TRANSFORMATION OF JAPANESE-STYLE CAPITALISM: INDUSTRIAL POLICY IN A GLOBAL ECONOMY

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INTRODUCTION

It seems that Japanese economy has finally taken the course of recovery after about fifteen years of struggling with recession after the Bubble Economy. Annual GDP growth ratio is 3.2 percent in 2005 and these recovery sessions have been continuing since 2002.

And furthermore, some Japanese products such as electric goods, cars including ecological cars, computer game machines, popular cultures, even business models and so on are accepted favorably in many foreign markets. A BBC Poll showed that Japan is one of the most favorably accepted countries, and one of the director of that poll said "Countries that relate to the world primarily through soft power, like Japan, France and the EU in general, tend to be viewed positively" [1]. There presumably is some reason for these situations.

When we look around the world, whereas globalization of economy is prevailing more and more, it seems to come to be clearer that there could be many types of economies even in capitalism. Besides American style free market economy, there are European market economy, Chinese communism-market economy and Islamic religion-ruled market economy and so on.

Samuel Huntington said in his book "the Clash of Civilizations" that there are six different original civilizations and "Japanese civilization" is one of the original civilizations. And many researches about Japanese style capitalism have been done in the past. I assume it is true to some extent that Japanese style capitalism is different from western style capitalism and could be explained as independent economic system.

However, we need to elaborate the theory of Japanese style capitalism more deeply and reflect recent structural and institutional change of Japanese economic system. And we need to distinguish

[1]BBC Poll conducted in 2006 – 2007 <http://www.worldpublicopinion.org/pipa/pdf/mar07/BBC_ViewsCountries_Mar07_pr.pdf>.

what should be changed or diminished and what should be remained or strengthened. Without that process, we cannot go further way.

From this perspective, I would like to focus on Japanese style capitalism on the aspect of employment system, labor institution, corporate governance and government-business relationship in this paper.

I do not intend to try to generalize Japanese style capitalism as a superior system than other countries and recommend or force to introduce the Japanese style capitalism into other countries (I suppose that it was a terrible mistake that the old Japanese Imperialism tried to force the then Japanese way onto Asian countries), but I do intend to try to illustrate each style of economic institution fits for each country and Japanese style economic system is now experiencing adjustment period to fit for current Japanese situation.

CHAPTER 1

WHAT ARE THE CHARACTERISTICS OF JAPANESE-STYLE CAPITALISM?

Basic Characteristics That Have Been Argued Traditionally

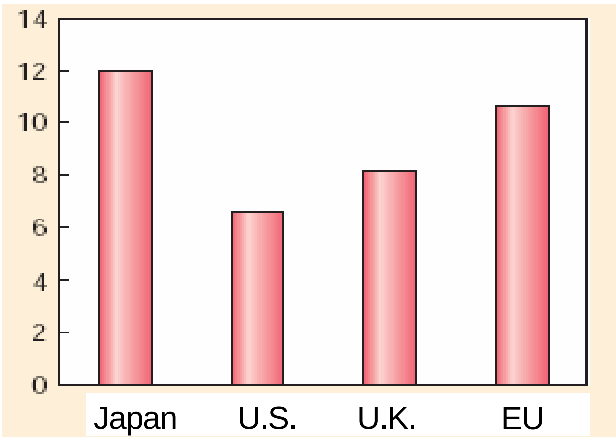
There are many research works within and outside Japan that debate the characteristics of the Japanese style capitalism. Here I would like to describe the typical image and factors of the Japanese style capitalism although some of those are that which it used to be. The most basic factors that have been argued are so called "three treasures" such as life long employment, seniority based wage system and inner company labor union. And long term relationship among the related companies such as manufacturing core company and subcontractor companies and main bank in terms of operating business transaction and financing in the long run. And moreover strict government business relationship and government's strategic regulations and allocation of resources are pointed out and sometimes called Japan Inc. Model.

Employment and Management System

It was said that Japanese companies have long term employment period. It was typical that once newly graduated students chose their job and company, then they do not quit that company until they retire in the age of retirement. Upon that, companies provide job training, education and welfare service for their employees and at the same time companies could evaluate their workers and distinguish top elites and others.

Figure 1. International Comparison of Continuous Employment Years[2]

[2]Cabinet Office, *Economic White Paper 2006.*



Along with long term employment, in many Japanese companies employees are evaluated by their age and paid proper amount of salary according to that seniority based evaluation. So basically the colleagues who entered a company at the same time promote at the same pace in terms of both wage level and level of position. Hence although young employees were paid relatively lower salary, they were patient about their condition including lower wage and concentrated to accumulate their skills which are needed to accomplish good performance in their specialty surely expecting future higher salary and condition.

By the way, the concept of these types of activities of Japanese companies has been established in current Japanese languages. In terms of terminology, one of the Japanese authoritative dictionaries defines *Nihon-teki Keiei* as “the way of managing of Japanese companies which is characterized by *Shushin Koyo* and *Nenko Joretsu Chingin*”. And the dictionary also defines *Shushin Koyo* as “the style of employment in which the relation of employment lasts from employment thorough retirement” and *Nenko (Joretsu-gata) Chingin* as “wage or salary which is paid based on factors such as how many years someone has worked or his/her age itself etc”[3]. From the aspect of academic research history, the first person who used the word “lifetime commitment” was Abegren (1958)[4].

[3]*Daijirin Japanese Dictionary* (Tokyo: Sanseido).

[4]Michio Nitta, *Employment System in Transition* (Tokyo Zaidan Shuppan-kai, 2003).

Whereas western style capitalism has the labor union system which is organized in each industrial sector, the labor union was organized in each company in Japan. And some of the labor union members also promote to managerial position in the company in many cases. Hence the labor union and the managers negotiate conditions of employment steadily and cooperatively.

And management style has also characteristics of Japanese style Capitalism. Managers of Japanese companies often derive from original workers who have promoted step by step within the company. That is called *Haenuki* system. And the management staffs tend to care for employment of labors and not to stick to their own high wage in comparison with managers in U.S. companies. In other words, Japanese typical companies tend to pay much more attention to stake holders than share holders.

Long-term Associations Among Related Companies

Japanese companies tend to establish long term transaction relationship among related companies called Keiretsu especially in the way that a core big manufacturing company has many steady subcontractors who supply their parts of products. Hence the core manufacturing company could procure their necessary parts and even in some case they exchange their employees in terms of job training or strengthening of their relationship which also played a role of adjustment of temporary gap of needs and supply of labor within Keiretsu companies. Moreover, the core company and their subcontractors have done so called cross share holdings.

