

## **J-Economy, J-Corporation and J-Power since 1990**

From Mutual Gain to Neoliberal Redistribution

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## **2 J-Corporation: Stuck In-Between Anglo-Saxon and Traditional Management System**

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Capital providers to companies that are listed at stock exchanges and publicly traded hold the legal privilege of limited liability. This privilege is awarded to stimulate funding by shareholders and to promote corporate investment in fields with a demand for capital, technology, management and time horizons that exceed the potential of individual ownership and management. As described in the first chapter, Japan’s large corporations have chronically reduced the cost of existent business without investments, giving preference to short-term over long-term, narrow over broad, particular over general interest since the early 2000s. This casts doubt on the legitimacy of public corporations and privileges granted to them and their shareholders by society. And if interest rates remain low for decades – close to zero or even negative – then capital is neither scarce nor the most important resource anymore. Consequently, its providers do not deserve to be privileged. But so far the coalition between publicly traded corporations and government in Japan has been unfettered in its complying with so-called global standards and the demands by mighty shareholders, first of all, institutional capital providers. This chapter takes a closer look at the transformation outlined in the first chapter. The focus of analysis shifts from the comprehensive macro-economic level, which regards private corporations more or less as one macro-actor, to a micro-economic or organizational level, in the attempt to identify the interests of different actors and stakeholders within or related to corporations as well as contradictions and implications of their actions from the perspective of corporate culture and strategy.

## 2.1 Defining J-Corporation

Japan's economy has been characterised by dual structures: the existence of a few large and many small firms (often dependent suppliers or traditional retailers), a private and a public sector, domestic (service) and export-orientated (manufacturing) industries, a modern industry and a traditional wholesale, retail sector and family-based agriculture, urban centres and rural areas.

Table 2.1 Composition of enterprises by size of regular workforce (% , CY)

	Enterprises (2014)	Workforce (2014)	Sales (2013)
Small (1 to less than 5, 20 regular employees)	85.1	23.5	10.1
Medium (5, 20 to less than 50, 100, 300 regular employees)	14.6	46.6	33.3
Large (50, 100, 300 regular employees and more)	0.3	29.9	56.6

Source: Author based on METI 2018a, 432, 436, 444

This dual structure is the reason for Japan's relatively low labour productivity: a high number of small enterprises and regular employees are concentrated in industry sectors with a labour productivity that is low on average, like construction, wholesale, retail, hoteling, restaurant, entertainment, recreation and healthcare business (tabs. 2.1, 2.2).

Table 2.2 Enterprises, sales, employees and added value by industry sectors in Japan as of 2016

	Enter-prises A	Employees B	B/A	Sales C (tr JPY)	C/A (m JPY)	C/B (m JPY)	Value D (tr JPY)	D/C (%)	D/A (m JPY)	D/B (m JPY)
Agriculture/Fish.	25,992	363,024	14	5	192	14	1	24	45	3
Mining	1,376	19,467	14	2	1,486	105	1	32	481	34
Construction	431,736	3,690,740	9	108	251	29	21	19	48	6
Manufacturing	384,781	8,864,253	23	396	1,030	45	69	17	179	8
Utilities	1,087	187,818	173	26	24,142	140	4	15	3,701	21
ICT	43,585	1,642,042	38	60	1,375	37	16	27	367	10
Transport/ Postal	68,808	3,197,231	46	65	942	20	17	26	242	5
Wholesale/ Retail	842,182	11,843,869	14	501	595	42	54	11	64	5
Finance/ Insurance	29,439	1,530,002	52	125	4,250	82	19	15	651	13

Real Estate	302,835	1,462,395	5	46	152	31	9	21	31	6
Research/Tech.	189,515	1,842,795	10	42	219	23	15	37	80	8
Hotel/ Restaurants	511,846	5,362,088	10	25	50	5	10	38	19	2
Recreation	366,146	2,420,557	7	46	125	19	8	17	21	3
Education	114,451	1,827,596	16	15	135	8	7	47	63	4
Healthcare	294,371	7,374,844	25	111	379	15	21	19	70	3
General Services	5,719	484,260	85	10	1,678	20	4	39	662	8
Other Services	242,588	4,759,845	20	41	168	9	14	35	60	3
<b>Overall Total</b>	<b>3,856,457</b>	<b>56,872,826</b>	<b>15</b>	<b>1,625</b>	<b>421</b>	<b>29</b>	<b>290</b>	<b>18</b>	<b>75</b>	<b>5</b>

