewhere else while payables were not yet due.

Credit is not the same as provision of financial capital. Credit is hidden and is not immediately noticeable or evident as an important source of finance. This practice of using credit to expand one's business without resorting to borrowing has been noted since Spanish times (Chapter 3).

FF's flexibility in terms of ownership arrangements has enabled the company to achieve a rapid rate of growth. From one store in 1985, it had 140 stores in 1997 and 200 in year 2000. The example of opening its store in Pampanga illustrated how FF was able to reap first-mover advantages. It was the only fast food type outlet in the area and enjoyed high sales growth.

One exception to the mutual advantages that IORs usually provided was JJ Chemical's joint venture with Chinese partners to manufacture mosquito coils. In this case an unsuccessful venture was kept going, even though it was 'inefficient'. Does this make sense economically? If one looks at it from a short-term point of view, this appears to be an unwise economic decision. From a longer term point of view, the 'failure' of the joint venture would reflect badly on the reputation of Honorio Wu, who was responsible for inviting the Chinese investors to Cebu. As noted in Chapter 2, one could argue that the primary motivation for maintaining the

arrangement was not to make a profit. The economic loss was acceptable in exchange for providing prestige and political credit to the family.

7.2 Intangible outcomes

Intangible outcomes refer to results that are not easily quantifiable, but can be observed nonetheless. These include joint problem-solving, information exchange and learning. Powell (1990) argues that networks are particularly apt for circumstances in which there is a need for efficient, reliable information. The most useful information is rarely that which flows down the formal chain of command in an organization, or that which can be inferred from shifting price signals. Rather, it is that which is obtained from someone whom one has dealt with in the past and found to be reliable. Information that comes from someone one knows well is trusted best. Kaneko and Imai (1987) suggest that information passed through networks is 'thicker' than information obtained in the market, and 'freer' than that communicated in a hierarchy. Networks, then, are especially useful for the exchange of commodities whose value is not easily measured. Such qualitative matters as know-how, technological capability, a particular approach or style of production, a spirit of innovation or experimentation, or a philosophy of zero defects are very hard to place a price tag on (Powell 1990).

Joint problem solving

Joint problem solving is quite common and very important but often goes unnoticed. It involves suggestions and technical advice from clients and the introduction of improvements to business processes (Uzzi 1997). Day-to-day problems between MM's fabric dyeing and finishing department and customers were often jointly resolved. At one stage, the researcher noticed that MM's dyeing and finishing department was having difficulty producing virgin white fabric: it was

coming out yellowish. With the help of MM's chemical supplier, different formulations were tested and the water temperature adjusted until the right colour emerged. MM's laboratory staff had instruction manuals to mix the dyestuff, but the head technician explained that these formulae did not always work in practice. Other variables such as water temperature, water quality and residues affected the end result. MM's chemical supplier had over thirty years' experience in the industry and had helped MM produce the difficult colours such as white and blue.

GG Shipping's CEO prided himself on his company's reputation for flexibility. Customers expected personalised service, which, from Mr. Lim's point of view, translated to problem-solving on a case-by-case basis. This was an effective way of relating to the customer, he stressed, because he or she was able to speak to the managers personally. 'Joint problem solving' in this case pertained to pricing flexibility, delivery arrangements, scheduling and prioritising, and even negotiations on credit terms.

The objective of mutual benefit was also demonstrated in the relationship between FF Food and one of its dessert suppliers. Having started as a home-based business, the dessert manufacturer had encountered quality control problems. She had packed various dessert ingredients (red beans, coconut slivers) in glass jars, but the stores had found broken glass inside the bottles. FF's solution was not to exit from the relationship but to work with Mrs. Lopez, the owner of the business, by experimenting with various packaging materials and different container designs to ensure that the contents would be free from contamination during the delivery process and storage period. The effort and time expended by FF went uncoded; FF did not bill the supplier for its assistance nor did the supplier charge FF any

additional costs for experimentation. Both parties developed a plastic package together that solved the problem.

JJ Chemical's relationship with one group of buyers, the mining companies, likewise illustrates the benefits of joint problem-solving. Johnny Wu paid regular visits to the mining sites and conferred with the managers regarding their product requirements. This was a way to increase dependency of the users, because price was not the only basis for exchange. Service was also important, in this case JJ's commitment to manufacture the activated carbon according to the miners' specifications. Johnny has to demonstrate his company's willingness and ability to manufacture according to the technical specifications as well as the willingness to adjust production schedules according to demand.

Information exchange

Information is important in doing business (Ben-Porath 1980). It is especially valued in highly uncertain business environments, which can be characterised by the (a) difficulty of finding reliable information, (b) speed at which things change, and (c) impenetrability of local networks (Redding 1995, 65). There are, according to Ben-Porath (1980), advantages of scale in the use of information. In addition, the identity of whoever transmits or shares information is important in evaluating it. These elements may increase the returns to cooperation based on personal contracts.

One's IORs can provide a businessperson with several types of market information, ranging from local demand and supply conditions to information regarding one's buyers, suppliers and competitors. The sawmill manager declared

Because we have been in operation for a long time and are quite a big player, market signals reach us through phone calls from various

agents and customers. If a customer is looking for a particular type of wood, it's an indication that there is a shortage or tight supply of this particular stock.

This type of information is valued because it is not readily available, and users demand quick information for rapid decision making. The benefits in non-economic terms for the firm are fast cycle time to market, improved quality, high-quality decision making and improved competitiveness (Smith, Carroll, and Ashford 1995). Indeed, the accounting manager at SS Sawmill made it a habit to check prices every morning by phoning around. She revealed that their own selling prices were adjusted according to the supply and demand conditions in the market.

The process of deciding whether to accept or reject a new buyer or supplier was often based on personal sources of information. One's IORs played a crucial role in the provision of information to assist in this decision, or what Uzzi (1997) terms 'expert rationality'. What kind of information was exchanged? The most common was information about other companies, which served as the basis for credit evaluation and sometimes imitation (of business strategies). Although credit rating agencies existed in the Philippines at the time of this research, they were of limited use as they only covered the largest companies. Certainly the case study firms believed that the agencies were often unreliable and that their information was out-of-date. Information was also exchanged in the areas of government policies and regulations affecting business activities, such as foreign exchange guidelines, import controls and industry deregulation.

MM Textiles evaluated its new customers based on information gathered from other companies in the industry. The usual procedure was for the sales manager, Mrs Yu, to ask the prospective buyer or supplier to provide referrals from

other companies he or she had previously done business with. Mrs. Yu also tried to get the views of the sales agents. If she did not get favourable feedback from these sources, she then decided against doing business with the person. However, if the person represented a large and well-known company, she tended to accept the order but started with a small transaction.

More rapid flow of information stems from relationships of trust and mutual dependency. In the textile industry of Japan, for example, news of impending changes in final consumer markets is passed more rapidly upstream to weavers and yarn dyers; and technical information about the appropriate sizing or finishing for new chemical fibres is passed down more systematically from the fibre firms to the beamers and dyers (Dore 1983).

Learning

Learning is broadly defined as 'the ways firms build, supplement and organize knowledge and routines around their activities and within their cultures, and adapt and develop organizational efficiency by improving the use of the broad skills of their workforces' (Dodgson 1993, 377). The case study firms deliberately pursued learning as an objective in IORs.

There are two general types of learning associated with the case studies' IORs. The first pertains to learning new things, such as entering new markets (Osborn and Hagedoorn 1997) and learning a new process or acquiring new technology. The second is learning to innovate and improve processes.

CC Construction's joint venture with Local Construction Company (LC Construction) was primarily to learn about the local Philippine construction market. CC Construction recognised that entering into a joint venture with a local Chinese

partner was the quickest way to achieve this goal. CC Construction was a large construction company owned by the government of China, with operations in almost every country in Southeast Asia.

In addition to the need to learn about a new market, CC Construction was also keen to become familiar with Philippine business culture. How did the company learn? Teams of professional managers and engineers were assigned to projects, with the Country General Manager overseeing project performance. Projects in the Philippines have included highways and bridges, and the firm was planning to go into real estate development by constructing housing subdivisions. CC Construction's joint ventures were on a per-project basis. It began with joint ventures with LC Construction. After two years in the country, it was also entering into contracts with Filipino-owned companies. This was because, the CC Construction's country manager remarked, Chinese firms were 'too clever' in the negotiations, and CC Construction ended up with very tight profit margins.

Learning occurs in joint ventures by developing competencies and borrowing/developing/lending new ideas (Hobday 1990; Lorenzoni and Baden-Fuller 1995). Learning is a dynamic concept and is undertaken to improve competitiveness, productivity and innovation in uncertain technological and market circumstances. In fact, it is argued that the greater the uncertainties, the greater the need for learning (Dodgson 1993).

JJ Chemical's joint venture with the Japanese company enabled JJ to acquire knowledge about international marketing strategies. This came at a cost: the sacrifice of short-term profit. Johnny Wu reflected:

I'm sure that in the first five years, they made a lot of money. Because they handled all the marketing and we had no knowledge about

activated carbon, we did not know how to sell. So for the first five years, it was a learning stage for us. All marketing was done by them, so I'm sure they made a lot of profit.

This quote reflects the long-term view of JJ Chemical, one that was echoed by other case studies. The firms were willing to forgo short-term profits in anticipation of long-term gains. This was true even when the firms were aware that the other party gained more advantage at the beginning of the venture (power asymmetry). Twenty years after the joint venture was established, JJ did not know the Japanese market because it was not able to directly participate in Japanese marketing. However, it has been able to successfully export to new markets in Europe, the US and Australia. How did JJ learn? Marketing was the responsibility of Johnny Wu, and learning was limited to him. His marketing team was quite active in the domestic market but international marketing was all done by himself and Nippon.

AA Plastics knew that its Taiwanese partner was reaping commissions from purchasing machinery on the firm's behalf, but needed the technology that this partner could bring to the new venture. MM Textiles likewise had to give in to a Taiwanese businessman's request for minority equity in the dyeing business, as he had the expertise to set up the factory. MM Textiles eventually bought out his share in the venture.