The word Keiretsu is originally Japanese word which is defined as "1) One of the connective relationships among companies, 2) Connective relationship between a large company and a small or medium company which is a subcontractor of it, 3) That includes connective relationship among large companies each other like a combine."[5] But now it also has became an English word defined by The

[5] *Daijirin Japanese Dictionary..*

Oxford dictionary as “a conglomeration of separate businesses linked together by cross-shareholdings in one another to form a robust corporate structure, highly resistant to take-over bids or drastic losses.”[6]

By the way, while some researcher argues that there is no Keiretsu actually, whether Keiretsu exists or not depends on its definition[7]. Although Miwa and Ramseyer define Keiretsu specifically, I take more general and broader definition in my research.

Besides, traditionally speaking almost companies including core big manufacturing company relied their financing upon so called the main bank. And it is said that the main bank system has also been played a role of governance to the companies which use the finance in the way that the main bank often advise and even supervise some times to their customers in terms of making sure that they could get their finance and return back.

Government-business Relationship

Another aspect of Japanese style capitalism which has been argued typically is strict relationship between government and business sector and government planed strategy for allocating resources and regulations toward market. That system of relationship and intervention to market was often called as Japan Inc. theory which regarded the Japanese companies and government as an individual incorporated company.

Most typical one of the policy is the industrial policy of then Ministry of International Trade and Industry (MITI, now Ministry of Economy, Trade and Industry; METI) and another is the financial policy of then Ministry of Finance (MOF, now Financial Service Agency; FAS) during the period of rapid economic growth. In addition to that, the regulation and intervention to the market which tend to

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[6] *Oxford Advanced Learner’s Dictionary* (Oxford: Oxford University Press, 2000).

[7] Yoshiro Miwa, and J. Mark Ramseyer, *Misunderstanding of Economic Theory of Japan* (Tokyo: Toyo Keizai Shinposha, 2001) 9.

direct to adjust the demand and supply and protect labors or small companies by the ministries such as Ministry of Agriculture, Forestry and Fishery or then Ministry of Labor (now Ministry of Health, welfare and Labor).

In terms of arguments which insist that Japan has original industrial policy, then-MITI's industrial policy was described as typical feature. They argue that MITI has done protective and strategic policy to promote domestic industry such as allocation of resources to selected leading industries, regulation of new entries, high tariff and so on.

Then MOF's financial policy was named as convoy system which protects and benefited Japanese banks by strict regulations and limit competition. The ministry used to impose much administrative guidance onto banks so as to avoid bankruptcy of banks.

While these used to be some features of relationship between Japanese government and business institutions, those have been criticized as improper intervention to business activity by United States for instance in Strategic Impediment Initiative in 1989.

History of and Theories About Japanese-Style capitalism

There are so many analysis and theories about the Japanese style capitalism. I would like to survey existing discussions here.

It is said that the feature of employment management such as life time employment and seniority based wage has been adopted by many companies in order to stabilize employees as a result of having been suffered from lack of labor force and huge payroll during industrial development period which is from the end of 19C through beginning of 20C. And they say that Japanese companies cannot help but to train their workers into skilled ones by themselves because industrialization got started later than Europe and United States in Japan and Japanese companies needed to catch up with new technologies quickly.

Some argue that Japanese style capitalism such as life time employment, seniority based wage, inner company labor union and strong government interference into business activity has formed during WW2 especially 1940's. For example, Law of General Mobilization of Nation was enacted in 1938 so that dividend and right of share owners was limited based on the law. Because of that companies was formed employment oriented organizations. On top of that, Industrial Association for National Benefit of Imperial Japan (*Sangyo hokoku kai*) was organized and government enacted many business regulation laws. That was said that basis of government-business relationship.[8]

It is said that the features like managers are promoted from workers and main bank system was affected by the measures to avoid excessive concentration of economic power which was held after WW2. Former managers were purged and shares which ware held by holding companies of *Zaibatsu* were taken off so that employees have chance to get the shares in advantage and the ratio of individual share holding rose. While management and ownership were united under the control of *Zaibatsu*, after disorganization of it, management and ownership got apart and managers got used to be chosen from employees. And companies wanted banks to be stable share holders in order to get finance from banks because of slump of stock market and to avoid M&A.

The other researchers point out that government got used to be able to order the Industrial Bank of Japan or other banks to finance industries and launched a system of assignment finance institution for munitions firm during WW2. That system assured munitions industries to get financed and financial-industry groups were said to be formed at that times.

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[8]Yukio Noguchi, *The 1940 Year System – Farewell to the Wartime Economy* (Tokyo: Toyo Keizai Shinposha, 1995).

CHAPTER 2

HOW HAS JAPANESE-STYLE CAPITALISM CHANGED?

Change of Business Situation

Change of Business Environment

After the Bubble Booming, the big stagnation named Heisei Recession followed the booming in early 1990'. During this recession, companies were suffered from three redundancies; debt, facilities and payroll.

Although there are so many analysis and theories about why and how the boom and the recession occur in Japan, I cannot afford to argue which theory is better than others in this paper. But it seems to be no doubt that one of the reasons is linked to over lending and investment to especially land related assets and financial policy change to restrain that heated financial activities. And after that government had paid so many efforts to solve the non performing loan which was generated during the Bubble Booming.

Companies tried to restructure their business to get over three redundancies and they took variety of measures. For example, many companies took some measures such as constrained excessive goods in stock or interest accruing debts, sold their financial assets or real estate properties, reduced law profited businesses, reorganized their deteriorated subsidiaries, did M&A, adopted merit based wage, cut bonuses, reduced new recruits and adopted non-regular workers etc.

And effect of globalization was very huge. A set of liberalization of financial institution made capital market global and business activities got more and more international. The ratio of stocks owned by foreigners has increased drastically from 5 percent in early 1990's to over 25 percent in these days. That suggests many foreigners have become interested in Japanese business culture and many Japanese managers cannot help being more sensitive to global standard of business way.

The rise of service sector industry which is now occupied about 60 percent of all industry in terms of GDP is affecting the industrial structure significantly. And even in manufacturing industry companies came to use short term work force such as dispatched labors and part time labors.

Institutional Change

Corporate Governance System

Commercial law has been revised several times along with change of business environment. A procedure of merger is simplified in 1997. Companies got to be able to acquire another company as a complete subsidiary by means of exchange or transfer of stocks without paying cash for the stocks in 1999. And procedure of creating subsidiary is simplified in 2001.

Because of revise of Commercial law in 2001, large corporations and constructive large companies got to be required to have at least three statutory auditors of which at least half must be outside statutory auditors. Auditors system has been a Japanese original corporate governance system. This revise tried to strengthen that governance function by introducing objectiveness and transparency.

Commercial law revised in 2002 introduced a kind of American style corporate governance scheme. Companies got to be able to establish an American style managing board which is composed of appointment board, reward board and auditor board. And more than half members of each board must be outsider. The point I would stress here is that companies can judge which style might fit much better for their own organizations. And then Commercial Law was reorganized into Company Law in 2005.

Accounting System

Accounting system also has changed drastically since late 1990's. Consolidated accounting was introduced in 1999, market value accounting was introduced on financial assets owned by companies in 2000, at the same time, retirement payment accounting was introduced so that it became mandatory for companies to disclose market value of pension assets and to balance pension deficit within 15 years. Market value accounting was introduced on cross share holding stocks in 2001 and on lands, buildings and facilities in 2005.

