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Another Side of the New Economy

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BARKING UP THE WRONG TREE?

Controversy has surrounded the new economy ever since the term was coined to explain the remarkably healthy economic growth in the US during the last decade. The term reflects the common recognition that the phenomenon was unexplainable by *old* economic theories. People are naturally led to believe in its verity by looking at visible changes in the society. Many positive changes in the recent years happen to be linked to information technology (IT), and IT has been widely acknowledged as the major thrust for the new economy [1][2]. Japanese Prime Minister Mori seems to be among those who share this view. He has placed IT development at the centre of the nation's policy for economic revival.

Like Mr. Mori, many political leaders in Asia are desperately looking for prospective ways to put their national economies back to the growth path. Not surprisingly they look for clues in the new economy, as they are eager to emulate the recent economic expansion in the US. Unfortunately for them, the new economy is not a modern version of the New Deal, and it has not arisen from any definite political agenda or program as the latter did. Furthermore, the current controversy and conceptual ambiguity surrounding the new economy hardly helps their quest for economic policies and strategies. Empirical knowledge is not sufficient for their policy-making either. What they need is a better understanding of the process through which the new economy has been realized in the US. With such understanding the process may be emulated to help lead to the revitalization of their economies.

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METAMORPHOSIS OF CAPITALISM

It is worth noting even at this juncture that IT is not in itself the process, although IT has no doubt been an important agent for accelerating the process. Such confusion may lead to miscued economic policies and management. Mr. Mori may not be taking a leap in the dark, but he sure looks like he is taking a leap of faith.

What is the process? The answer lies in the history of capitalism. History suggests that the new economy has been ushered in by globalization, and it has emerged out of the maturation of capitalism. Globalization has helped enhance the world economic system, and that in turn has enabled capitalism to work to its full potential. Accumulation of greater wealth in capitalists' hands is a natural consequence. This wealth continues to look for investment opportunities [3]. However, the economic landscape has much changed in the last few decades. Long gone are the good old days for industrial investment to have the "double effects" of balanced economic growth that E.D. Domer theorized [4]. After all, capitalism had no inherent mechanism for maintaining the equilibrium between the supply and demand of economic goods. Furthermore, sad to say, money has no morale and capitalism has no altruism. Thus the interest and culture for investment capital to seek quick returns grew. As a consequence, many countries have experienced steep stock inflation and bubble economies in recent years.

The eventual burst of the bubble and economic crises in East Asian countries have made it clear that such investment practice is neither sound nor sustainable. The events have also indicated that the world financial market as a whole finds more capital than opportunities for investment. Accordingly, the future of capitalism depends more on our ability to create or generate new investment opportunities, rather than on our competence in exploiting existing investment opportunities. This changing outlook may not appear drastic or far-reaching, but in effect it represents a metamorphosis of capitalism. It is a metamorphosis into "venture capitalism."

This naming acknowledges two essential features of the metamorphosis. One is that *high-risk high-return* business ventures will become the mainstay of economic expansion. The other is the concomitant change in the economic system that will facilitate and foster such business development. Creation of new investment opportunities is certainly riskier than sifting through existing opportunities to invest. If this risk has to be taken, then the entrepreneurs as well as investors who take such risks have to be compensated by high returns, if and when their ventures succeed. This is no revelation but simple economic common sense. However, its implications are manifold and rather revealing.

New investment opportunity presents itself with a change in productivity. Here the word "productivity" should be read as a short form of "productive activity" and it should be understood to include the process as well as outcome of production. Technological innovations drive such changes. IT and related changes in productivity are particularly noticeable in recent years. For this reason, some people characterize the new economy as "technology-driven economic expansion," and many people have closely associated it with IT. In short, technological innovation has come to the fore of business strategy in the new economy. There are many telltale signs of this change. For example, Corporate America's R&D expenditure is reported to have increased at more that 10% annual average rate in the last several years. Also the need as well as demand to protect the advantages derived from technological innovation has heightened to an unprecedented level. Accordingly the US government has started to grant patent rights to such innovations as mathematical algorithms and business models that would have been unthinkable by the traditional criteria.