The discussion so far has centred on the positive outcomes from IORs. The next section focuses on the possibility of opportunism within IORs.

7.3 Opportunism

Opportunism is defined as 'self-interest seeking with guile' (Williamson 1991, 92) What makes one opportunistic act different from another? What is the

difference between delaying payments (extending credit period) and absconding? Why would JJ Chemical tolerate delayed payments (of mining companies) and uneven profit sharing with Nippon Trading? Are these not opportunistic acts of the other parties?

Among the case study firms, it could not be said that perfect trust existed within their IORs. Nevertheless, all safeguards in the world will not be enough if another person deliberately sets out to be dishonest (Johnny Wu). Businesses also avoided legal recourse, unless they wished that the tie be permanently severed.

Misunderstanding and errors can occur from informal transactions. As discussed in the case of AA Plastics, errors occurred with both suppliers and buyers. This did not represent opportunism, but rather mistakes and misunderstandings arising from the attribute of agreements. In the case of suppliers, errors occurred most often in the areas of price and quantity, as most orders were placed over the phone. With their buyers, the disagreements occurred with quantity and delivery agreements.

The methods by which case firms evaluated their business partners were not fool-proof. There were several cases of default payments by buyers. MM Textiles has faced several cases of buyers behaving opportunistically, in terms of absconding on payments. To illustrate with an example, there was a Filipina businesswoman who purchased fabric from them and paid in cash at the outset. After about a dozen transactions, she asked for a credit line, which was granted by the credit manager, Lilian. Being a prompt paying customer, the businesswoman eventually amassed a liability of approximately 3 million PhP. Her cheques then started to 'bounce' (be dishonoured) and it was only at this point that the manager was aware that something was wrong. The businesswoman eventually vanished and the shop she

was operating from emptied. What was MM's recourse? Cooperation between MM Textiles and other firms was observed when this crisis occurred. Lilian proceeded to inform other businesses that she had a customer who was dishonest. The firms she informed were MM's supplier firms. She did not include competitor firms, because she said they would be in competition to confiscate the defaulter's property. Nonetheless, Lilian was not able to recover the full amount. She was able to repossess a used delivery truck and a few sewing machines, but these were not enough to cover the loss.

But what did this episode imply for MM's credit evaluation system? In hindsight, Lilian reflected that she probably ought to have checked the businesswoman's background more carefully and avoid extending a large amount of credit in a short span of time. 'Everyone's doing it though', she continued, 'so if we do not give credit, we will lose out on the sale.'

Case study firms predominantly relied on credit evaluation systems that incorporated information from their personal ties, but the final decisions varied between the firms. MM Textiles appeared to have the highest default rate as a percentage of revenue. SS Sawmill had a low rate (less than 5 per cent of revenue), as they required cash payments from new customers. For those who have credit accounts, the company used the Chinese sales representative to monitor their business condition. SS Sawmill's manager remarked about credit:

If I decide to give credit to a customer, I usually start with a small amount after asking around about this businessman. What will give me added confidence is if he had a shopfront. It will be more difficult for him to abscond in this case.

MM's contact with credit customers was more sporadic. For service businesses such as the two shipping companies, the outstanding amounts were not very large, as these involved service charges for shipping and haulage, for instance. KK Stores and FF Food both sold on a cash basis. JJ Chemical also had a low default rate, as Nippon Trading accounted for most of the activated carbon sales. AA Plastics had a low default rate, but payments were often delayed.

Lorenzoni and Baden-Fuller (1995) talk of trust and reciprocity as complements, not substitutes, to other obligations. The Benetton clothing company does not use legal contracts in Europe; rather it relies on unwritten agreements. This, it claims, focuses everyone's attention on making expectations clear. It also saves a great deal of time and expense.

One of the ways in which positive behaviour is encouraged is to ensure that the profit-sharing relationship gives substantial rewards to the partners. None of the central firms that Lorenzoni and Baden-Fuller studied seeks to be the most profitable firm in the system; they are happy for others to take the bulk of the profit. In Benetton, a retailer may find his or her capital investment paid back in three years. In Corning, some partners have seen exceptional returns. This seemingly altruistic behaviour, however, does not mean that the rewards to the central firm are small (Lorenzoni and Baden-Fuller, 1995).

In a study of local subcontracting networks established by multinational corporations in Singapore, Wong (1992) concluded that spillover benefits confirm the importance of informal, non-contractual processes that accompany business relationships. One deterrent factor on short-run opportunism is the likely adverse effects it has on reputation in the long run. The existence of spillover benefits suggests another important deterrent factor to opportunism: the foreclosure of future

opportunities of gaining information/know-how access through the subcontracting relationship. Three factors reduced the probability of opportunism for the case study firms: outcome interdependence, risk spreading and social control.

Outcome interdependence. Outcome interdependence can be a solution to opportunism, since its structure influences the accompanying behaviours and results in particular attitudes and approaches to exchange (Axelrod 1984; Jones 1993). Conflict research suggests that positive goal interdependence (joint payoff) increases productivity, the exchange of ideas and information, and emphasises mutual interests (Jones 1993). These lead to cooperative behaviour and the establishment of trust and cohesion among participants in the exchange.

A type of non-legal sanction is the most obvious: both business units involved in the exchange desire to continue successfully in business and will avoid conduct that might interfere with attaining this goal. 'One is concerned with both the reaction of the other party in the particular exchange and with his own business reputation (Macaulay 1963, 63)'. Buyers can withhold part or all of their payments until sellers have performed to their satisfaction. If a seller has a great deal of money tied up in his performance that he must recover quickly, he will go a long way to please the buyer in order to be paid. Moreover, buyers who are dissatisfied may cancel and cause sellers to lose the cost of what they have done up to cancellation. Furthermore, sellers hope for repeat orders and one gets few of these from unhappy customers.

A situation of mutual dependence and mutual self-interest was created by JJ Chemical and its suppliers of corn by-products. Honorio and his brothers had developed a machine adapted to local conditions for corn milling, the idea taken from Taiwanese machinery they had imported. The brothers were clever enough to

modify the design and produced their own equipment for the Cebu market. After selling this machine around the province, the brothers requested these mills to sell the corn by-product back to JJ. This clever arrangement resulted in a long-term IOR between JJ and its suppliers. The mills were dependent on JJ for technical support and, in turn, JJ was assured of a stable supply of cornmeal.

The interdependence of outcomes is also illustrated in the relationships between Chinese wholesalers and European trading houses during the Spanish era discussed in Chapter 4. Credit was given by the trading houses to Chinese merchants in exchange for these merchants supplying the Europeans with agricultural commodities. The situation with the case study firms was similar. Many had exclusive arrangements in exchange for protection, as in the case of AA Plastics' five exclusive distributors who were not allowed to sell any other products on the understanding that the company would give them exclusive distributorship.

Risk spreading. To avoid one-sided dependence, an organization may wish to restrict interaction with a given party by extending its networks, as in the case of split sourcing (Thorelli 1986). Buyers can place orders with two or more suppliers of the same item so that default by one will not stop the buyer's assembly lines (Macaulay 1963). Multinational companies in Singapore appear to practice multiple sourcing to insure against over dependency on one subcontractor (Wong 1992, 35). Yeung (2000, 79) also concludes that Chinese family firms managed risks by minimising commitments and maximising flexibility. This study also found risk management through multiple sourcing a common practice among case firms, even though they repeatedly stated that they had long-term relationships with their buyers and suppliers.

The sawmill industry was plagued with high uncertainty, changing government regulations, and fluctuating demand and supply conditions. SS Sawmill had longstanding relations with several Chinese log importers and was able to leverage one against the other in search of lower prices or, in times of high demand, larger quantities of supplies. MM Textiles purchased from two yarn suppliers on a regular basis because quality was important and these suppliers were reliable. 'Of course,' Jose Yu reiterated, 'if we had a problem we would shift suppliers. But as long as we are happy with the service, we will not change our suppliers.'

Social control. Belonging to a community discourages opportunism, because if one behaves dishonestly, one's reputation may be destroyed within that community. Is opportunism averted because the benefits of being part of the group outweigh the benefits of opportunism (shadow of the future)?

Social control mechanisms act as constraints on opportunism (Jones 1993). These mechanisms include the development of collective and metanorms through peer or mutual monitoring to enforce these norms (Axelrod 1984), reputational effects, and exclusion (Jones 1993). These social controls allow for the effective use of relational contracts under conditions of uncertainty with asset specific transactions. Moreover, recurring relations provide the context in which norms and expectations develop to govern the relationships. Thus, asset specific investments do not have to be housed within a firm to protect them (Jones 1993). Self-interest curbs opportunism (Eccles 1981). Opportunism is attenuated by the likely adverse effects it has on reputation in the long run. Reputation and identity can therefore function as controls (Larson 1992).

Why do Chinese businesses prefer to do business with each other? IORs with non-Chinese have been noted, but the majority of longstanding ties in this

research were still with people of the same ethnic background. The predominance of Chinese business networks can be attributed to their sharing of a common set of unwritten rules and the ability to be identified as a group, as seen in Chapter 4. This observation does not only apply to Chinese communities, but can also be seen in other immigrant societies (Koreans in the United States and Jewish diamond traders, for example). The common denominator is the ability to identify persons belonging or not belonging to the group and mechanisms for regulating behaviour within the group. To illustrate, there is a tendency for most businesses in the Philippines, whether Chinese or Filipino, to under declare income. Hence, one cannot assess the true financial picture of a business from financial statements. There is a self-interest motive to keep business within themselves since there will be mutual protection (less chance of snitching to authorities, for example).

It should be clarified that the social control mechanisms are not deliberately regulated. This notion is in contrast to Miles and Snow's (1992) arguments that key managers in partner firms may function in the role of 'caretakers' who engage in nurturing and disciplinary behaviour. When a firm exploits its position in the grid - for example, by obtaining some short-run gain at the expense of its actual or potential partners- the caretaker's challenge is to point out the dysfunctional effects of such behaviour and teach the offending firm how to behave more appropriately for the common good (Miles and Snow 1992, 17). This is theoretically reasonable but not feasible in practice, at least not with the case firms studied.