Source: Author, based on MIC 2018g, 2, 6, 13

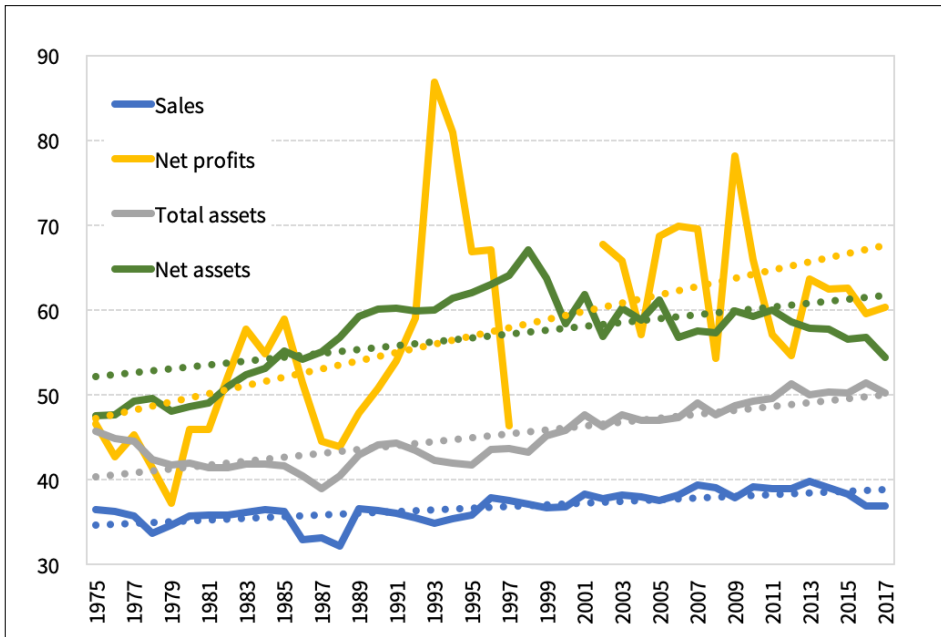
More than half of all regularly surveyed SME are dependent suppliers or vendors (*shitauke*) at the bottom layers of conglomerates (*keiretsu*), which use them as capacity and cost buffers.<sup>1</sup> Large enterprises are often stock exchange listed corporations, closely connected with banks, general trading houses and each other through cross-shareholdings. They control their supply chains, dominate domestic markets and foreign trade, influence politicians, parties and government mainly through their lobby organisation, the Japan Business Federation (*Keidanren*), and offer their employees much better conditions than SME with monthly basic salaries being about 30-50% higher.<sup>2</sup>

After the burst of the asset bubble in 1990-1991, the former six main banks reduced shareholdings to cover their asset value losses and merged into three financial groups (MUFG, SMFG, Mizuho), overlapping the former *keiretsu* borders. Cross-shareholdings have been almost halved as financial institutions were forced to sell off these assets to cover bad loan write-offs and keep the required level of equity ratio. But non-financial corporations have not reduced their shareholdings. They have maintained

1 In 1991, 77% of all regularly surveyed SME in Japan achieved more than 30% of their total sales with one particular corporate client. In 2013 (2016) the respective share fell to 61% (60%) (METI 2018a, 118). In 1995, 68.9% of all SME in Japan had only 5 or less companies as permanent clients, in 2013 (2015) 53.7% (55.65%) (METI 2015a, 114; METI 2015b, 4-6).

2 After the end of World War 2 the big four traditional conglomerates (*yondai zaibatsu*), Mitsui, Mitsubishi, Sumitomo and Yasuda, in addition to Fuji Sangyō, were judged to be responsible for supporting Japanese militarism and providing the economic base of Japan's military aggression. Therefore, the GHQ dismantled them between 1945-1947: the holding headquarters were closed, the owning families expropriated and expelled from the board of directors, the shares dispersed. But against the backdrop of the Korean War (1950-1953) and a related fundamental policy shift by the GHQ anti-monopoly regulations were relaxed and large corporations allowed to re-organise, which resulted in six big conglomerates (Mitsubishi, Mitsui, Sumitomo, Fuji, Sanwa, Daiichikangyō) with banks and general trading houses (*sōgō shōsha*) at their core (Hanazaki 2017, 95-6).

Chart 2.1 Share of corporations with capital of 1 billion JPY and more (FY, %)



Source: Author, based on MOF 2018b. Note: Net profits lacking for 1998-2001 due to negative value

their capital relations to other large corporations and important Tier-1-suppliers within the same conglomerate (charts 1.20a-b). Thus, although less dominating, conglomerates do still exist. And those large corporations, which are connected to them, have continuously increased their share of net profits (flow) and net assets (stock) to about 60% (chart 2.1).

If not indicated otherwise, these large (mainly stock exchange listed) corporations from all industries are the main subject below. They have been structurally dominant not only in the domestic market, but also in international trade as well as direct investment from inside and outside of Japan. And, as in all other developed economies, large corporations have been strongly influencing politics, public administration, jurisdiction, mass media, education and so on.