These changes had influence on reconsidering management style which relied on book profit, avoiding concealment of losses by means of transferring the losses to subsidiaries and unwinding cross share holding.

Financial Institutions

Through 1980s and 1990s, financial deregulation such as liberalization of asset dealing, relaxation of bond issuing condition, and so on had been conducted.

In 1996 the then prime minister Hashimoto proposed a package of six financial reforms called "Big Bang". That included 1) complete liberalization of foreign exchange trade, 2) liberalization of investment trust, pension and trust market, 3) liberalization of stock dealing fee, 4) deregulation of new financial services, 5) removing the ban of financial holding companies, 6) liberalization of mutual entrance to bank, security and insurance in the way of holding company, 7) reinforcement of account standard.

These financial deregulations resulted that business corporations came to be able to get their fund from many other channels like bond issuing besides borrowing fund from banks.

Labor Market

In 1999, the Worker Dispatching Law was deregulated and as a result of that deregulation, private companies was allowed to provide temporary staff placement business and companies became to be able to use the temporary work force more flexibly. Although using dispatch workers was not allowed in categories such as manufacturing, construction, harbor services and a few other areas, the law was deregulated again in 2003 and manufacturing companies were allowed to use dispatch workers.

While court decisions had ruled that employers could not dismiss workers without cause unless they met fairly stringent criteria for economic hardship, the government revised the Labor Standards law to codify guidelines for dismissing workers.[9] Those deregulations caused that companies could use external labor force market and in fact many companies shifted to use that option.

Change of Business Behavior

Internal Corporate Management

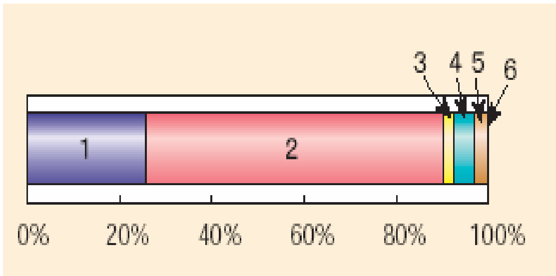
Long-term Employment

According to a survey about business behavior held by Cabinet Office in 2004, 83 percent of about 1,000 sample companies answered they have adopted merit based wage system. And it seems that such kinds of companies that aggressively adopt workers who have special skills are more likely to adopt merit based wage system. On the other hand, there seems to be many companies that still retain long term employment.

[9]Steven K. Vogel, *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism* (Ithaca, NY: Cornell University Press, 2006).

Cabinet Office's survey below shows that about 90 percent of questioned companies answered that they will somehow maintain their long term employment system.

Figure 2. Company's Policy regarding Long-term Employment[10]



1. Principally Maintain Many Workers
2. Maintain Many Workers Considering Business Environment
3. Limit Maintaining Workers Because of Bad Performance
4. Limit Maintaining Workers for seeking of Competitiveness
5. Having no Priority on Maintaining Workers

Ministry of Health, Labor and Welfare analyzes in their white paper that "Long-term employment is hold fast as enterprise's basic policy whereas seniority based waging is modified. Fundamental point of change of Japanese style employment system is that collective labor relationship which has dealt labors by measures of external factors such as age or years of working has been changing, and especially individual labor relationship which based on individual ability building and ability evaluation regarding wage has been forming. And this individualization of labor relationship includes tendency to inevitable expansion of difference in wages."[11]

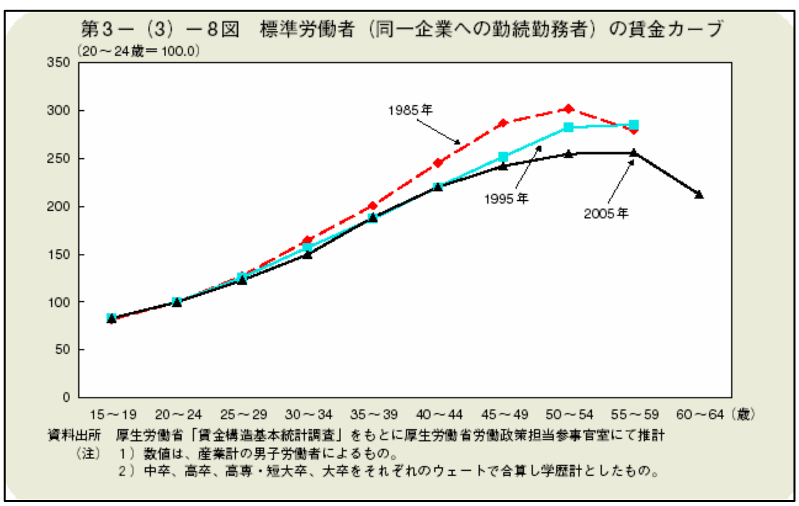
[10]Cabinet Office, *Economic White Paper 2006* (Tokyo, 2006).

[11]Ministry of Health, Labor and Welfare, *Analysis of Labor Economy 2006* (Tokyo, 2006).

Seniority-based Wage System

Seniority based wage system was supporting long-term employment system. Corporations kept young employees wage level relatively low and gradually raised their wage in line with their employment periods. Thorough this employment system, corporations could keep their employees' loyalty to their corporations high and maintain motivation to get their skill level up. Corporations could maintain seniority based wage system only in the condition of going through successive growth and employing newly graduated work forces. But after 90's recession made corporations reduce employment of newly graduated work forces and that resulted in shift to having many older work forces. And that caused high cost of employment and that gave corporations motivation to change their wage system into more merit based one. Then, the figure below shows that a wage curve is getting more and more flat in these days.

Figure 3. Shift of Wage Curve[12]



A survey shows that 83 percent of sample corporations have adopted some king of merit based wage system and 13 percent of those are thinking of adopting that.[13]