7.4 Change over time

As an organization contracts with another for a length of time, familiarity and knowledge about the other increases. This does not necessarily equate to increasing trust. It does mean, nonetheless, that the other is able to predict its

partner's actions more accurately. Over time, one partner can also become more dependent on the other (power asymmetry). Costs (including transaction costs) can also decrease. Finally, IORs may come to an end (exit).

Level of trust

The emotive terms used in relation to the ethnic Chinese case are equally observed in relation to the French. An 'incomplete contract' indicates that the initial agreement serves as the reference point and adaptations will have to be made. Time and experience are elements in deciding whether or not to trust (Lorenz 1988).

A remarkable development from FF's IOR with its dessert supplier was that the latter handed over her recipes to FF so it could manufacture the product in Cebu. How was this possible? FF was expanding into the southern part of the Philippines and required a substantial amount of regular dessert supply. Mrs. Lopez, however, was hesitant to establish a manufacturing facility outside of Manila. She could only manage the business in Manila. FF then arranged, for a small fee, for Mrs. Lopez to set up a manufacturing facility in Cebu. Included in this arrangement was her training of the production staff and disclosing her recipes for the various sweet products. Mrs. Lopez put her business at risk with this action: FF could decide to manufacture all the dessert requirements on its own now that it had possession of the recipes. Yet she trusted the company to abide by the agreement that production would only cover Cebu.

Trust can also become institutionalised. Wallace Tan of KK Stores said

Right now, people in our position [of CEO] hardly know our suppliers. Fifteen years ago, I knew all our suppliers, but right now I hardly know our suppliers because they are changing and most of the ones who are very close to us, their children are taking over, so I hardly know them anymore.

Wong (1991) argues that familism found in Hong Kong is impermanent. Since sons are equal heirs in a Chinese family, there is an inherent tendency towards segmentation in the life cycle of the family. As the family is not a permanent entity, family reputation is likewise short-lived. The Chinese family does not furnish a secure basis for long-term business trust to be maintained. Therefore, entrepreneurs are fully aware that trustworthiness is essentially tentative and transient, and personal trust has to be continually renewed.

An increased level of trust was demonstrated through increased capital investments. FF Food suppliers made capital investments in food processing equipment over time, thus increasing these suppliers' dependence on the firm.

Dependency and power asymmetry

FF Food's relationships with its suppliers have changed over time. These suppliers were chosen through personal connections and referrals from staff. Gradually, the functions of its suppliers began to change. From supplying generic products such as flour, meat and vegetables, these businesses began to take on more of the processing activities at the initiative of FF Food. FF would negotiate with the pork suppliers to supply pre-cut pieces. Later on, it decided to provide them with marinade sauces and asked these suppliers to invest in marinading and packaging equipment. These developments resulted in increasing reliance and dependency on its suppliers. Another company supplied FF with pre-mixes (spices mixed according to certain formulas). FF aimed to deliver these pre-mixes to meat suppliers and let them assume the marinading function.

Cost reduction and quality

The long term character of case firms' IORs permitted a gradual improvement in efficiency based on cooperation between supplier and buyer. One interviewee gave an example of a Manila-based subcontractor who was contracted by a Japanese company to manufacture golf bags for 10 USD but could only do it for 11 USD. The Japanese accepted this but stipulated that the subcontractor would have to aim for 10 USD after a season. He eventually was able to lower costs through technical assistance from the Japanese company.

Do IORs foster long-term efficiency or inefficiency? A business consultant (Tan, 1996 personal communication) who was interviewed said that 'you are making one assumption: that what you do now you will continue to do in the future. This is not what is happening anymore. Change is happening all the time. While the relationship may be a long-term one, the product may be short-term. When a business becomes inefficient, both parties lose.'

Eccles (1981) found that nearly all contractors in the U.S. construction industry periodically 'tested the market', either through formal competitive bidding or simply by asking other builders what prices they were paying for subcontractors. Builders also spoke of being approached by subcontractors who would offer very low prices as an incentive to the builders to give them an opportunity to work for them. Builders were cautious in accepting these offers, due to concerns about quality and experiences in the past when a subcontractor had started to raise his prices once he thought he was firmly established. MM's Jose Yu regularly checked cotton prices, not only domestically but also internationally. Haggling was a common practice among case study firms. AA Plastics' manager haggled with different suppliers of chemicals on almost every order.

A by-product of the system of relational contracting is the emphasis on quality (Dore 1983, 475). According to the relational contract ethic, it may be difficult to ditch a supplier because, for circumstances for the moment beyond his control, he is not giving you the best buy. It is, however, perfectly proper to ditch him if he is not giving the best buy and not even trying to match the best buy. The single most obvious indicator of effort is product quality. A supplier who consistently fails to meet quality requirements is in danger of losing even an established relational contract.

For Benetton, a leading garment manufacturer based in Italy, the benefits of stable inter-firm relations with subcontractors included flexibility in production and reduction in commitment to maintaining stock (because manufacturing was akin to Japanese just-in-time system) (Belussi 1993). Over time, there was pressure on suppliers to reduce costs and increase quality.

Subcontracting relationships, according to a business consultant interviewed, is an illustration of mutual dependence (Tan 1996). 'If I depend upon you for orders, I will have to be focused on what exactly you need and try to attend to everything you want. Since I do not want to lose you, I will try my best to be honest.' Communication becomes more open the longer the relationship proceeds. One result is the custom of 'cosuto daun' (cost reduction) (Sako 1992, 229) in Japanese subcontracting. This results from expectations by customers of continuous cost reduction due to learning-by-doing and rationalisation. A relationship that does not appear to be the most efficient in terms of production costs to begin with, may gradually approach or even surpass least cost alternative in the future. Dore's (1983) findings in regional production networks suggest that embedded actors satisfice rather than maximise on price and shift their focus from the narrow

economically rational goal of winning immediate gains and exploiting dependency to cultivating long-term, cooperative ties.

Finally, transaction costs reduce over time for IOR partners for two reasons (Ben-Porath 1980). First, rules or norms are established for their exchange relationships. Second, the expectation of continuing exchange has a favourable effect on the behaviour of parties (shadow of the future).

Exit

Exit refers to the termination of a business relationship. When does a company eliminate or change IOR partners? In the case of AA Plastics, the implementation of ISO practices will change its transacting practices, but not its relationships. In contrast, SS Sawmill broke its ties with one major supplier, a large Filipino-owned company, due to the poor quality of its supply. AA Plastics bought out its two other initial partners, including the Taiwanese technical partner. MM did the same with its Taiwanese investor and partner in the dyeing business. None of these cases resulted from partner conflict, though. Exit per se therefore does not connote a negative outcome if both parties gain from the relationship.

7.5 Summary

The conditions for the existence of stable networks are the same as the conditions for the existence of organizations. These conditions are that it must be effective and it must be efficient. An organization is effective if it achieves the desired end. It is efficient if it does so while, at the same time, offering more inducements to the members of the organization than efforts they have put into it (Jarillo 1988, 36).

The basic condition for efficiency is that the gain to be accrued by being part of the network is seen as superior, over the long term, to the profits that can be obtained by going alone (or by establishing short-term, changing relationships) (Jarillo 1988). Efficiency is defined as the relationship between expenditure of resources and results (Hodge and Anthony 1988, 299). Hodge and Anthony (1988, 297) explain that 'to be efficient means to get the most of whatever goal an organization wishes to pursue. An organization can be effective but not efficient. Organizational effectiveness is a condition in which a focal organization, using a finite amount of resources, is able to achieve a stated objective(s), as measured by a given set of criteria.'

The examination of tangible and intangible outcomes demonstrates both elements of efficiency and effectiveness. In many cases, the consideration of effectiveness seems to have propelled the case study firms to enter into IORs. At the beginning, a firm's youth and small size limit its alternatives. Through historical analysis, however, one appreciates the changes in the IORs. The ability to achieve economies of scale and specialisation contributes to efficiency gains. Likewise, learning outcomes provide cost improvements.

For the case study firms, mutual economic advantage was necessary but not a sufficient rationale for long-term IORs. An obvious incentive was the primary economic exchange, defined as the economic value of the annualised economic transaction. This was demonstrated in Chapter 5. The growth of the relationship served as an added incentive. Within this second phase was a trial period which enabled the development of familiarity. Two key dimensions within this trial period were the institution of rules and procedures that introduced into the exchange a predictable structure and a basis for performance and monitoring that provided

stability and efficiency and the evolution of clear expectations within each alliance (Larson 1992).

The exchange process is not only a learning process but also an adaptation process for the case study firms. Adapting is important because it strengthens bonds, making them more enduring, and affords space for change in relationship and mutual orientation (Johanson and Mattsson 1987; Lax and Sebenius 1986). Therefore, interorganizational relationships typically involve much more than just the contractual business exchange process itself: significant resources are invested in developing the relationship (Wong 1992).

A network is economically feasible because the specialisation of each supplier makes the final total cost lower. It can be sustained because long-term economic bonds lower transaction costs. A 'fairness' in the sharing of the value added is achieved through valuing the relationship itself, which makes it easier to solve specific problems (Jarillo 1988, 39).

The argument that relational and reputational concerns direct exchange interactions rather than impersonal standards or authority relations (hierarchies) or price competition (markets) (Jones 1993, 11) has not been supported in this study. The findings in this study indicate that price has an equally influential role as that of social control. Sako's (1992) study of Japanese networks likewise finds that price is just as important as relational concerns, something often overlooked because of the assumption of the hierarchy and market continuum.

Chapter 8

The Paradox of Chinese Networks

8.1 Trust and cooperation

Low trust is said to characterise Chinese society (Fukuyama 1995; Redding 1995; Wong 1988) yet the 'strength of weak ties' theory argues that it is one's weak ties that enable access to outside resources (Granovetter 1973). This paradox is the central focus of this concluding chapter. It is presented because its solution ties together the salient elements from the previous chapters. These elements include (a) the dichotomy of trust and distrust, (b) the reasons behind IORs and (c) the sustainability of long-term cooperation. This chapter presents evidence from the case studies and the literature to demonstrate how and why IORs can exist and thrive within what some researchers characterise as a low trust community.