## 2.2 Corporate Culture and the Rise of the J-Corporation

Culture is a blank space, a highly respected, empty pigeonhole. Economists call it 'tastes' and leave it severely alone. Most philosophers ignore it - to their own loss. Marxists treat it obliquely as ideology or superstructure. Psychologists avoid it, by concentrating on child subjects. Historians bend it any way they like. Most believe it matters, especially travel agents.

(Mary Douglas, 1982, *Cultural Bias*, 183)

Management is about engaging actors with different interest, roles and tasks in communication and collaboration to ensure the functioning of organizational processes. Once these collective actions have borne satisfying results, they are considered legitimate and as such worthy of reproduction without reconfirmation. The involved actors begin, often unconsciously and informally, to share the aim of maintaining those very structures that they have created through their collective action in the first place (Schein [1985] 2004, 12, 17). This collective sharing, the shared assumption of legitimate structures among the majority of actors within corporate organisations, is called 'corporate culture'. As Weick has convincingly argued, corporate culture generates a kind of order or centralisation among different actors allowing for local, decentralised and unique interpretation, improvisation and action (Weick 1987, 124). In this sense, culture fills the gap between "the three 'cannot' (cannot foresee, know or control) and the three 'must' (must act, plan and organize)" (Weick 2016, 333-4), helping managers within corporate organisations, who "must act when [they] cannot foresee consequences; [...] must plan when [they] cannot know; [...] must organize when [they] cannot control" (La Porte 1975, 345). But the importance of culture is often only acknowledged when sudden change disturbs the patterns and routines of collective action (Weick 1985, 381-9).

Interest in corporate culture was triggered in the '80s by the increasing share of Japanese manufacturing corporations in the US and other foreign markets for passenger cars, motorbikes and electronic goods (chart 1.31). Questions arose why particularly Japanese corporations had been successful in outpacing their competitors from the US and Western Europe, while using the same resources, technologies, tools and processes: what enabled Japanese corporations to expand production and sales of reasonably priced products in variation and reliable quality? How could they implement flexibility into industrial mass production? Japanese corporations appeared on the stage of international competition at a moment when demand for standardised mass consumer goods had been saturated; when unionised industrial workers in Western Europe had expressed their dissatisfaction with being treated as administrated workforce, potentially inferior to machines; when centralised mass production, often organised in an oligopolistic manner, and mass consumption seemed to have reached

their economic, social and natural limits. The assumption was that, if Japanese corporations used mainly the same material hardware, it could be only the cultural software, a different way of managing that made their employees and corporate stakeholders communicate and collaborate, and enabled flexible response to changed market conditions.<sup>3</sup> Particularly Toyota appeared as the benchmark for overcoming the limits of Fordism as a learning organisation that supposedly represented central features of Post-Fordism<sup>4</sup> or Postmodern Industrialism<sup>5</sup> in the '90s.

Insofar as the recessions of 1973-1975 and 1979-1981 were perceived as crises of Fordism, it was obvious to explain the success of Japanese corporations in overcoming them as evidence for a progressive system. However, this macro perspective, insofar as it had assumed a structural superiority of the Japanese economic system, was empirically debased by Japan's entry into deflationary stagnation and the decline in global market share not only in the financial industry, but also in the electronic and automotive industries<sup>6</sup> (chart 1.31). In response to the macro-economic backlash of the '90s and 2000s, the discourse about the Japanese corporate system took a micro-economic turn: under the name of J-Firm a discussion set in to what extent Japan's corporations were to adapt to the dominant Anglo-Saxon model (Aoki, Dore 1994).

Initially, the term J-Firm was coined by Aoki (1984b, 1990, 1992) and Itami (2001) to describe the nature and general importance of the Japanese corporate governance system, based on institutional and behavioural theories.<sup>7</sup> The distinctive characteristic of J-Firm as a system was seen in the long-term orientation as well as the sharing of risks and returns

3 See Barley et al. 1988, 33, 39; Deutschmann 1989a, 1989b, 1989c.

4 In Japan, numerous respective publications were authored by former Toyota managers, for example Shibata, Kaneda (2001); Wakamatsu (2007). Outside of Japan, this perception was strongly represented in the US and spread from there to Europe: Womack et al. (1990); Adler, Cole (1993); Kenney, Florida (1993); Womack, Jones (1996, 2005); Liker (2004). As the main proponent in Japan, Fujimoto characterised the Toyota Production System (TPS) as a hybrid between the Ford System and specific Japanese elements rather than a systemic alternative (Fujimoto 1997, 120-3; 2001, 79-82; 2003, 143-70).

5 Interest from outside of Japan occurred not only in response to the success of Japanese corporations in international competition. It also arose from a postmodern discourse, which questioned capitalist modernism with its teleology and convergence dogma and showed curiosity about everything that seemed different but had previously been ignored. Central to many contributions to the Toyotism debate was the French Regulatory Theory, which attempted to define the crises of 1973-1975 and 1979-1981 as crises of Fordism and the social system of capitalism in its various national forms of development (Amin 1984, 1-39; Coriat 1991; Boyer, Durand 1997).