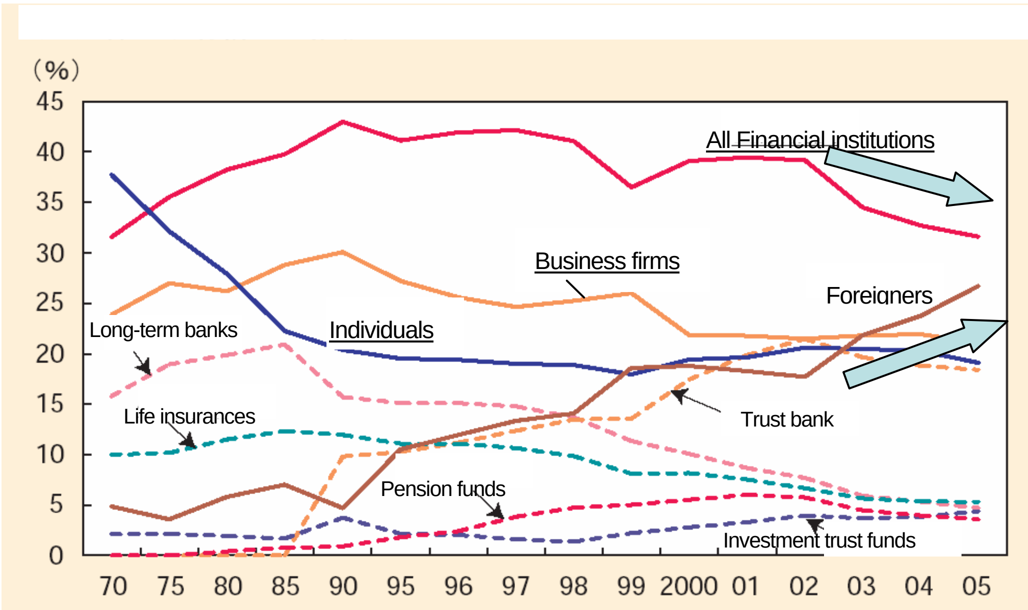
[12]Ministry of Health, Labor and Welfare, *Analysis of Labor Economy 2006* (Tokyo, 2006).

[13]Cabinet Office, *Economic White Paper 2006.*

Corporate Governance

The figure below shows that share of shareholders has changed drastically. Especially foreign stock owners are increasing rapidly. Along with rise of pressure from capital market, many corporations have been now struggling with reform of their corporate governance system.

Figure 4 Shift of Ratio of Different Shareholders[14]



A survey held in 2002 shows that 33 percent of sample corporations have adopted executive director system, 2.7 percent of those are going to adopt it and 25.8 percent of those are thinking of it. 36 percent of those have adopted outside director, 2.9 percent of those are going to adopt it and 32.6 percent of those are thinking of it. 28.1 percent of those have adopted stock option system, 1.9 percent of those are going to adopt it and 15.2 percent of those are thinking of it. And the 105 corporations have adopted committee establish method (December 2006).

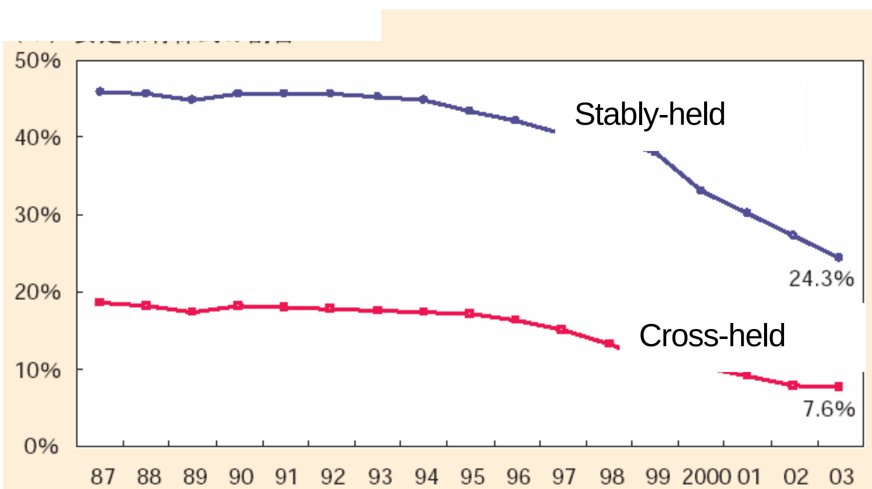
[14]Cabinet Office, *Economic White Paper 2006.*

Inter-company Relations

Cross Shareholding

Cross share holding between two firms or between a firm and a bank has been declining. The ratio of cross share holding declined from about 20 percent in 1990's to 7.6 percent in 2003. The ratio of stable share holding which include stocks that are owned by financial institute and firms declined from about 46 percent in 1990's to 24 percent in 2003. As a result of that, variety of stock holders has increased and the ratio of foreign stock owners has got up to over 20 percent.

Figure 5. Shift of Stable Shareholders[15]



A survey below held by Fiscal General Policy Research Institute on 2003 shows that 1) rate of companies which were questioned and answered that they will "weaken" and "slightly weaken" their cross share holding with both business firms and financial institutions overwhelmed the rate of

[15]Cabinet Office, *Economic White Paper 2006.*

companies answered they will “strengthen” and “slightly strengthen” it, 2) larger companies are more likely to tend to weaken their cross share holding than smaller companies.

Figure 6. Situation on Cross Shareholding[16]

(Billion Yen, %)

		under \10b	\10-30b	\30-100b	\100-300b	over \300b	total
companies having cross-share holding with business firms		57.1	65.0	72.0	74.0	73.7	69.5
their future policy	"strengthen"	0.0	1.5	0.5	0.9	1.2	0.8
	"slightly strengthen"	4.2	1.5	5.5	5.5	0.0	3.7
	"status quo"	58.3	59.9	49.3	49.3	47.6	52.0
	"slightly weaken"	20.8	27.0	24.4	24.4	33.3	28.2
	"weaken"	16.7	10.2	20.3	9.1	17.9	15.3
companies having cross-share holding with financial institutions		67.9	76.7	78.6	82.9	83.3	78.5
their future policy	"strengthen"	0.0	0.6	0.4	0.0	0.0	0.3
	"slightly strengthen"	0.0	0.6	0.0	0.8	1.1	0.4
	"status quo"	63.2	62.5	44.9	41.3	34.7	48.5
	"slightly weaken"	26.3	25.6	33.9	36.5	42.1	32.9
	"weaken"	10.5	10.6	20.8	21.4	22.1	17.8

According to a research which was held on 1999 by questioning to top executives of 731 listed companies shows that 1) 66.5 percent of 719 companies which have stable share holders answered that over 50 percent of their stocks were held by the stable share holders and 2) 75 percent companies have a board of director of which over 50 percent of the members are composed of inner promoted directors.[17] It seems that this research shows that many Japanese companies still have Japanese way of managing and relationship among stable share holders to some extent even in recent years.

[16]Fiscal General Policy Research Institute, *Progressing Corporate Governance Reform and Revitalization of the Japanese Corporation* (Tokyo: 2003).

[17]Michio Nitta, *Employment System in Transition* (Tokyo: Zaidan Shuppan-kai, 2003).

Main Bank

A survey below held by Fiscal General Policy Research Institute on 2003 shows that some companies with good rating tend to be going to weaken fund raising from their main bank somewhat meanwhile some companies without rating tend to be going to strengthen it.