Chinese society, Fukuyama (1995) argues, is an example of a familistic community in which the primary avenue to sociability is family and the broader forms of kinship, such as clans. He asserts that familistic societies frequently have weak voluntary associations because unrelated people have no basis for trusting one another. Chinese societies such as Taiwan, Hong Kong and China are cited as examples, but this economic culture can also be seen, he continues, within the minority Chinese ethnic enclaves in Malaysia, Thailand, Indonesia and the Philippines. France and Italy also share this characteristic. Although familism is not as pronounced in either society as in China, there is likewise a deficit of trust among people not related to each other. In contrast, high-trust societies such as Japan,

Germany and the United States are inclined toward spontaneous sociability and possess dense layers of intermediate associations.

Spontaneous sociability refers to the capacity to form new associations and to co-operate within the terms of reference established (Fukuyama 1995). The result of this spontaneity is a wide range of intermediate communities, distinct from the family or those deliberately established by governments. For example, Fukuyama observes that the United States has a dense network of voluntary organizations such as churches, professional societies, charitable institutions, private schools, universities and hospitals.

Fukuyama's (1995) low-trust/high-trust comparison leads him to conclude that social capital and the proclivity for spontaneous sociability have important economic consequences. He observes that the typical firm size in the United States and Germany is significantly larger than those in Italy and France. In Asia, Japan and Korea have large firms and highly concentrated industries while firms in Taiwan and Hong Kong tend to be much smaller. He argues that there is a relationship between high-trust societies and the ability to create large, private business organizations. In addition, as technology and markets change, societies well supplied with social capital will be able to adopt new organizational forms more readily than those with less. Family businesses have traditionally populated the economies of low-trust societies such as Taiwan, Hong Kong, France and Italy. In these societies, Fukuyama continues, the reluctance of non-kin to trust one another has delayed and, in some cases, prevented the emergence of modern, professionally managed corporations.

Firm size does not appear to have serious consequences for a nation's ability to grow and prosper at an early stage of economic development. However,

Fukuyama argues that firm size does affect the sectors of the global economy that a nation can participate in and may in the long run affect overall competitiveness. He hints at the possibility that the constraint to creating large-scale organizations will harm the long-term growth potential of countries like China and Italy. Fukuyama makes a crucial assumption in his analysis: that large corporations are more advantageous than small ones due to the size differential.

Fukuyama's (1995) analysis presents a compelling paradox because many explanations of ethnic Chinese prosperity hinge on 'Overseas Chinese business networks' that transcend national borders and depend on personal contacts (East Asia Analytical Unit 1995; Goldberg 1985; Hiscock 1997; Redding 1993; Tanzer 1994). Redding (1995) describes Chinese firms as typically small scale with relatively simple organizational structures and as family-owned and controlled. The typical Chinese firm, he continues, is also focused on one product or market and emphasises centralised decision-making, with heavy reliance on one dominant chief executive. In addition, Chinese family businesses appear to have enormous difficulty in making the transition from family to professional management, a step that Fukuyama (1995) contends is necessary for the enterprise to institutionalise itself and carry on beyond the lifetime of the founding family.

The key feature of the traditional centralised organizational structure is the ability of one person to retain control. Because of this constraint, the average firm size is small. However, two responses allow the size limitations to be transcended. The first is a careful strategic choice of business field and the second is networking (Redding 1995, 64). Fukuyama (1995) also acknowledges that Chinese firms can develop the equivalent of scale economies through family or personal ties with other small Chinese firms through networking.

In contrast to Fukuyama's (1995) proposition, Williamson's transaction cost theory (1975) makes a different argument: firms internalise due to transaction costs brought about by the threat of opportunism. When there is high distrust, firms internalise activities due to the high cost of monitoring other firms. Therefore, when there is high distrust in the business environment, transaction cost theory predicts larger, not smaller, firms. This prediction directly contradicts that of Fukuyama's.

The paradox of low trust and networking remains. For how can entrepreneurs network if it is claimed that they distrust others? What are the implications of the research findings, including the Essential Network framework, for this paradox? The next section summarises evidence from the research findings and the literature, demonstrating that trust does not have to be a precondition for cooperation. Fukuyama's (1995) low-trust argument is treated with caution. The findings from the case studies show that the Essential Network is not with one's strong ties (i.e. those whom one trusts the most).

Once a firm engages in an IOR with another, however, what sustains this cooperation? Section 8.2 compares essential versus strategic networks by using the case of Chinese versus Japanese firms. Section 8.3 ties Chapters four to seven together by outlining the conditions for sustained cooperation between Chinese firms and their business partners. These four conditions were first proposed together in a study of Japanese firms by Edwards and Samimi (1997).

Trust

Fukuyama's main argument is that Chinese societies have low trust: non-kin are reluctant to trust one another. These societies, therefore, have smaller average firm sizes. Such societies also experience a delay in the emergence of modern,

professionally managed organizations. In contrast, people in high trust societies are able to create large, private business organizations more easily.

While Chinese enterprises in the Philippines are predominantly small and medium sized, there is an increasing number of large organizations. These include several of the largest domestic banks (Metrobank, Allied Bank), large conglomerates owned by the taipans (Henry Sy, John Gokongwei Jr, Lucio Tan), and large shipping companies (two of the case study firms). Interestingly, Redding (1995) counters that smallness may be a strength, as it offers flexibility and quick decision making. Networking is also one way that Chinese firms overcome their small size. However, if Fukuyama does perceive a high sense of distrust in Chinese society, how can networking ever come about? The concept of 'trust' will first be discussed. This section will also show why trust is not a precondition for cooperation.

Gambetta (1988, 217) defines trust as follows: 'When we say we trust someone or that someone is trustworthy, we implicitly mean that the probability that he will perform an action that is beneficial or at least not detrimental to us is high enough for us to consider engaging in some form of cooperation with him.' Barney and Hansen (1994) define trust as 'the mutual confidence that no party to an exchange will exploit another's vulnerabilities.'

To further refine the definition of trust, consider the three types outlined by Sako and Helper (1998, 388): contractual, competence and goodwill trust.

- Contractual trust: will the other party carry out its contractual agreements?
- Competence trust: is the other party capable of doing what it says it will do?

- Goodwill trust: will the other party make an open-ended commitment to take initiatives for mutual benefit while refraining from unfair advantage taking?

It is the 'goodwill' type of trust that is referred to when the term is used here. Therefore, to be more precise, it is goodwill trust that is not necessarily a precondition of cooperation. Rather, the preconditions lie partly in the objective circumstances, and partly in the accumulation of knowledge with reference to mutual interests and the potential satisfaction of those interests through cooperative behaviour. The understanding that mutual interest makes defection costly enough to be deterred increases the probability that the other party will not act in a harmful way (Gambetta 1988, 226).

The evolutionary approach suggests that trust is better understood as a result rather than a precondition of cooperation. Trust would exist in societies and groups that are successful because of their ability to cooperate, and would consist in nothing more than trust in the success of their previous cooperation. Trust does not operate to trigger cooperation, but comes about simply by a set of fortunate practices, random at first, and then selectively retained (Gambetta 1988, 225).

In a study of the film industry in the U.S., Jones (1993) finds that both opportunism and trust are present. Trust does not precede establishing cooperative relations. Social control through embeddedness rather than trust oversees exchanges in network organizations. Networks are not unique because they have more trust and less opportunism than market transactions; rather, they have developed social institutions and structures which support recurring and relational exchanges (Jones

1993, 72). Trust and reciprocity are complements, not substitutes, to other obligations (Lorenzoni and Baden-Fuller 1995).

Lorenz's study of small and medium engineering firms in France also shows that firms avoid too much reliance on trust. Two interesting empirical results arise from this study of French engineering firms. The first is that there is extensive use of safeguards by client firms (buyers) to minimise the possibility of being the victim of opportunistic behaviour and hence the need to rely on trust. As the Italian saying goes, 'It is good to trust but it is better not to trust'. Client firms solicit tenders and may also split an order between subcontractors. Subcontractors, on the other hand, diversify their clients in order to reduce the risk of dependency (Lorenz 1988). Given that the organization's vulnerability derives from dependence on single exchanges, the most direct solution is to develop an organization which is dependent on a variety of exchanges and less dependent on any single exchange (Pfeffer and Salancik 1978).

The idea that trust might follow rather than precede cooperation is reinforced by work in game theory, including that of Axelrod (1984), which shows that even where trust is very limited and the chance of communication very slim, cooperation may still evolve if other conditions obtain. One of these conditions is that the parties know they are locked in this situation for a long period, the end of which is unknown (Gambetta 1988, 226). Swedish studies find that sharing of technical, organizational, commercial or market information leads to adaptiveness, and it is this success that builds trust (Alter and Hage 1993).

The evidence for non-reliance on goodwill trust from the case study firms is their avoidance of over-dependence on one network partner. The practice of splitting orders among several suppliers reduces the risk in case a supplier defaults.

MM Textiles even resorts to purchasing from competitors. The firms do not extend business credit without careful investigation, even if the customer is known to them. JJ Chemical's credit manager visits the site of mining companies not only to get acquainted with the management of its potential customer, but also to observe their operation, the technology used, and the number of staff.

The strategy that Gambetta (1988, 229) proposes is where one sets his or her sights on cooperation rather than trust. In other words, the onus is on promoting the right conditions for cooperation, relying above all on constraint and interest, without assuming that the prior level of trust will eventually be high enough to bring about cooperation on its own account (Gambetta 1988, 229). This is the solution to the paradox.

If firms do not rely on trust before they cooperate, then how do businesses engage in IORs with each other? There are four conditions that enable Chinese businesses to enter into IORs. Before these are discussed, the concept of strategic networks is contrasted with the Essential Network concept developed by this research.