6 Except for Toyota, which has maintained its share in worldwide sold cars slightly above 10%.

7 Firm is a general term, denominating an organisation for doing business. Corporation is a firm that can act as an individual (legal entity) but with limited liabilities of its owners.

between all stakeholders in order to prevent moral hazard and short-term opportunism. Japanese corporations were able to shield themselves against uncertainties, such as market volatility, and achieve collective learning returns and productivity gains in the long term. Koike (1981, 1991, 1994, 1997) identified self-determined and experience-based collective action of multiple-qualified skilled workers in long-term employment with seniority pay, promotion and permanent function rotation as Japanese characteristics of labour relations. Asanuma (1997) defined the relationship between suppliers or vendors and final producers as a risk sharing and learning coalition. Aoki (1988, 1990, 2000) combined these approaches under the concept of corporate governance, described the quality of interaction between stakeholders as dominantly horizontal coordination and finally integrated them into the concept of the J-Firm. Thus the J-Firm, or more precisely the J-Corporation, was characterised as the organizational integration of (a) long-term employment, rank hierarchy, horizontal information exchange, functional rotation, internal promotion and enterprise unions as principles for internal organisation; (b) long-term relations to the main bank, which provided not only credit finance, but was also the major shareholder, leading underwriter for bond issues and investment advisor; (c) cross-shareholdings with core member firms and Tier-1 vendors; and (d) long-term vendor-relations, based on hierarchy, close activity coordination and selected shareholdings. In the name of Japanese corporate culture, specific behavioural and ideological patterns of collective acting were regarded as typical for the J-Firm (Ouchi 1981).

The popularity of this view, which had been maintained for more than a decade even after the burst of the asset bubble in Japan, is surprising. After all, the J-Firm concept seemed to have been falsified by the crisis of Japan's economy and corporate governance system as well as the declining competitiveness and world market shares of large Japanese corporations. Many of the former J-Firm supporters converted to neoliberalism in the '90s and called for global convergence to the US or Anglo-Saxon model.<sup>8</sup> However, it was not only academic remoteness from practice or nostalgia which gave rise to interest in a concept, whose subject (the J-Firm) was undoubtedly in crisis. Because social transformation is historically concrete, complex and exhausting, academics appreciated the J-Firm concept for its potential to reflect about the complexity, historicity and social nature of Japan's corporate governance system and to search for structural corrections instead of committing to an allegedly superior imported model. The

<sup>8</sup> Critical positions were taken particularly by Katō, Steven (1993) criticising Florida, Kenney (1993) and by Nomura (1994, 1998) and Kamī, Nomura (2001) in a dispute over Koike (1981). Outside of Japan, critique appeared in the form of characterising 'Toyotism as Hyper-Taylorism' (Dohse 1984), 'Totalitarian or Collective Taylorism' (Jürgens 1992) or a 'Modified Taylor-Ford-System' (Berggren 1993).

plea for diversity and respect towards path dependency inherent to the J-Firm concept was welcomed by the protagonists of a crisis-ridden system. Therefore, a closer look into the historic change of Japan's corporate governance system is required. Corporate governance is understood here in a broader sense than methods of executing a given paradigm, namely, as an institutionally reproduced power configuration, adjusting, absorbing and integrating the interest of various corporate and social stakeholders in the process of corporate management and reflecting management in its inherent contradictions (Weick 2016, 333-4).

### 2.3 Change of the Corporate Governance and Management System in Japan

As distinct from a market-orientated control nexus, Japanese corporations have been characterised as organisation-orientated and dominantly self-referential: new employees, recruited right after leaving high school or college, enter the company at the lowest rank; staff fluctuation is low and on-the-job-training is central; employees are involved in the operational management. The company is not an abstract property of its shareholders, but a community: its core members are the employees. Managers are not shareholder-authorized representatives from outside, but mainly senior members of the corporate community, promoted and selected from internal managerial ranks. Shareholders are supposed not to be primarily equity investors, demanding the maximisation of short-term returns, but banks, suppliers and distributors, that are interconnected through cross-shareholdings and interested in long-term stable transactions. Instead of being a means for delivering maximal financial returns to capital investors, corporations use capital to expand themselves (Watanabe S. 1994; Itami 2001).