Figure 7. Survey on Fund Raising from **the Main Bank**[18]

(%)

	2002			1999
		(a)	(b)	
Strengthen	4.2	0.6	5.2	4.9
Slightly strengthen	3.9	3.5	4.0	7.8
No change	73.3	72.1	73.7	64.0
Slightly weaken	7.9	9.3	7.5	12.5
Weaken	4.1	5.2	3.8	3.9

(a)=companies with good rating
(b)=companies without rating

S. Vogel evaluates "the main bank system has not dissolved but rather fragmented into a eider range of relationships. The Nihon Keizai Shinbun finds that 95 percent of listed firms still report that they have a main bank. According to a MOF Policy Research Institute survey, 73.3 percent of firms intended to continue raising funds from their main banks at current expected to decrease it." and "stronger companies have grown more independent from their main banks while weaker ones have gone back to their main banks and smaller companies have strengthened main bank ties."[19]

[18]Fiscal General Policy Research Institute, *Progressing Corporate Governance Reform and Revitalization of Japanese Corporation*, Tokyo, 2003.

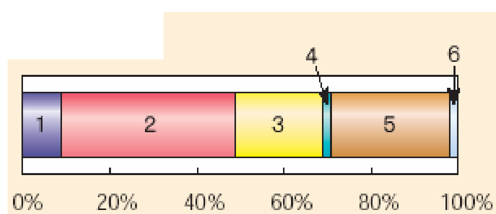
[19]Steven K. Vogel, *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism* (Ithaca: Cornell University Press, 2006).

And Economic White Paper says "the feature of participation in corporate governance by main bank has presumably come weaker these days at least in large companies."[20]

Keiretsu

A survey shows that over 60 percent of sample corporations are thinking they are going to develop new business relationship or revise their existing business relationship, while less than 10 percent of those answered they will maintain existing business relationship. But it presumably rational to suppose that situations are different from each business case, because each corporations' business way are so much various regarding their business type such as manufacturing, service provider, exporting company and so on.

Figure 8. Keiretsu relationships in future[21]



1. Maintain their own long-term relations
2. Maintain it and search new relations
3. Partially maintain it and Search new relations
4. Revise long-term relationship
5. Having no Keiretsu relations

Change of government–business relation

[20] Cabinet Office, *Economic White Paper 2006.*

[21] Cabinet Office, *Economic White Paper 2006.*

Reform of Administrative Organization

In 1994, Deregulation Subcommittee was established under the Administrative Reform Committee. It was reorganized as Deregulation Committee under the Headquarter of Promotion of Administrative Reform in 1998, renamed to Regulative Reform Committee in 1999, reorganized as Council on General Regulative Reform in 2001 and finally Council on Regulative Reform and Privatization and the Headquarter of Regulative Reform and Privatization were launched in 2004.

When administrative reform was held in 2001, besides many ministries was reorganized, the Council on Economic and Fiscal Policy was established. The members of the council consist of the prime minister, ministers of MIAC, MOF and METI, and the four private experts including professors and business leader. The council has created annually The Basic Policies of Economic and Fiscal Management and Structural Reform which includes overall policies related all ministries and that basic policy becomes a Cabinet Decision.

Structural Reform

In 2002, Special Zones for Structural Reform Law was settled and the Office for the Promotion of Special Zones for Structural Reform was created in Cabinet Office. The system of this institution is that private sector or local government provides certain request for deregulation to the Cabinet Office and then the Cabinet Office negotiates against related Ministries to embody that requested deregulation in limit of the requested regional zone. After some experimental periods the Cabinet Office will estimate whether there is aftereffect, and if not, the deregulation will be expanded to whole nation. Through this system business people became to be able to make their desirable deregulation for better business environment. By 2008, nine hundred and ten Special Zones were established and three hundred and six of those were sort of “graduated” into national deregulation from region limited deregulation.

The most prominent example of concrete Special Zones for Structural Reform from the perspective of my argument is deregulation of entrance of corporations into the three big markets that is agriculture, hospital and school.

Now Privatization Test system was working under the Council on Regulatory Reform and Privatization. This system started in 2005 and now based on the Law of Reform of Public Services by Introduction of Competition which enacted in May 2006.

Reform of Administrative Procedure

Information Disclosure Law which entitled all Japanese people to request all administrative documents and information enacted in 1999. At the same time all administrative bodies was obliged to file and keep their administrative documents and open the titles of their documents. And then people got to be able to know the huge amount of administrative information including policy making discussion.

Administration Procedure Law which was enacted in 1993 was revised several times and then it became mandatory to ask public comment from all over the nation when a ministry will create any rules or major decision makings. And then Administrative guidance became old fashioned.

Finally, I would point out the fact that spread of information technology has significant effect to current government policy making process. As described above, the nation got a legal right to request to get a copy of certain administrative documents or information and at the same time each ministry became to have to file all administrative documents according to length of keeping of each document and disclose the title of all filed documents public which include the argument of certain policy making process. And many individuals and Non Profit Organizations got to discuss and express their own policy proposals more and more in their internet web sites or blog. Even politicians who represent the nation often have their own web site or blog and got involved in such a virtual and broad discussion on the web and actually they made questions and proposals at the real diet discussion some times on the basis of such a virtual discussion.

It is possible to say that these changes above means that a sort of democratization of the policy making process to the public. Nowadays, there is no administrative interference like what existed in the past.

CHAPTER 3

WHAT SHOULD BE THE FUTURE OF THE JAPANESE STYLE CAPITALISM

Thinking all things above considered we should discuss about what should be the future of the Japanese style capitalism.

For Whom and for What Do Corporations Exist?

What Is a Corporation?

We should begin with thinking of what is a corporation, because the answer for the question "which way should we go?" would be various depending on what standpoint we take with regard to understanding characteristics of corporations.

According to Okabe[22] who is an economist of Keio University, there are two ways of answering to the question; "what is a corporation". The first way is to explain it in terms of financial contract. In this approach, it comes to be natural t consider that a corporation belongs to shareholders. Managers are only the agents employed and entrusted by shareholders to execute corporation management in behalf of shareholders. Corporations' purpose is to maximize profit (or dividend) or stock price because they are acting to contribute to shareholders. Managers are monitored by outside directors in light of whether a corporation is managed properly or not. Management is disciplined by the action of shareholders such as a claim ("voice") on a general meeting of shareholders or a selling their stocks ("exit") when the performance was bad. This view is also referred as "financial approach", "shareholder view", "agency view" or "outsider model". In this view, fundamental factor of corporation is fund or capital stock. This view is prevailing much more mainly in America. This view is

[22]Mitsuaki Okabe, *Japanese Firm: Behavior and Structure Evolving* (Tokyo: 2005) 11.

reflected by American cultural characteristics such as an ideology which pays respect for individualism, having a lot of immigrants, variety and fluidity of human resource and well developed capital market.

The second way is to explain "what is a corporation is?" in terms of stakeholders. In this approach, a corporation belongs not simply to shareholders but also to all of stake holders such as employee who are involved in the business in the long run, managers or related banks and so on. Hence, the purpose of a corporation is not simply to maximize short-term profit or dividend but to maximize all stake holders' benefit. In this view, that profit tends to be measured by long-term profit, scale of a corporation or market share of its products like Japanese corporations during rapid economic growth. The management on a corporation of this type tends to be executed by managers who promoted from employees inside the corporation and monitored by directors who promoted from managers or main bank. This view is prevailing much more mainly in Japan especially during rapid economic growth and some German corporations. By the way, this view is reflected by Japanese cultural characteristics such as having respect for community rather than individual in comparison with Anglo-Saxon society, homogeneous society that has little immigrants and indirect financing supported mainly by banks.