8.2 Essential and strategic networks compared

Chapter 6 identified the sum of the case study firms' close interdependent relationships with other firms as representing their Essential Network. Edwards and Samimi's (1997) characterisation of strategic networks has similar features to the case study findings. Recall from Chapter 2 that, when faced with the prospect of a new activity or product, firms have the option of undertaking the activity themselves (internalisation) or contracting to others (subcontracting). The primary requirement for the emergence of a strategic network is a remarkably high level of cooperation among member firms. Such cooperation is observed in the case study firms' IORs.

In both strategic and essential networks, transactions between member firms incorporate substantial scope for contingency losses. However, Edwards and Samimi (1997) argue that when faced with the risk of losses, member firms in strategic networks do not respond by implementing protection measures (such as internalisation or decomposed subcontracting) to reduce their exposure to such losses. Such a finding is in sharp contrast to case study firms' behaviour as observed in the field and discussed in Chapter 7. The case study firms do implement protection measures when dealing with members of their essential network. Table 8.1 contrasts the two types of networks along three parameters. The Japanese case is presented in the next section to illustrate the conceptualisation of strategic networks.

Table 8.1. Essential and strategic networks compared

	Essential network	Strategic network
Level of cooperation	High	High
Scope for contingency losses	High	High
Protection measures	Yes	No

Strategic networks in Japan

Edwards and Samimi (1997) argue that a strategic network is a rare form of business organization. The exogenous circumstances that are almost invariably required to stimulate the formation of strategic networks cannot be prescribed. Is it indeed a rare form?

The authors point to Japan to illustrate the formation of strategic networks. According to them, Japan in the 1950s provided one instance where the business environment was conducive to the formation of strategic networks. Two factors in the business environment were important. The first was government interventions and priorities, especially where they influenced the allocation of Japan's then extremely scarce resources: funds for investment and foreign exchange. The second factor was surges in demand.

The Japanese government used numerous interventions to assist preferred industries in the 1950s. Three contributed significantly to the emergence of vertical *keiretsu*. These were policies related to: (a) foreign exchange allocations, (b) production by foreign firms in Japan and (c) technology transfer from abroad. The combination of these policies indicated to firms like Toyota that they could benefit more from forming their own supplier network than they could from remaining a stand-alone firm. Government policies effectively required that investible funds available from market sources be used for the building of factories and the purchase of production line equipment and machinery, not for takeovers. Moreover, faced with exploding demand, the major companies had priority uses (scaling up, modernisation) for their own limited access to investible funds. From the mid-1950s, there was a scramble by these major producers to form links between themselves and as many of the small scale, craft-based industrial workshops as they required. These workshops had the experience and skilled manpower to put into place the technology transfer mandated by government policies. In this respect, they supplemented the major firm's resource base (Edwards and Samimi 1997).

The surge in demand in the 1950s arose from the Korean War and the resulting demand for trucks and military equipment. This was followed by a

sustained rise in demand in Japan for a wide range of industrial and consumer goods. Major firms in these fields realised that they risked losing market share if they continued to attempt to extend the range of parts and components they themselves produced. The process of internalisation and of transferring necessary technology from abroad was protracted and tied up significant amounts of scarce skilled manpower and capital. An alternative was for the major firms to focus more on assembly activities, and to encourage the many small and medium scale industrial workshops to join them and supply different components and parts (Edwards and Samimi 1997).

According to Edwards and Samimi (1997), Toyota's strategic network gained advantage over competitors in America because it was relieved of two major transaction costs: those linked to internalisation and decomposed subcontracting. In addition, successful networks developed intragroup understandings that led to significant reduction in both interfirm coordination costs and direct production costs.

Essential networks of the Philippine Chinese

In comparison with the Japanese case, this study suggests that circumstances favourable to the formation of essential networks among the ethnic Chinese in the Philippines arose during the 1960s and 1970s. There were three that have been pivotal: (a) a common business history and background; (b) government nationalistic policies towards the Chinese; and (c) national economic development policies. Their common business history and the Philippine government's nationalistic policies against the Chinese banded the community together and, to a large extent, kept information within the group. When the government introduced import-substitution policies, skilled Chinese flocked into small and medium-scale manufacturing, creating a criss-crossing network of relationships among end-product

manufacturers and support industries. These support industries included suppliers of packaging materials such as bottles or plastic containers, printing services and machinery parts.

The business history of the Philippine Chinese was discussed in Chapter 4. Many Chinese migrants shared the common experience of starting small and growing into medium and large enterprises. Their businesses are also almost all family-owned and managed. Limlingan (1986) documents Chinese business practices in the Philippines and highlights two unique strategies. The first is the low margin/high volume strategy of concentrating on price as a means to increase market share. The second is the use of business credit (including the issuance of post-dated cheques) to expand one's business.

In the Philippine Chinese case, surname and village associations were significant in the earlier periods and later on, alumni associations and Lions and Rotary Clubs increased in importance (See 1997). Most of these Chinese-based organizations perform social rather than economic functions (Cariño 2001). See (1981) observes that clan associations mainly help to preserve Chinese identity rather than protect the livelihood of its members. Members of family and clan associations may have unofficial business ties with each other but business activities are not part of the official activities of clan associations. These associations rarely give help to improve one's livelihood, such as providing jobs or business credit. Any assistance of this nature is done at the personal level. However, they do support those affected by misfortunes such as fire or long illness and provide scholarships to children of needy clansmen. Omohundro (1981) finds among the Chinese in Iloilo that clan and family associations provide an informal network that reinforces

business links among the Chinese, but agrees with See that these associations do not officially perform business functions.

According to Cariño's (1998) research, even the Federation of Filipino-Chinese Chamber of Commerce and Industry (FFCCCI), established in 1954, has not played a distinctive role in facilitating assistance to Chinese business. Instead, it primarily serves as a channel through which the Philippine government transmits and implements policies concerning the Chinese.

The second circumstance, the policies of the Philippine government towards the Chinese, was discussed in Chapter 4. The chapter described how the nationalisation movement attempted to push the Chinese out of areas where they had economically thrived. They were accused of controlling the economy, unscrupulous economic activities and of illegal pursuits. Between the end of the Second World War and 1975, the Filipino Chinese suffered from a strong sense of political vulnerability and insecurity (Cariño 1998). Li (2000) points out that when legal protection is weak, personalised obligation and reciprocity step in to provide what the legal system fails to provide. This also explains why informal networks were important to Chinese communities where they faced racial discrimination as a minority, since their marginal social status also resulted in their being peripheral to the legal system and other social institutions (Li 2000). The granting of Philippine citizenship to the Chinese by President Marcos in 1975 provided some stability and political security to the community.

Third, national economic development policies favouring import-substituting industrialisation (ISI) encouraged a large number of Chinese entrepreneurs to enter manufacturing. This eventually led to a large pool of manufacturers in textiles and the various supporting industries (yarn, dyeing services and tools).

The next four sections outline the conditions for sustained cooperative networking. The conditions are discussed in relation to Chinese commercial history in the Philippines (chapter 4) and the research findings (chapters 5 to 7).

8.3 Conditions for sustained cooperation

Four conditions need to be fulfilled for sustained cooperative interaction within strategic networks (Table 8.2). These relate to (a) payoff structures, (b) end-game conditions, (c) social embeddedness and (d) tit-for-tat mechanisms. First, the payoff structure for each member firm from group cooperation needs to consistently exceed the benefit that any network member may obtain from pursuing its own dominant strategy in preference to the group's strategy (Edwards and Samimi 1997). There is no need to assume trust between the players: the use of reciprocity can be enough to make defection unproductive. Altruism is not needed: successful strategies can elicit cooperation even from an egoist (Axelrod 1984).

Table 8.2. Four conditions for sustained cooperation

Payoff structures	End-game conditions	Embeddedness	Tit-for-tat mechanisms
<ul style="list-style-type: none"> • Every participant benefits, but payoff structure is asymmetric (no strict one-to-one reciprocity) 	<ul style="list-style-type: none"> • Relationship without a clear end-point • Long-term outlook 	<ul style="list-style-type: none"> • Ability to regulate business partner's behaviour • Partner's identity is important 	<ul style="list-style-type: none"> • Punishment and reward mechanisms need to be credible

Second, network member firms need to view the game being played as one without a clear end-point. For cooperation to prove stable, the future must have a

sufficiently large shadow. Hence, the probability of a next encounter between the same two individuals must be great enough to make defection an unprofitable strategy (Axelrod 1984).

Third, business relationships need to be supported by a corresponding network of social relationships (Granovetter 1985). Finally, satisfactory tit-for-tat response mechanisms need to be developed and understood by each party. These final two conditions require some assumptions about the individuals and the social settings (Axelrod 1984, 174). Two are particularly salient: (a) that an individual be able to recognise another player and (b) that an individual can remember his or her prior history of interactions with this player.

These four conditions permit the formation of essential networks. The essential network model also addresses the paradox of Fukuyama's (1995) line of reasoning: that Chinese society is characterised by low trust and yet networking is so prevalent. Ultimately, these conditions are interrelated: common interest is reinforced by end-game conditions and tit-for-tat mechanisms can be more effectively enforced within a community (embeddedness).

Payoff structure and common interest

The concepts of payoff structure and common interest originate from game theory. The payoff structure under common interest assumptions favours cooperation in a repeated game (Edwards and Samimi 1997, 508). In effect, the common interest objective makes the long-term incentive for mutual cooperation greater than the short-term incentive for defection (Axelrod 1984).

The logic that leads to cooperation in repeated transactions is non-zero-sumness. The asymmetric payoff structure is what makes the game non-zero sum:

one player's gain is not cancelled out by the other player's loss. The essential feature of non-zero-sumness is that, through cooperation or reciprocation, both players can be better off. Non-zero-sumness is, by itself, not enough to explain the evolution of reciprocal altruism. Even in a non-zero-sum game, cooperation may not necessarily make sense. It depends on the prevailing social environment.

The common interest condition is manifested in the case study firms in two ways: (a) the benefits and costs associated with IORs are not completely quantified and (b) no strict one-to-one reciprocity or exchange (asymmetric benefits) is evident. Chinese business relations are described as explicitly predicated on economic validity and mutual self-interest. DeGlopper (1972) argues that simple economic rationality and functional specificity suffice to explain much of the pattern of economic relations in Lukang (Taiwan) but that they are not the only forces at work. The importance of particularistic ties is seen in problems of credit, of access to restricted or limited supplies or markets and of partnerships (DeGlopper 1972).