Against this backdrop, the Japanese corporate system has often been ascribed an inherent network orientation (Moerland 1995a, 1995b). Rather than the final purpose, networks are merely a means for organizational expansion: they function mainly as barriers, filters or control gates of entry and exit for actors, protecting corporate organisations against opportunistic behaviour and market volatility (Ikeda 1997). Hierarchical ruling and subordination are thus neither abolished nor are realised only as top-down order-and-report or one-sided instrumentalization of the subordinated. The interaction of actors who are aware of their mutual dependency plays the central role (tab. 2.3). This relationality cannot necessarily be conceived as the inevitable outcome of a somewhat particular Japanese culture. It is historical. The period from 1912 to 1925 was characterised by entrepreneurship and market-competition: entrepreneurs were acting as trustees (*ōmotokata*) of owner families, like in the case of the four conglomerates or *zaibatsu* (Mitsubishi, Mitsui, Sumitomo, Yasuda), or as owners (and



major shareholders) of their enterprise; a huge gap of incomes and assets existed between entrepreneurs and employees; a market-driven (short-term) allocation of yield-sensitive capital and high intra- and inter-sectoral labour mobility dominated (Okumura 1992, 2-3, 186-7; Iwai 2009, 202-3). Social polarisation and speculative over-accumulation of capital led to the militarised economy of World War 2, to destruction and defeat.

Table 2.3 Comparison of Japanese and Anglo-Saxon corporate management systems

	<b>Japanese corporate management</b>	<b>Anglo-Saxon corporate management</b>
Sovereign Power	Employees	Shareholders
Stakeholders	Employees, customers, vendors, shareholders, local community, nature	Shareholders
Finance	Debt, banks, indirect, long-term investment-capital	Equity, broker, direct, short-term financial-capital
Risk/Return	Low risk, low return, safety first	High risk, high return, tolerance to change
Employees	Lifetime employment	Frequent change of employers
Personal management	Seniority, negative counting, Y-theory	Capability, result, positive counting, C-theory
Corporate formation	Comprehensive	Specialised
Corporate life expectancy	Long	Short is ok
M&A	Negative perception, difficult	No managerial resistance, easy
Organisation	Community, collectivism	Economic Rationality, Individualism
Innovation	Collective improvement, sustainable	Individual concept & product, disruptive
Business Development	Internal, proprietary, vertical	Use of external resource, horizontal
Quality	Priority of quality	Preference for speed over quality
Suppliers/Vendors	Long-term, trust, closed	Cost-performance-driven, open
Market	Galapagos-like (Domestic)	Global
Nationality	Peasant type, island country	Hunter type, colonies

Source: Satō 2016, 27

### 2.3.1 Absorbtion of Market Volatility Through Internalisation

Single elements of those structures and patterns of organizational behaviour that have been seen as typical for Japanese corporations (J-Firm), such as long-term employment and seniority-based wages, were implemented by large private corporations already in the '20s pre-war period to attract and keep well educated elites or highly performing employees as managerial cadres, and they were also applied partly to experienced workers with

special skills and knowledge in the heavy industry. Ideologically linked to general mobilisation, differences between white and blue collar workers were first reduced during World War 2.<sup>9</sup> But the main elements and structures of Japanese corporations are to be traced back to the democratic break-up of the political pre-war system, structural modification of the collapsed state-controlled war economy, economic reform in the Cold War Era of the '50s and corporate reorganisation until the early '60s.<sup>10</sup> Aoki has described these elements and structures as follows: internally, operational practices were realised through horizontal coordination by knowledge sharing and operational flexibility in contrast to the separation of planning and operation in economies of specialisation. Operational coordination and decision-making were less formalised and less hierarchical. Thus, employee competition for higher ranks in an incentive hierarchy resulted in maintaining operational effectiveness and organizational integrity. Externally, the main bank intervened only in crises. There was no clear hierarchy between corporate control and operational management. Companies competed with each other for higher rankings by growth in profits and sales. Thus, managerial decisions were affected more by employees and financial interests than by unilateral shareholders. This resulted in a longer view on investment and growth, in higher job security, in limiting workforce expansion relative to value-added growth by means of spinning off labour intensive work to suppliers or the outside, in shifting towards capital-intensive technology and in innovation based on in-house knowledge (Aoki 1990). Top managers were not managing owners with significant shareholdings in the company anymore. They were recruited inhouse, from employees and managerial ranks. The fundamental conflict of interest between capital and labour was appeased through long-term employment, mutual consultation and operational participation. Combined with seniority-linked payment components, the internal competition among employees resembled a tournament for high reputation and early promotion. Proposals were to be discussed and modified before the final decision by formally authorised managers. Participation generated informal rights to be informed and involved. The general aim was to improve communication and collaboration between related actors and to implement decisions in a faster and less contested way. But involvement has its price: it is not only time-consuming, but it also prioritizes compromise and consent over quality, consistency and emergency; it makes personal responsibility unrecognizable and hampers radical corrective action. Nonetheless, in the

9 Ōtaka 1984, 38-44; Chūma 1994, 223-41; Noguchi 1995; Iwai 2009, 201-31; Ogura 2013, 27-31.

10 Shimada 1994, 47-84; Itō M. 1995, 225-6; Yoshida 1996, 71-97; Nagano 1996, 24-32; Nitta, Hisamoto 2008, 12, 31-6, 51-6, 80-102.