I think the latter way is better to explain Japanese real economic circumstance according to Okabe's classification. The reason will be shown in some surveys below.

What Are the Important Factors in Japanese Corporations?

Firstly, the survey of Nikkei Shinbun held in 1990 below shows that; in response to the question "to whom should corporations belong", 80 percent of questioned corporations answered "employees", 70 percent of those answered "all of society", 67 percent of those answered "shareholders". And in response to the question "to whom do corporations really belong", 77 percent of questioned corporations answered "employees", 65 percent of those answered "managers", 59 percent of those answered "shareholders".

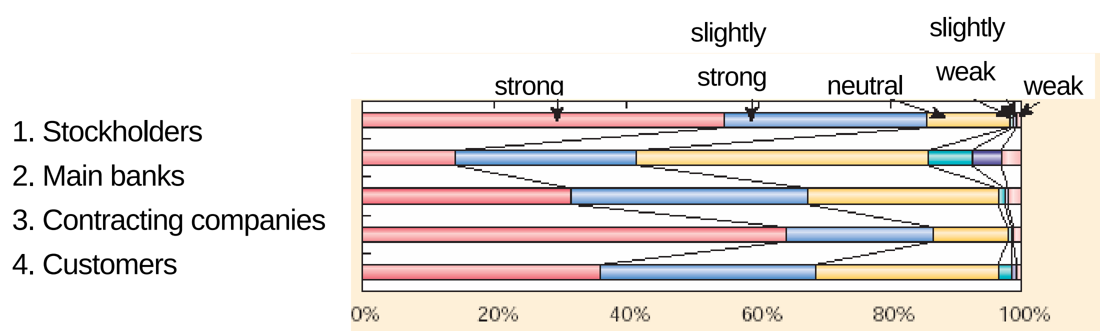
Figure 9. Answers for the Questionnaire regarding Corporations

(%)

	Whose it should be	Whose it really is
Stockholder's	67	59
Manager's	19	65
Employee's	80	77
Whole society's	70	23
Customer's	27	26
Region's	10	3

Secondly, a survey below about corporate governance held by Cabinet Office on 2006 shows that corporations look customers (over 60 percent), shareholders (about 55 percent) and employees (about 35 percent) as very important stake holders.

Figure 10. Which stakeholder is regarded as important[23]

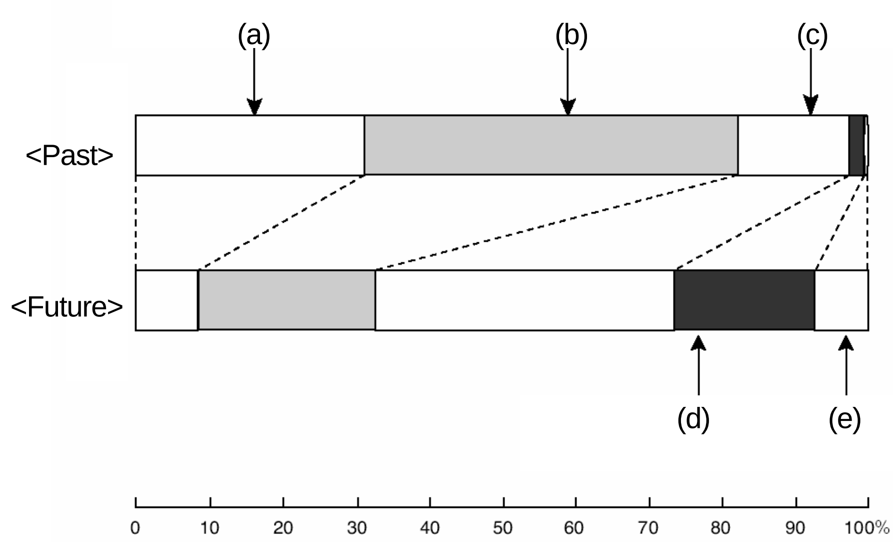


These two surveys illustrate that employees are thought as one of the most important stake holders in Japanese corporations. And the customers or community are also regarded as one of the most important factors.

[23] Cabinet Office, *Economic White Paper 2006.*

But it is also true that some changes are now going to occur on this situation. A survey below held by Economic Planning Agency (now Cabinet Office) on 1999 shows that while over 80 percent of questioned corporations answered that volume of sales or profit was important in the past, over 30 percent of those answered volume of sales or profit will be important in the future. On the contrary, while less than 5 percent of questioned corporations answered rate of profit on capital or efficiency of capital was important in the past, about 25 percent of those answered rate of profit on capital or efficiency of capital will be important in the future. Hence, it is reasonable to say that Japanese corporations are getting more and more sensitive of capital efficiency or shareholders' requests.

Figure 11. What Factors Corporations Regard as Important: Past and Future



(a) Amount of sales / profits
(b) Comparatively amount of sales / profits
(c) Evenly both of amount of sales / profits and ROA / capital efficiency
(d) Comparatively ROA / capital efficiency
(e) ROA / capital efficiency

But even so, since a survey held by Cabinet Office on 2006 shows that corporations still make much of "ordinary profit" (about 55 percent of corporations answered so), "operating profit" (about 53 percent) and "sales" (over 40 percent) in stead of "ROE (Return On Equity)" (about 23 percent) or "ROA (Return On Asset)" (about 18 percent), speed of this change of mind set seems to be relatively slow.

Variety of Concepts of "Corporate Governance"

The concept of corporate governance or what point they focus on is slightly differ from each definition depending on how we understand sovereignty of corporations. Mataro Miyamoto who is an economist of Osaka University assembles several definitions of corporate governance below[24].

Firstly, Japan Corporate Governance Forum (JCGF) defines "corporate governance" as "board of directors' making decision on business principle and fundamental strategy whose are chosen by shareholders as agencies of shareholders who have rights of governance and monitoring how well managers are administrating a corporation using its resources such as workforce, assets and capital." Hiiroshi Osano who is a financial economist of Kyoto University defines "corporate governance" as "to discipline managers for the sake of shareholder's benefit in a long run" from the stand point of theory of financial contract[25]. These definitions are based on the view of shareholders' sovereignty on corporations.

Secondly, Mitsuhiro Fukao who is a professor of commerce of Keio University and Yasuko Morita who is a research fellow of Bank of Japan defines "corporate governance" as "1) mechanism of managerial decision making in corporation, 2) mechanism of adjustment of relation between stake

[24]Mataro Miyamoto et al, *Dealing with Japanese Capitalism: Current Thinking and Future Prospects* (Tokyo: 2003) Chapter 4 Japanese-style Corporate Governance.