Yao Souchou (1987) quotes a Singaporean Chinese businessman who explained that he engaged in particularistic transactions because he had to. Reciprocity is clearly underpinned by common self-interest: a combination of self-perception, cultural norms and economic pragmatism defines the nature of the transaction. The significance lies not so much in the *guanxi* sentiments but rather in the structural differences in the relationships involved. Control of the desired goods is the objective. Indeed, transactions take place in a set of relationships that was characterised by a vertical structure of unequal access to a resource, which in this case is money (Yao 1987).

For the case study firms, the goal was to obtain resources to achieve their strategic business objectives. Resources are widely defined to include financial

resources as well as technology and access to supplies and markets. The company's strategic decisions and stage of development as well as environmental factors affect such resource requirements. Environmental factors outside an organization's control are constantly changing and may require incremental or major strategic adjustment. The next subsection illustrates the payoff structure and common interest concepts with reference to the case study firms.

Stage of development. The objective of this subsection is to illustrate how the common interest perspective is manifested within the case study firms' IORs. Aspects of non-quantified benefits and asymmetric exchange are discussed. Strong ties are heavily relied upon in the early stages of development because business start-ups face tremendous uncertainty. The better-established businesses extend assistance to Chinese entrepreneurs they know. Many new entrepreneurs are former employees of these established businesses. Common interest, as a precondition for sustained cooperation, is necessary, although resource needs evolved as the case study firms grew and developed.

Personal ties appear to be more important in the early stages of a firm's development than when it is more established. At an early stage, the firm has virtually no reputation or track record and experiences a highly uncertain financial standing. A businessman's strong ties play a salient role here and the case study firms used them as sources of tangible and intangible benefits. Tangible benefits include start-up capital while intangible benefits include being their guarantors of credit or character references. Pre-existing networks of relationships enable small firms to gain an established foothold fairly quickly. Li (2000) observes that, generally, firms that are relatively small tend to rely more on family members to run the business. He argues, therefore, that the size of firms has a bearing on the use of

personal connections. However, this research has found that in addition to the size of the firm, the industry that the business operates in also has an impact on the reliance on personal ties. Menkhoff's (1996) study of small traders in Singapore supports this finding. He discovers that the nature of business activities and resource needs influence one's networking. These antecedents of business relations were covered in chapter 5.

The need for resources changes as the firm grows and finds the need to expand its market access and venture into new fields. This finding is consistent with Carroll's study of Filipino and Chinese entrepreneurs in the Philippines. In his study of these entrepreneurs, Carroll (1965, 149) concludes that the main problem in getting started in business changes from financing to dealing with government and later, to technology and training requirements and that it changes according to the prevailing climate of entrepreneurship. This was demonstrated with respect to the case study firms in Chapters 6 and 7. The strategies of the firms varied, ranging from those that focused on core competencies (KK Stores, FF Food, SS Shipping and GG Shipping) to those that grew through diversification into unrelated activities (MM Textiles, CC Chemical). Notwithstanding these differences, the reliance on weak social ties becomes more pronounced as companies grow larger. The emphasis on some 'tie' is important, as one recalls DeGlopper's (1972) remark that 'one does not do business with strangers'. IORs between Chinese and non-Chinese firms follow this principle. SS Shipping's alliance with two other shipping companies (one Chinese, one Spanish-owned) stemmed from the company knowing these other two players from many years of doing business in Cebu.

The economic rationale is paramount. Access to resources and skills was the common interest. Chapter 5 outlined the case study firms' needs for resources,

which ranged from capital to technology and raw materials. The changes in their IORs over time were revealed in Chapter 7. The pursuit of common interest was reflected in the firms' long-term commitment within the Essential Network framework. The firms expected that these relationships would grow for mutual economic gain. The total alliance between SS Shipping and the two smaller shipping companies was a defensive reaction against the threat of new entrants. The alliance also fulfilled individual firm needs by allowing each participant access to the partners' strengths in marketing, logistics, and technology. The effectiveness of the common interest objective is closely tied to the next condition for long-term cooperation, that of end-game conditions.

End-game conditions

The second condition for stable cooperation is that network member firms need to view the game being played as one without a clear end-point (Edwards and Samimi 1997). The majority of IORs in the case study firms were long-term and ongoing. These IORs began with the exchange of goods and services, but became more complex and multi-layered as time passed. Consequently, future benefits were neither exactly known nor easily quantifiable. One can see that this condition is intimately tied to the common interest condition. The existence of common interest incentives contributes to making the game open-ended. What makes this outcome possible? Two observations support this condition for the Chinese case: (a) the emphasis on future orientation which places importance on learning, an outcome which does not occur immediately but takes place in the medium to long-term and (b) the defined boundaries of the group. Illustrations from the case study firms are discussed and the two observations noted above are elaborated in the next section.

For the case study firms, the actual duration of most IORs was long-term (more than ten years) and the intended duration was long-term (end-game condition). The growth of the relationship and the long-term benefits from such growth are important findings, as shown in Chapter 7. For instance, many of KK Stores' suppliers had been doing business with the company for at least two generations. Because well-established companies of at least ten years' operation were used for the case studies, the examinations of changes to IORs as well as the exploration of business conflict and mistakes were possible. Both were accomplished and demonstrated in Chapter 7. Adjustments over time were also a significant discovery. The common interest here is a long-term outlook; it is the interest in continuing in business for the long-term, in part because there are limited occupational choices available to the Chinese. There is also a belief within the Chinese community that there are higher financial rewards for being in business rather than in paid employment.

Long-term orientation. Why do entrepreneurs have a long-term outlook? Could it be that long-term arrangements can be relied upon in certain countries (such as in Japan or Chinese societies) more than in other economies (Dore 1983)? The preference for relational contracting (where there is no one-to-one exchange) cannot be separated from the players' long-term future orientation. Entrepreneurs who experience a short-term loss associated with sacrificing a price advantage have the assurance that one day they can 'call off' the same type of help from their trading partner (Dore 1983, 468-470).

Keister's (2002) study of business groups in China found that while cost is an important determinant in exchange, environmental uncertainty matters even more. Specifically, to minimise long-term cost rather than minimising current price,

firms opted to trade with others that would be stable trading partners. The cost of searching for new trade partners are particularly high in developing markets, where potential partners are scarce and information about their track records is limited.

In the case of Chinese entrepreneurs in the Philippines, participation in open-ended relationships is possible because future compensation can be relied upon. Long-term relations benefit both parties because one can evaluate a partner's reliability over time. As customers, firms need to have reliable suppliers who are able to deliver as promised and meet quality standards. As suppliers, firms also desire to transact with reliable customers, who are able to pay their accounts. Finally, ongoing relationships permit learning to occur.

Long-term orientation is an attribute that has been observed in certain Asian countries. Hofstede (1984) cites a Chinese values questionnaire that was composed and distributed by Chinese social scientists to male and female students in 18 countries and two regions. The statistical analysis yielded four dimensions, three of which were similar to Hofstede's (1980) earlier findings from his study of IBM employees. These were: Power Distance, Individualism/Collectivism and Masculinity/Femininity. The fourth was a dimension the researchers labelled 'Confucian Dynamism' to show that it deals with certain principles from Confucius' philosophy. Its positive pole reflects a dynamic, future-oriented mentality, whereas its negative pole reflects a more static, tradition-oriented mentality. Hong Kong, Taiwan, Japan and South Korea held the top positive positions in the 'Confucian Dynamism' scale, which reflected the high importance placed on values oriented towards the future (perseverance and thrift) (Hofstede and Bond 1988, exhibit 3). The next high scores were found for Brazil, India, Thailand and Singapore (Table 8.3).

Table 8.3. Confucian dynamism dimension score for twenty countries and two regions in the Chinese values survey

Country	Confucian Dynamism	
	Index	Rank
Australia	31	11-12
Brazil	65	5
Canada	23	17
Germany (F.R.)	31	11-12
Great Britain	25	15-16
Hong Kong	96	1
India	61	6
Japan	80	3
Korea	75	4
Netherlands	44	9
New Zealand	30	13
Pakistan	0	20
Philippines	19	18
Singapore	48	8
Sweden	33	10
Taiwan	87	2
Thailand	56	7
United States	29	14
Region		
East Africa	25	15-16
West Africa	16	19

Source: Geert Hofstede and Michael Harris Bond, 'The Confucius connection: From cultural roots to economic growth,' *Organizational Dynamics* 16, no. 4 (1988).

There is, of course, much contention about attributing certain behaviours and outcomes to Confucianism. Li (2000) points out that as a broad philosophy, Confucianism promotes many values, including the ones that happen to be important to *guanxi* formation.

However, it also has others that are not supportive of business undertakings. Wang Gungwu (1991) argues that traditional Confucian values were not particularly sympathetic to merchant activities, and that Confucian philosophy in fact placed merchants at the lowest level of the four-tier social stratification system, after the

scholars, peasants and artisans. It is clear that using the term 'Confucianism' is fraught with difficulty. Nevertheless, 'Confucian Dynamism' is cited here simply to illustrate the contrast between a more future-oriented society from one which is more static and traditionally oriented.

Embeddedness

The first condition for stable networks, payoff structure and common interest, ties together the findings in chapter 5, which discussed the antecedents of IORs. The second, end-game conditions, draws from the analysis in chapter 7 and emphasises long-term orientation and open-ended relationships as contributing to sustainability of IORs. The third condition is embeddedness.

The evolution of cooperation requires that individuals have a sufficiently large chance to meet again so that they have a stake in their future interaction. Cooperation, once established based on reciprocity, can protect itself from invasion by less cooperative strategies. The ability to recognise the other player from past interactions and to remember the relevant features of those interactions is necessary to sustain cooperation (Axelrod 1984). The third condition, embeddedness, is an important mechanism for developing this ability. Under circumstances where it is important to evaluate the reputation of a potential business partner and regulate his or her behaviour, the concept of social embeddedness is imperative.