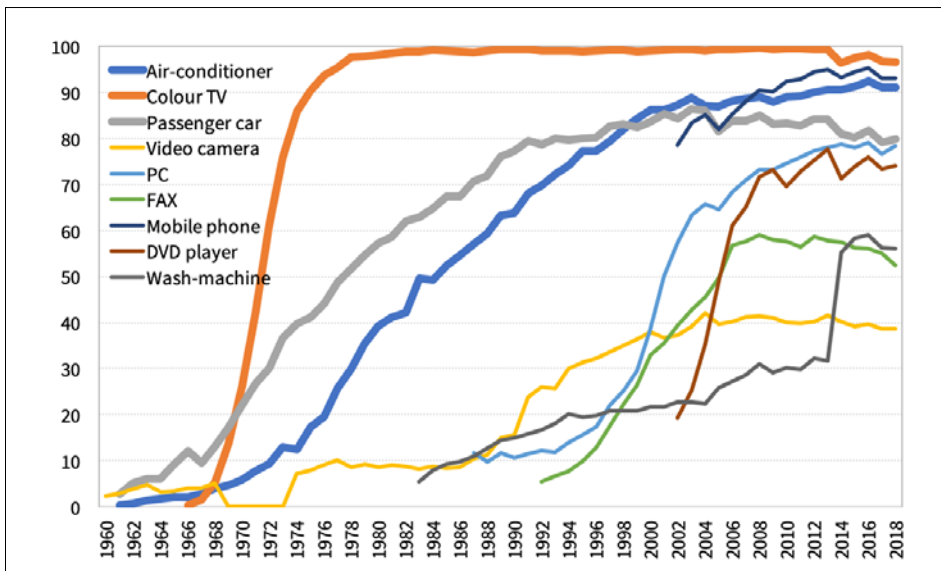
context of underdeveloped resource accumulation and insufficient market allocation, it is rational to bind important resources internally, stabilise the conditions of their reproduction and reduce transaction cost, i.e. pursue internal resource accumulation. Highly motivated, managerial and non-managerial employees committed themselves to the corporation; hierarchically organised suppliers and distributors stayed loyal; banks acted as patient creditors and corporate shareholders silently tolerated managerial decisions as long as there was no existential threat (Itami 2001).

Under this system large corporations developed collective patterns of behaviour and thinking, which facilitated continuous process improvement and incremental efficiency enhancement, and which facilitated manufacturing mass products in high variance and high quality at low cost. Its main features were: (a) internalisation and long-term allocation of core resources, (b) stabilisation of central reproductive relations and activities, (c) functional flexibility and (d) operational process optimisation in production. The benchmark for success was to expand production volume, sales turnover and market share. Accordingly, the 'how' of acting was perceived as most important. The allocation and evaluation of inputs and outputs was primarily process-orientated. Rather than signals from external markets, it was micro-political positioning, i.e. the personalised relationship between internal actors that counted most for corporate decision making. Consequently, managing in Japanese corporate organisations was shaped by inductive thinking, informal communication, decision-making and incremental acting (Yokota 1998). In contrast to the - highly rationalised - direct production in large manufacturing firms, other areas, particularly marketing, distribution, wholesale and retailing, remained conservative and, by international comparison, relatively inefficient due to systemic reasons: large-scale industrial production and final assembly were at the centre of strategy and efficiency enhancement. Here, capacity was continuously expanded and technologically renewed through high capital expenditure. A large variety of product parameter as well as short-term model changes ensured that these capital-excessive facilities were utilised at high degree, while operational process optimisation helped to reduce costs and defects. The manufacturing plants of the large corporations were seen as the 'profit centres'. Marketing and sales were 'only' to sell the output, i.e. translate the gains achieved in production into an increasing market share. Marketing and sales were therefore managed as subordinate cost centres. The top priority was to improve the process quality of production, not product differentiation.

2.3.2 Challenges and Systemic Limits for the J-Corporation

Every system contains the causes for its self-deconstruction; its expansion advances internal contradictions and incompatibilities with the external environment until it reaches its limits (Seo, Creed 2002). Given the extent to which the Japanese system had realised its goal, i.e. incremental growth, it was to meet its limits inevitably in a twofold way: on the one hand, its constantly growing product output had to be realised in the market, either by generating and meeting growing demand with sufficient purchasing power or by replacing competitive supply. On the other hand, stable allocation of resources requires their cost-effective availability, trust of suppliers in continued mutual expansion, and non-disruptive technological and intra-industrial environments. These conditions have dwindled since the '90s. In addition to the saturation of demand in the domestic market, lower-cost supply from competitors in East and Southeast Asia have led to the commoditisation of many existing mass products and to fierce price and cost competition in the related markets (chart 2.2).