[25]Hiroshi Osano, *Economics of Corporate Governance* (Tokyo: 2001).

holders who are concerned with a corporation's performance 3) way of control and monitoring on managers by shareholders" and "the matter how share rights and responsibilities and how distribute the values which corporations created between stake holders such as shareholders, managers, employees and customers in terms of how to manage corporations efficiently"[26]. This definition is based on the understanding that shareholders are not the only ones that have sovereignty over corporations.

Thirdly, Hiroyuki Itami who is a scholar of business administration of Hitotsubashi University defines "corporate governance" as "to influence on management by the persons who have civil rights (*Shimin-ken-ja*) on the corporation for the sake of maintaining corporations' desirable performance"[27]. And he also defines that *Shimin-ken-ja* are "the persons 1)who provide resources which are inevitable to develop a corporation and 2)who commit themselves in the business and take large risk through rise and fall of the corporation". Then he argue that *Shimin-ken-ja* are 1) shareholders who provide capital without exit, 2) managers and core employees who have committed themselves in the corporation in a long run. And besides, he argues that since core employees are more important in terms of contribution and scarcity, corporate governance should be mainly based on employee sovereignty rather than shareholder sovereignty.

In light of global aspect, OECD (Organization for Economic Cooperation and Development) Principles of Corporate Governance mentions that "employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation" and "in addition, factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which a company operates can also have an impact on its reputation and its long-term success.[28]"

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[26]Mitsuhiro Fukao and Yasuko Morita, *International Comparison of Corporate Governance Structure* (Tokyo: 1997).

[27]Hiroyuki Itami, *Japanese-style Corporate Governance* (Tokyo: 2000).

[28]OECD, *OECD Principles of Corporate Governance 2004* (Paris: 2004).

Although I do not suppose that there is only one way of defining the concept of corporate governance, I would suppose the second (Fukuoka and Morita's) and third (Itami's) way of definition might fit much better for Japanese real business circumstance rather than first (JSGF's) one.

Intellectual Asset Management

Because of development of information technology, globalization, getting mature in market, becoming more important to provide services rather than products and so on, our economic situation has been shifting into so called "Knowledge Economy" or "Knowledge Based Economy" nowadays. In this economy, corporations have to keep differentiating themselves from other corporations in order to keep themselves getting "Rent (extra profit)". And to do that, it is important for corporations to execute management recognizing and making use of their own "intellectual assets (a corporation's intangible resources which create profitability or value of the corporation)". [29]

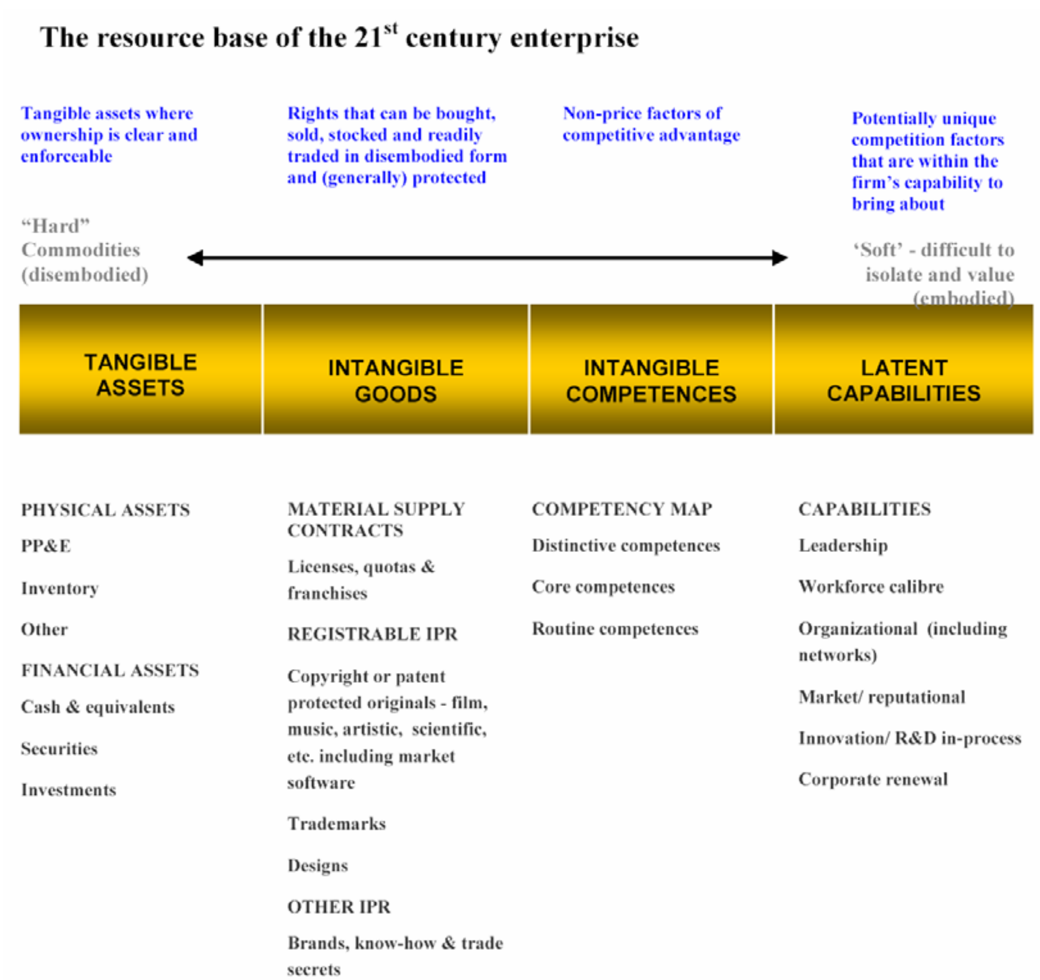
And also in light of global arguments, intangible assets or intellectual assets are internationally getting more and more recognized as important assets for value or management of corporations.

According to a research held by American Brookings institution, 69 percent of all assets of listed non-financial corporations were intangible assets such as patent rights, brands, databases, manager's ability of planning, engineer's ability of development, employee's know-how and so on in 1998 while the rest of assets of those were tangible assets such as machines and facilities. Since 83 percent of all assets of those were tangible assets in 1978, the situation has changed radically in these 2 decades. Since these intangible assets are not on the balance sheet, shareholders who provide capital can not claim that these assets belong to them.

[29]METI, *Interim Report of Management and Intellectual Assets Committee, Division of New Growth Policy, Council on Industrial Structure* (Tokyo: 2005).

According to “the PRISM report 2003” issued by European Commission, it showed the vision of “the resource base of 21st century enterprise” below in the new knowledge-based economy. In this vision, new resource base includes latent capabilities such as leadership, work force caliber, networks and reputation etc. and intangible goods such as material supply contract. On top of that, the report proposes some policy suggestion which include 1) to revise the System of National Accounting (SNA) which can not indicate these intangible assets and 2) to revise business accounting system which does not show these intangible assets on balance sheet in order to cope with these intangible assets.