Identity becomes highly important when there is uncertainty about the quality of the object of exchange and terms of the transaction and when transactions are not consummated instantaneously (Ben-Porath 1980, 7). In this situation, there is a need to evaluate the reputation of partners. A common identity engenders concern for each other's outcomes and thus, mutual trust. Being members of industry associations or of social, ethnic or political groups can put normative curbs

on organizational behaviour through generally accepted norms of behaviour and through fear of being ostracised socially (Bhattacharya, Devinney, and Pillutla 1998). This section covers the conceptual definition of embeddedness through the two dimensions of horizontal and vertical ties. The outcomes that result from embeddedness are then discussed.

Granovetter (1985) defines embeddedness as the proliferation of links resulting from mutual obligations. By this definition, embeddedness is closely related to the concept of *guanxi*. As previously discussed, the term *guanxi* refers to webs of interpersonal connections, or social networks, which the Chinese are believed to have developed wherever they reside because of their strong attachment to the family. However, the use of *guanxi* as a conceptual tool to understand business networks is limited because the usage of this term is very broad. There is little agreement over the conceptual and actual boundaries of the term and its use is often imprecise (Li 2000). The findings that relate to embeddedness from this research are, hence, more usefully characterised along the horizontal and vertical dimensions of ties. A useful framework for horizontal comparison is the dichotomy of strong and weak ties developed by Granovetter (1973).

Horizontal embeddedness. Personal ties often serve as bridges to other business partners, and the 'strength of weak ties' theory (Granovetter 1973) is salient here. Granovetter (1973, 1361) explains that most intuitive notions of the strength of a tie should be satisfied by the following definition: the strength of a tie is a combination of the amount of time, emotional intensity, intimacy (mutual confiding) and reciprocal services that characterise the tie. Weak ties are more likely to link members of different small groups than are strong ties, which tend to be concentrated within particular groups.

In Granovetter's (1973) research on how American blue-collar workers find out about jobs, the natural *a priori* idea was that those with whom one has strong ties are more motivated to help with job information. Contrary to this, Granovetter contends, is the structural argument that those to whom one is weakly tied are more likely to move in circles different from one's own and will thus have access to information different from that which one receives. The results from his study validate the structural argument: of those finding a job through personal contacts, 83.3 per cent of these contacts are classified as the job seeker's weak ties.

This research supports Granovetter's (1973) theory and finds that very few of a business owner's strong personal ties form part of his or her Essential Network. The majority of Essential Network ties are with one's weak ties, with the exception of AA Plastics, whose five key distributors are either the owner's relatives or townmates.

Within the Philippine Chinese business community, strong horizontal ties refer to an individual and his close associates with whom the individual interacts most intensely and most regularly and whom he regards as his social equals. This is equivalent to Granovetter's (1985) concept of strong ties. A person's extended network consists of the same individual plus those with whom he has less intense and less frequent relations and whom he does not necessarily regard as his equals (Barnes 1972, 14). These particularistic ties among the Chinese community fulfil two critical functions (Wong 1991). They:

- provide a firmer basis for confidence within the network. Members of the group can access information to evaluate each other's credit-worthiness. They can also exert greater control over those who do not conform by invoking communal sanctions; and

- furnish a justification for discrimination. People with common ties belong to a moral community with shared rights and obligations, so that it is legitimate to keep economic benefits within the network.

Vertical embeddedness. A businessperson can also be vertically embedded. For example, Confucian values emphasise the relative importance of ordering relationships by status and observing this order. Hierarchical dualities and interrelatedness lie at the heart of the Chinese conception of being human. In Confucian teaching, the stability of society is based on unequal relationships between people. The *wu lun* or 'five relationships' are composed of ruler/subject, father/son, older brother/younger brother, husband/wife, and older friend/younger friend. These relationships are based on mutual, complementary obligations: the junior partner owes the senior respect and obedience; the senior owes the junior partner protection and consideration (Hofstede and Bond 1988).

Modern application of these five relationships in the Philippine Chinese case appear to be based on the distribution of unequal economic power rather than on moral or ethical obligations. In terms of the business hierarchy in the Philippines, wealth and the size of one's business interests matter more than seniority or family connections. As seen in Chapter 4, this hierarchy involves the owners of the largest conglomerates (or the taipans) at the top level, followed by owners of large and medium-sized enterprises in the middle tier. Small business proprietors comprise the bottom level. What then are the effects of horizontal and vertical embeddedness in practice?

Effects of embeddedness in practice. Behaviour is closely embedded in networks of interpersonal relations (Granovetter 1985). The 'undersocialised' view

argues that clever institutional arrangements make it too costly to engage in opportunism. In contrast, the 'oversocialised' view maintains that generalised morality is a social mechanism that discourages opportunism. The embeddedness argument is slightly different again. It emphasises the role of concrete personal relations and structures in generating trust and discouraging malfeasance (Granovetter 1985). The use of personal ties can be observed in many societies and communities.

Diamond merchants illustrate the case where transactions based on oral contracts are possible in part because they are not atomised from other transactions but embedded in a close-knit community of merchants who monitor each other's behaviour closely (Ben-Porath 1980). Li's (2000) account of the Canadian business establishment also reveals a close-knit circle of business elites. Li (2000) argues that there appears to be little difference between Chinese diaspora tycoons and Western corporate power brokers in the way they use contacts and connections to advance business interests. The similarity indicates that the use of personal connections is universal in the corporate world and not unique to ethnic Chinese culture.

A study of U.S. firms' relations with investment banks shows how pre-existing ties between companies and the interpersonal ties of company employees influence subsequent cooperative relations. Financial officers report that their firms use non-market ties (such as family, business, college and professional school ties) to reduce uncertainty and ensure satisfactory performance when assembling the financing for a deal (Mizruchi and Galaskiewicz 1993, 54). This does not necessarily imply that non-market ties lead to inefficiency, because there is accountability for performance (as the section on tit-for-tat mechanisms will show).

The use of interpersonal ties might even lead to reduced risk (because one does business with people whom one knows can do the job). Sako and Helper (1998, 388) refer to this as having competence trust, where the other party is capable of doing what it says it will do.

Ethnic bonds played a crucial role in nineteenth-century banking in Europe. In an international profession that depended on the closest mutual confidence, the dispersion of certain persecuted or disfavoured groups with common values and ways of life to cement them from within, and common pressures and prejudices imposing unity from without, was a positive advantage. However, one should not overestimate the importance of ethnicity. As Swedberg's (1990, 270) study showed, ethnic bonds might help a firm to establish itself, but in the long run it is usually profit and pragmatism that count.

Outcomes of embeddedness. The previous section discussed a visible outcome of embeddedness, that of the choice of business partners. Another outcome is institutional isomorphism. Uncertainty is a powerful force that encourages imitation. When organizational technologies are poorly understood, when goals are ambiguous, or when the environment creates uncertainty, organizations may model themselves on others. An example of how institutional isomorphism occurs is when American corporations implement (their perception of) Japanese models to cope with productivity and personnel problems in their own firms (DiMaggio and Powell 1983). In the case of the top level of the Chinese business hierarchy in the Philippines, what is observed is a similarity of their business structures and industry participation. They have a core activity (i.e. retailing, manufacturing), but usually add to this a property development arm and equity in a financial institution (usually a bank or insurance company). Institutional isomorphism is observed in this

business community, with a mixture of cooperation between some conglomerates and competition against each other (Cariño 2001).

To summarise, the two-dimensional conceptualisation of embeddedness is useful in portraying how businesspersons' links to others affect their actions. In practice, the use of personal connections is observed not only within Chinese business but also in other business communities. A visible outcome is, of course, the choice of business partner. Another is a similarity in institutional structures among certain business groups. Finally, embeddedness enables tit-for-tat mechanisms, the topic of the next section, to be carried out.

Tit-for-tat mechanisms

The final condition for sustained cooperative interaction is that punishment and reward mechanisms need to be credible (Edwards and Samimi 1997, 494). Hence, tit-for-tat mechanisms that are understood by each party need to be developed. This condition is intimately related to embeddedness. Axelrod (1984, 60) argues that it is easier to maintain the norms of reciprocity in a stable small town or ethnic neighbourhood. In game theory, tit-for-tat is defined as the strategy of cooperating with one's partner and then doing whatever the other player did on the previous move (Axelrod 1984, 113). If the business partner cooperates, then the player also cooperates. If the business partner defects, the player responds likewise. Tit-for-tat is an equivalent given in retaliation (Axelrod 1984).

The effectiveness of tit-for-tat is also closely related to end-game conditions. Mutual cooperation can be stable if the future is sufficiently important relative to the present. This is because the players can each use an implicit threat of retaliation against the other's defection. However, the threat is effective only if the interaction lasts long enough (Axelrod 1984, 126).

Tit-for-tat mechanisms as observed in the field were discussed in chapter seven. The Chinese firms practise tit-for-tat that functions through embeddedness. A consequence for a business that does not live up to its word is the damage to its reputation. It is not common practice to resort to litigation, an observation that Macaulay (1963) also notes in U.S. firms. In the unfortunate event that a buyer defaults on a payment, MM Textiles tried to seize whatever property it can. If it waited to bring legal action against the buyer, the manager remarked, it would be too late and it would not be able to recover anything at all. Instead, news about the buyer's actions was disseminated around the business community, with the consequence that the buyer would find it very difficult to do business with other firms in the future. Needless to say, this buyer would not be able to access business credit in future.

In order to avoid or minimise defaults occurring, the case study firms spread their risks. This strategy can be seen as an indirect tit-for-tat action: firms spread their risk because they have experienced defaulters. The practice of using multiple suppliers was widely observed in the case study firms. This was done not necessarily to seek the lowest price, but to control the risk of delivery or quality problems. Collaboration and alliances with competitors (such as the case of SS Shipping) were other avenues for risk-sharing.