Chart 2.2 Diffusion rate of durable household goods in Japan (as of March CY, % of all households with two and more persons)



Source: Author, based on CAO 2018b

Furthermore, the process competencies of Japanese corporations have been equalised and devalued by IT or internet-based open-modular production and process architectures, which shortened product cycles and expedited the diffusion of product innovations (Kokuryō 1999, 173-97). The

delimitation of decision-making and action areas as well as the technological rationalisation of communication and interaction have promoted the modularisation and transferability of goods and services, reduced transaction costs and offered external market alternatives to the internal organisation. Actors were linked to market forms of coordination and cooperation; open transaction relationships and disintegration (decentralisation) of existing business activities as well as organizational units came to the fore. These changes were practically implemented as restructuring, with an emphasis on the core business and on outsourcing. The insider learning returns, generated long-term in closed networks, were devalued (Ikeda 1997, 167-93). Qualities of action, that the Japanese corporate system was not designed to generate, became relevant: rapid decision-making by selectively assessing internal and external options, explication of tasks and duties, self-responsible action, flexible resource allocation and result-reflecting assessment. Managing could no longer rely on internal micro-political compromise, that is, consensual cooperation in the experience-driven corridor of incremental process optimisation and the constantly expanding utilisation of resources. Instead, market-responsive thinking and acting were required: changes in the environment had to be observed and immediately interpreted, potentially profitable products and business fields identified, resources acquired and the combination of exploring new business with exploiting existing business had to be organised. Business could no longer take the form of iterative authorisation and operational intervention by corporate headquarters. An indicative management, based on a transparent set of general rules for project evaluation, accounting, quality assurance, investment and capital cost calculation, was necessary; that is, a management that would mediate internal negotiations between self-responsible organizational units and individual employees over resource allocation and evaluation of results (Ōta 2017, 157-210).

According to Nadler and Tushman (1986), in the mature phase of industrial development the focus shifted from incremental process to product innovation: closed product and process architectures became disadvantageous, because they focused on process optimisation. When markets saturate, scale-dependent productivity gains can no longer be realised against competing supply at falling prices by displacing such supply or by placebo-stimulated demand, and capital investments can no longer be amortised before the respective product technology becomes obsolete. Consequently, in regard to focus as well as mode of controlling, value creation and process chains must be reset. Facing saturated markets for common goods, an intensified supply competition and an accelerated speed of transactions, neither sellers nor buyers can predict precisely what is needed for how long in which quantities at what parameters and prices. A control of process chains, which starts from market demand, presupposes that this demand persists and that customers know exactly what they want. Such a

system must be reconfigured in an open and modular way in order to meet differentiation criteria, such as variants, delivery speed and low prices. What remains, alongside such strategic variants as cost leadership, value-slicing and value-integration, is a dialogical exploration of the unknown in collaborative action between producers and customers: how does the other side think and act? What can tie both sides to each other? How does the other side evaluate existing products and new proposals? What other problems related to the use of existing products are to be solved?

### 2.3.3 A Self-Deconstructing Ancient Regime?

Both business model and governance system of Japanese corporations assume a continuous expansion, based on stable conditions for supply and demand. In contrast, the increasingly uncertain environment calls less for operating flexibility and incremental improvement within a given product portfolio or stable technology frame, but for strategic flexibility: renewing old and inventing new business models.

Table 2.4 Comparison of ROE drivers (average 2004-2013)

Country	Sector	ROE (%)	Sales Margin (%)	Turnover Rate	Leverage
<b>Japan</b>	Manufacturing	6.8	3.5	0.91	1.91
	TOPIX Non-manufacturing	6.7	3.2	0.86	2.28
	500 Total	6.8	3.3	0.92	2.02
<b>US</b>	Manufacturing	18.1	8.4	0.77	2.24
	S&P Non-manufacturing	14.5	8.0	0.61	2.33
	500 Total	16.0	8.3	0.87	2.29
<b>Europe</b>	Manufacturing	15.3	6.8	0.79	2.44
	STOX Non-manufacturing	15.6	7.8	0.68	2.74
	600 Total	15.4	7.2	0.86	2.58