Figure 12. The Resource Base of the 21st Century Enterprise



These movements of international arguments are relatively consistent with Japanese current business situation. Therefore, it is significant to contribute to these international arguments for Japanese business leaders. And the contribution will benefit to both Japanese corporations and development of these advanced way of thinking.

Business Performance and the Japanese-style Management System

An OECD data shows that Japanese manufacturing industry has still high productivity comparing to other OECD countries. Especially technology concentrated industries such as electric machine, auto mobile and general machine etc. have relatively competitiveness among the other countries. And that data also shows that the amount of Japanese R&D (Research and Development) investment comparing to GDP is third of all OECD countries. Therefore Japanese industry still has superiority especially in high tech field, and companies' R&D division is supporting that superiority.

Japanese companies as a managerial strategy has invested R&D in a long run because they have tendency of aiming at long term development, are aggressive on investing R&D because Japanese managers have promoted inside their companies and are also engineers in many cases, and the workers in the field can easily adapt new technological scheme because cooperation level is very high among the workers in the field such as research, manufacturing and sales division. These kinds of characteristics are presumably related to Japanese style management such as long term employment or life time employment, existence of stable share holders and governance power of inner-promoted managers is strong.[30]

A research held by Cabinet Office in 2006 shows that since there is positive correlation between Japanese style corporations which make much of their employees and capital efficiency like

[30]Cabinet Office, *Economic White Paper 2006.*

ROA, it seems that Japanese corporations' way of coping with their employees is consistent with the level of capital efficiency.[31]

Another research held by General Fiscal Policy Research Institute in 2003 shows the research results below;[32]

1) Reform of corporate governance structure especially such as disclosure reform contributes to improvement of corporate performance through the cut of agency costs and commitment effect of managers and employees.
2) Adoption of American style corporate governance like executive director or outside director itself does not contribute to corporate performance. If these mechanisms could contribute to corporate performance, these would have to be consistent with the corporation's existing business model and internal organizational structure. For instance, for a corporation which concentrated on just one business sector or a conglomerate which has strong technological ties between its business sectors, the cost of director's board reform might be higher than the benefit of that reform. Therefore, existing auditor system might be more rational for these types of corporations.
3) Degree of employees' participation in corporate management does not necessarily conflict with reform of internal corporate governance structure. For corporations which face to strong pressure of capital market, the stronger their employees engaged in management, the more aggressive on corporate governance reform the corporation becomes. And such corporations that trying to shift to ability based wage from seniority based wage and maintaining long-term employment are aggressive on corporate governance reform like

[31]Cabinet Office, *Characteristics of Japanese-style Management from the View of a Questionnaire Survey* (Tokyo: 2006).

[32]Fiscal General Policy Research Institute, *Progressing Corporate Governance Reform and Revitalization of Japanese Corporation*, Tokyo, 2003.

disclosure and besides, their performance is good. This is good combination between merit based wage and corporate governance reform for such corporations that maintain long-term employment and besides, this might be the new Japanese corporation model.

What Is the Best Institution?

There are many discussion on what is or what should be the future system of Japanese style corporations as follows.

RIETI (Research Institute of Economy, Trade and Industry) discuss that Japanese companies' business style has been changing drastically but it does not mean the convergence to American style business way. And there has been more and more diversity such as J-Firm (firms that has still Keiretsu companies and rely on bank loan and then be negative to corporate governance remodeling), Hybrid type (firms that rely mainly on bond and institutional investors and then be positive to corporate governance remodeling).[33]

Gregory Jackson who is a researcher of RIETI says "Although corporate governance in Japan has been diversified from the past, it is not true that it converge into American model. New Japanese model might be kind of hybrid one that challenges to mix a stake holder model which is more transparent to outsiders and an internal control model which have sound tension inside the organizations. It seems that there are no Japanese business men who think that companies should serve for only share holders' benefit and market mechanism will settle the other things."

Ministry of Finance Policy Research Institute argues that Japanese style economic system is an overall system in which the long term relationship plays significant part. And through the stagnation in 1990's it became clear that some of the long term relationship is not necessarily desirable. But there are

[33]Gregory Jackson, Hideaki Miyajima et al., *Japanese Corporate Governance Which Is Diversifying – Convergence to a Certain Model?* Policy symposium at Research Institute of Economy, Trade, and Industry (October 20, 2004).

still Japanese style system which improves economic efficiency such as human capital investment in the way of cooperation between manager of a company and labors of the company. [34]

Chalmers Johnson who is a professor researching on Japan for long time says "what are wrong with Japanese management today are not the three sacred treasures[35]. It is instead the Japanese government's commitment to one-way trade, Japan's closed markets, its favoring producers over consumers and its devotion to export way out of the post-bubble recession that constitute the main problems." [36]

And Japan Business Federation (*Nippon Keidanren*) suggested a practical proposal.[37] Thay proposed that stock holders who have had their stocks in a long period should be granted the advantages in aspect of dividends, right to vote, tax and so on, in order to develop corporations' value in a long run.

[34]Keimei Kaizuka, et al. *Revisiting the Japanese-style Economic System* (Tokyo: Ministry of Finance Research Institute, 2002).

[35]Here, the long-term employment and seniority-based wage systems, and labor unions.

[36]Chalmers Johnson, "Japanese-Style Management Revisited" *Japan Policy Research Institute Working Paper No.4 November 1994.*

[37]Japan Business Federation, *How the Institution of Corporate Governance Should be in Japan* (Tokyo: 2006).

CONCLUSION

Japanese style business practice and institution have changed in many ways. Several regulations and laws which are connected to corporation's business behavior have been reformed and deregulated. In line with that, corporations have got able to take various way of managing their business. Many corporations tend to shift from seniority based wage to merit based wage while they maintain long-term employment. And business relations like main bank, cross share holding and Keiretsu are relatively weakened. Many corporations are now challenging with corporate governance reform, while the ways they are going are different from each other based on their own business conditions.

On the other hand, in line with rise of knowledge based economy, it is getting more and more important to make use of corporation's own intangible assets including manager's ethics, employees' commitment, and contribution to environment or community and so on. And these factors and disclosure of these are getting more and more significant to corporation's performance. New Japanese style management model might have advantages on this new circumstance.

There are many ways which corporations can take. American style business way or capitalism is not necessarily the only way for Japanese corporations or society. Some corporations might fit for American way and others might fit for Japanese way. Japanese government should be careful about which way is better for Japanese corporations and should remain various options to various corporations.

Government-business relationship also has changed very much. Both the government itself and government intervention into business have become smaller. Procedure of policy making became more open to public. Deregulation and privatization have been held in so many fields. Market and business circumstance have got more flexible and effective.

In very short, although Japanese capitalism is now transforming in many ways occasionally referencing American way, Japan is not simply going American way but rather now trying to get to new model of Japanese style capitalism.

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