To summarise the discussion on the four conditions, repeated games promote cooperation for players who participate. Embeddedness in a social and business environment, where reputation counts, promotes cooperation for players who are involved. Common interest contributes to open-ended games, which in turn promotes cooperation for self-interest. The fact that tit-for-tat mechanisms can be

effective, due to embeddedness, end-game conditions and common interest, prevents opportunism.

8.4 Conclusion

The findings from the fieldwork are presented in a networking process framework. This framework begins with the antecedents of interorganizational relations (IORs) and then considers their nature and outcomes (chapters 5 to 7). This study finds that the firm's 'essential network' is composed of its most valuable set of partners, which can be its key customers or major suppliers or both. This network enables a firm to access resources, including technology, finance, supplies, and marketing channels. Nevertheless, the findings need to be analysed in the context of Chinese business history in the Philippines (chapter 4).

Informal agreements are the primary devices behind networking. Businesspeople often prefer to rely on a person's 'word of honour' in a brief letter or a handshake, even when the transaction involves exposure to serious risks, according to Macaulay (1963). The creation of exchanges is done on a fairly noncontractual basis; adjustments of such relationships and settlement of disputes are even less formal. Indeed, a common observation from the case studies is the reliance on oral agreements for orders. MM Textiles' purchaser would ring their yarn supplier and order a few thousand US dollars' worth of cotton yarn over the telephone. The warehouse manager signed the delivery receipt that accompanied the goods as evidence of receipt. However, this document only contained information on item and quantity and omitted price details. A sales invoice would sometimes be sent by the supplier, but the researcher observed that the delivery receipt frequently became the basis for paying.

Informal contracts and oral agreements are not always the ideal, however. AA Plastics saw this as a less than optimal arrangement for three reasons. The first was the risks that were associated with defaults or disputes; these risks increased with the size of the transaction. Second, no protection was offered for mistakes, especially when there was no documentary evidence, such as written contracts and invoices. Third, the practice did not comply with the international standards regarding accounting controls that the firm needed to follow.

AA's dilemma between using formal and informal contracts is also observed in Taiwan. Until the 1970s, formal contracts were not used between businessmen who knew, and had a basis for trusting, each other; instead, business deals were made on the basis of verbal agreements. Within Taiwan, the potential damage to one's reputation for trustworthiness was sufficient sanction to make the system work. The increased use of contracts came by the 1980s with government insistence on formal contracts for tax purposes. Despite this, businessmen still checked the reputation of the other party before signing because they felt the costs in time, money and energy to take a contractual matter to court outweighed any damages that might result. Personal relationships are, therefore, still regarded as important (Schak 2000).

A pragmatic approach to networking is observed in Taiwan. In Lukang, Taiwan, entrepreneurs maximise their autonomy and their ability to take advantage of any opportunity that comes their way by: (a) insisting on their freedom to do business with whomever they choose; (b) maintaining strict secrecy about the details of their financial affairs and their intentions; and (c) spreading their debts and obligations as widely and as they safely can (De Glopper 1972, 326). Large businesses in Taiwan are also pragmatic in the way they utilise networks in making

joint investments or cultivating political connections: almost any kind of network is used if it is useful (Numazaki 1991).

The economic achievement of the Chinese in Southeast Asia is a result of the ability of the Chinese to draw upon the strength of their socio-cultural resources to adapt to the ever-changing political and economic conditions of their respective national societies as well as the global political economy. The Chinese are also concerned with long-term economic relations intertwined with the complicated network of credit relations (Tan 1992). The four conditions for sustaining IORs are the 'glue' that make it possible for flexible and informal connections.

The typical large Chinese business enterprise in Southeast Asia is a diversified family-owned conglomerate headed by the founder-patriarch and his immediate descendants. It is tempting to see ethnic cultural characteristics embedded in this enterprise form. Nevertheless, it is at least equally likely that environmental conditions dictate this form – specifically the underdevelopment of markets and the consequential importance of relationships (Keister 2002; Lim 1996, 62). In economic terms, added value is the difference between the value of a firm's output and the cost of the firm's inputs. One way that value is added is by developing a set of relationships which others are unable to make (Kay 1993). These relationships then become the competitive asset of the firm which is leveraged to provide new business that is likely to be in different sectors, given relatively small markets and rapid growth (Lim 1996, 62).

In contrast to Weber's (1951) argument, traditional Chinese culture lacks neither the motivation nor values for economic performance. The economic achievement of the Chinese in Southeast Asia demonstrates that motivation and values can activate the orientation towards economic success only in a larger society

whose economic and administrative systems are not detrimental to business development and where there is room for economic expansion. The ability to adapt to a changing situation and to organize efficiently by drawing upon the strengths of kinship, social organizations and other forms of personal contacts are important reasons for Chinese economic success (Tan 1992, 11).

In the end, a robust and realistic view of alliances and networks could very well be built on a foundation of dualities:

- They are temporary mechanisms and long-lasting relationships.
- They are cooperative and competitive weapons.
- Each is unique, but they often share similar properties.
- They have intended purposes, yet their emergent benefits may be more important.

8.5 Limitations of the research

A common concern about case studies is that they provide little basis for scientific generalisation (Yin 1994, 10). Indeed, the case studies completed in this research do not represent 'samples' in the statistical sense. The researcher's goal was to expand and generalise theories (analytic generalisation) and not to enumerate frequencies (statistical generalisation).

With statistical generalisation, an inference is made about a population on the basis of empirical data collected about a sample. This commonly occurs when surveys are used. However, case studies are not sampling units. Rather, individual case studies were selected as a laboratory investigator selects the topic of a new experiment (Yin 1993, 31). Under these circumstances, the aim is analytic generalisation, in which the previously developed theories about inteorganizational

relations are used as templates with which to compare the empirical results of the study.

The case study approach was used over other possible approaches (such as surveys and historical or archival analysis) because it is suited to examining contemporary events (Yin 1994, 8). The case study's unique strength is its ability to deal with a full variety of evidence – documents, interviews and observations – beyond what might be available in the conventional historical study. In addition, the case study approach offers the depth unavailable in surveys.

Based on the aim of analytic generalisation, the findings have two limitations. First, are they generalisable to ethnic Chinese in countries other than the Philippines? Second, are the findings generalisable beyond Chinese business?

8.6 Future research directions

Three research avenues in the study of interorganizational relationships will be rewarding for scholars and practitioners alike in the future:

- a study of networks delineated along functional rather than ethnic lines;
- a focus on essential networks; and
- the study of IORs over time

The differentiation of networks as either 'Western' or 'Chinese' is not as useful as characterising and describing networks according to their functions or nature, such as networks built around access to finance, technology or research and innovation. Focusing on particular business functions facilitates the tracing of network ties. Meaningful comparisons between different industries or communities can also follow.

Another fruitful focus of further investigation is on a firm's essential networks. Essential networks are composed of a firm's most important ties. This importance can be evaluated quantitatively (such as percentage of sales or purchases) or qualitatively (such as technology partners). Studies focussed on firms within particular industries enable the comparison of strategy between firms.

The study of networks over time is necessary. This study has demonstrated the importance of analysing business relations within their historical and environmental context. The consideration of this context allows one to consider the effects of economic conditions, government policies and technology on the evolution of business relations. The study of networks and their change using a historical lens permits meaningful questions to be asked about why and how their nature and composition have evolved over time.

APPENDIX A

Interview guide

BACKGROUND

History

1. When was the company founded?
2. Describe your operations five years ago (or ten years ago) and compare with today.
3. What has your revenue growth rate been over the last five years?
4. What were the primary drivers of that growth?
5. What role has your relationships with other businesses played? (Suppliers, customers, competitors, venture partners)
6. Historically, how important have they been?

Business description

7. What are the company's products/services?
8. In what markets and industries does the firm compete?
9. How competitive are these?
10. What does a firm have to do to be successful in these businesses?
11. What are the most important drivers of competitiveness?
 - price
 - quality
 - delivery times
 - product features
12. Are business partners (or alliances) part of a strategy for success in these businesses?
13. What research and development activities are you involved in?
 - existing product improvements
 - new product development
14. Total number of employees:
 _____ Permanent _____ Casual
15. Sales turnover _____

GENERAL BUSINESS RELATIONSHIPS

16. How many material suppliers do you have?
17. On the basis of the cost structure, your product's value breaks down as follows:
 _____% value added by company _____% material from suppliers
18. Map out partners

APPENDIX A - continued

SPECIFIC BUSINESS RELATIONSHIP

19. Any collaborations?

- joint ventures
- subcontracting
- licensing agreement
- distributors
- other

History

20. Please consider your most important/largest/longest business relationship.

21. How did this relationship begin?

22. What factors caused you to enter into the relationship?

23. Are they the same factors that keep you involved today?

24. Describe the exchange as it began and any important stages in its evolution.

Product or service exchanged

25. What is the product, how is it made?

- resource type

26. What percentage of sales or cost of goods sold does this represent?

- scope
- salience (goal relevant or ancillary activities)

27. Partner size (larger, smaller) and importance to partner of this partnership

Benefits

28. How would you describe the benefits you get from this arrangement?

29. Are there non economic benefits?

- reputation
- information
- learning

30. Were non-economic benefits expected?

31. In your overall assessment, how has the alliance performed as compared to your expectations?

5 = very well; 4=well; 3=neutral; 2=poorly; 1=very poorly

32. Does your company have more or less influence over the direction and development of the partnership than your partner?

33. Do you see the alliance as a long-term commitment? How long?

APPENDIX A - continued**Costs**

34. Describe communications between the two firms.
 - structures
 - regularity of meetings
 - personnel involved
35. What are the costs of maintaining the tie?
36. Have there been disputes? How have they been handled?
37. Has it been easy/difficult to maintain this alliance?
38. What explains the stability over time?
39. What kinds of investments have you made in this relationship/alliance?

Performance

40. How do you measure performance?
41. How do you exercise control?

Subcontracting

42. Why did you form a relationship/alliance instead of manufacturing in-house?
43. Are there advantages to this arrangement compared to manufacturing in-house?
Disadvantages?
44. How difficult/easy would it be to replace this alliance?
45. What would be the gains/losses and costs?

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