AGAINST *HIGH-RISK, HIGH-RETURN* IS THE NAME OF THE GAME

Accelerated speed of technological innovation inevitably leads to shorter product life cycle [5]. This forces the business enterprise with any profitable productivity innovation to adopt a strategy to earn the highest return in the shortest possible time. This strategy entails marketing power in a large market. In other words, the market size matters in the new economy. Corporate America thus has an inherent advantage by being in the largest single domestic market. It even strives to gain freer access to other markets through intergovernmental agreements.

Likewise, the strongest driving force for the European Union is the realization of a single market in Europe.

Marketing power comes in various forms: established marketing channels, corporate or product brand names, a wider product range and integrated marketing, and nowadays competence in e-commerce, to name just a few. Whatever the sources of power may be, the dominant marketing position really counts in the new economy. Such a position certainly helps the business enterprise to reap high returns from its own productivity innovations. Furthermore, it also provides the enterprise with opportunities to share the merits and returns from innovations by others as well. This is because small business ventures with profitable productivity innovations face the same challenge of the new economy: i.e., to reap the highest return possible in the shortest time. They, therefore, have to find a suitable marketing partner to realize this goal. The logical choice for their partnership will be the enterprise that has the dominant marketing power to do so. This explains why the world has seen an increasing number of business mergers and alliances between corporations in the same industries.

VENTURE CAPITALISM NEEDS A NEW ECONOMIC SYSTEM

Even in the new economy, some economic rules remain constant. For example, economy of scale still applies, and lower production cost as a competitive advantage is as important as ever. In order to realize these advantages, business enterprises will have to adapt their production operations. Increasing popularity and success of outsourcing and manufacturing foundry operation attest to this trend. Globalization has made it easy for such networking in production to expand beyond national borders. Globalization has thus opened up many new opportunities for enterprising entities to seek and realize cost advantages and business successes.

Changes are coming to the production system as well. Lately such famed technological innovations in production as *flexible manufacturing* and *a lean production system* look rather dated. This perception stems from appreciation that accelerated speed of technological innovation in the new economy makes these systems vulnerable to premature obsolescence. In due course, they will be followed by a new system of manufacturing that can minimize the risk and maximize the benefit of rapid productivity innovation. It may be called *a composite manufacturing* system. It distinguishes itself with two features. One feature is the practice to engineer a new product, not *from scratch*, but by taking into consideration all available productivity innovations from its design stage. The other feature is the strategic tie-ups for effective organization and coordination of components production and assembly operations. These features are also useful in maximizing cost-competitiveness. Models of composite manufacturing already exist. Many are found in the PC industry, which is well noted for the speed of technological progress and innovations.

Even the combination of winning productivity innovation and efficient manufacturing or marketing practice is no guarantee for business success. The only thing assured for such a business venture is *high-risk*, and not *high-return*. This indicates the need for corresponding makeover of the economic system to allow and approve high return on investment, in order to compensate higher investment risks. Take the capital financing for example. The higher risk of the venture makes its financing less suitable for bank loan finance: instead, it needs an alternative means to spread and share the financial risk. In the US this need has led to the emergence of new culture and practice for venture capitalism. This is embodied in the emergence of *angels* and venture capitalists who share the risk through equity finance. Such names apart, they are not philanthropists, but capitalists all the same. They need the financial means to reward themselves for their risk-taking, if and when the venture succeeds. The establishment of NASDAQ, a risk-taking equity market, is an answer to this need. Nowadays development of similar financial institutions for venture capitalism is spreading to other advanced economies.

Although such institutional development is important in fostering venture capitalism, it only represents one element in the necessary makeover of the economic system. The overall objective of this makeover is to give budding business enterprises fair chances of success. That should start from the lowering of hurdles for entry into the market. In contemporary parlance this means *deregulation*, for historical reasons. Many nations have gone through their respective phases of *industrial development*, and many industrial regulations and practices were established in order to protect and promote *national industries* and state enterprises. Accordingly, these regulations and practices are in effect restrictive of market participation by new business entities. For this reason, *deregulation* should be an important part of the makeover.

Deregulation is also important because of a broader implication it has on the economic system; namely enhanced economic efficiency. History shows that closed market structure or practice stifles productivity innovations, and that in turn leads to the loss of vitality and competitiveness by the protected industry. The loss eventually translates into higher prices for the economic goods that the industry supplies, and its effect permeates into the entire economic system. In other words, those regulations that in effect restrict participation in the market always run the risk of raising the transaction cost in the economic system.

For a nation and its government, that may still appear a rather small price to pay for keeping "national" industries alive. However, globalization has made such parochial industrial policy and practice increasingly untenable. The new economy will make them outright harmful. As is earlier mentioned, prospective business ventures must count on a large sales volume of their goods, in order to reap high returns for their investment. For that, not only the market access but also the competitive price for their goods matters. If the economic system where they operate has restrictive regulations for market participation and tolerates higher economic transaction cost, they cannot realize the critical competitive advantage. That will confound the management of business ventures, by significantly lowering the chance of success and heightening the risk of failure.

PROCRASTINATION IS NO CURE FOR GLOBALIZATION

Under such circumstances, any determined business ventures would likely move to another country with a more favourable economic environment. This is already happening. Currently the US leads the world in providing such an economic environment. Consequently, the US leads the world in attracting entrepreneurial and technological talents, as well as investment capital. Governments of other countries are gradually taking notice of the importance of such talents and capital for infusion of vitality into their economies. However, their determinations and strategies for economic revitalization will vary, and so do their degrees of success. Their difference will become apparent in the coming decade, and the world may see the emergence of *developed nations* and *developing nations* in the new economy.

Sceptics of the new economy may see the prediction rather farfetched. They should be advised to contemplate the *multiple effect of innovation.* Individual innovations may arise in *ad hoc* manners, but they are just like *flowers* and *fruits* that have grown out of the nurtured field of science and intellectual initiatives. If they are taken away from the field, then the field is deprived of their seeds for good. Furthermore, with fewer flowers and fruits, the field would becomes less attractive for, and less visited by, the animals that feed on them and supply different seeds in return. In due course, the field would become barren. Productivity innovations are even more susceptible to the nurturing conditions than scientific innovations, because the former require not only scientific knowledge but also engineering experience. In other words, the former needs the nurturing by thriving industries that not only demand productivity innovations but also provide opportunities for pertinent experience.

As the above arguments suggest, the necessary makeover of the economic system entails government initiatives. No government can be indifferent to economic development, and none can be hostile to business ventures or productivity innovations, Nonetheless, many governments will not see the full implications of the economic metamorphosis that the new economy represents, or the imperative of the economic system makeover for venture capitalism. Even if they have perceived the imperative, they may not be able to act accordingly.

POLITICS CAN MAKE OR BREAK

Two major obstacles often stand in the way for the makeover: namely bureaucratic inertia and political acquiescence. Bureaucracy is best served by the *status quo*, anytime anywhere. It therefore entails strong political leadership to overcome bureaucratic resistance and procrastination against the makeover. Thus political leadership is essential to override and overcome such bureaucratic inertia. However, even in democracy, and even when the public is aware or resentful of bureaucratic inertia and self-interest, politicians may still fail to side with the public. Such apparent contradiction arises from their need to finance their costly election campaigns.

Consequently, political leaders are rarely after popular votes and, instead, they are more likely after supporters and contributors to their election campaign. They find such supporters and contributors among those who have enjoyed economic privileges in the existing economic system and regulations. Thus political connivance and bureaucratic procrastination often prevail, unless the public at large come to realize that the nation's future well-being is at stake in the economic makeover and they demand a political makeover. The public must realize that the obsolescent economic system for venture capitalism will drive progressive business enterprises out of the country, and that failure in the necessary economic makeover will deprive the nation of her economic vitality and defraud her people of their economic security. This spectre is most evident in Japan today.

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