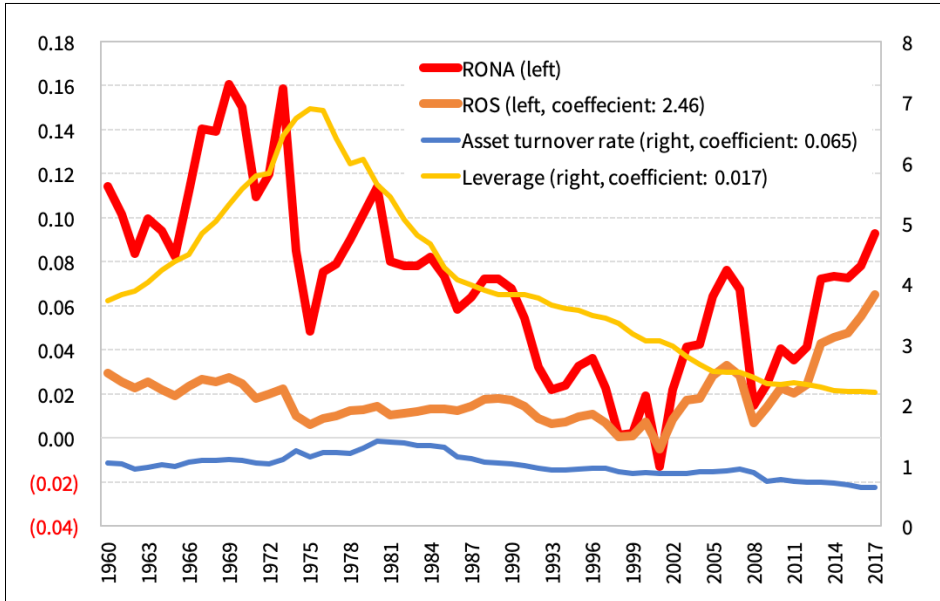
Source: Kobayashi 2015, 8

Japanese corporations and their top managers perceived these changes primarily as a problem of declining profitability and a cost issue. And indeed, a comparison of Japanese with European and US corporations, according to the Du-Pont-Formula,<sup>11</sup> shows, that their lower financial performance is due to a lower level of sales profitability, while their opera-

<sup>11</sup> In simplified terms: Return on Equity (ROE: net profits/equity) = Net Return on Sales (ROS: net profit/sales) × Asset Turnover Rate (sales/total assets) × Financial Leverage (total assets/equity); as extended version: ROE = Gross Sales Margin (earnings before tax and interest/sales) × Interest Burden Rate (pre-tax profit/earnings before tax and interest) × Tax

tional efficiency is better and financial leverage is lower than that of their foreign competitors (tab. 2.4).

Chart 2.3 Breakdown of return on net assets (RONA) at large Japanese corporations (all industries excluding financial and insurance, capital of 1 billion JPY and more, FY)



Note: multiple regression coefficient with RONA as y-value.

Source: Author, based on MOF 2018b

An analysis of the long-term trend of profitability at big Japanese corporations here measured as Return on Net Assets (RONA) and its main drivers (Return on Sales: ROS, Asset Turnover Rate and Leverage) according to the DuPont-Formula reveals that RONA has fallen until 2001, mainly due to continuously decreasing ROS, while efficiency in utilising assets for generating sales decreased (as a result of heavy investment in capacity expansion) and leverage was also reduced after 1980 (chart 2.3). Itō (1995, 236-8) and Mizuno (2016, 26-7) explain the relatively low level of capital productivity (measured as RONA or ROE) and sales margin (measured as ROS) as a consequence of relative overcapacities in production. This overcapacity is typical for large Japanese corporations and an outcome

Burden Rate (net profit/pre-tax profit) × Asset Turnover Rate (sales/total assets) × Financial Leverage (total assets/equity).

of their dominating business model, as they compete with similar core products and production technologies over small parameters, economy of scale and market share. Iriyama (2017, 140-1) calls this mode of competition the “Chamberlain type”: it results in continuous improvement, but it also leads to a narrow focus, a lack of responsiveness to competition and innovation. But Mizuno (2016, 28-9) sees not only disadvantages, because overcapacity of supply and continuous improvement had enabled Japanese corporations to increase exports, trade surplus, foreign currency reserves and foreign investment, generating a positive payment balance and income from abroad.

Insufficient sales profitability can be improved by raising prices (while keeping cost constant) or by lowering cost (while keeping prices constant). As prices reflect not only internal target margins, but depend also on external demand and competing supply, they are less under managerial discretion than cost. Large Japanese corporations have relied mainly on medium level price setting in order to target mass segments and continuously expand production, sales volume and market share. The absence of sufficient product differentiation and the lack of potential for raising prices were both cause and consequence of this business model. Traditionally, cost pressure was shifted to lower layers of the vendor hierarchy by reducing the vendors’ selling prices and outsourcing cost-prone operations. In case of deep recessions such as 1973-1975, shrinking demand, continuous losses and labour costs were absorbed by introducing short-time work, cutting overtime payment and bonuses, delaying promotions and regular salary raises, laying off non-regular workforce, stopping new hiring, transferring employees to other units, subsidiaries and vendors or starting early retirement programmes. But the dismissal of regular employees was always avoided if possible.<sup>12</sup> Confronted with bleak macro conditions, an aging workforce and growing competition, however, cost pressure was perceived as exceeding the scope of common responses within the existing structures. The increasing ratio of labour cost/sales and labour ratio (labour cost/added value) (until 2000) seemed to evince the necessity for a fundamental change (charts 2.4, 2.5).

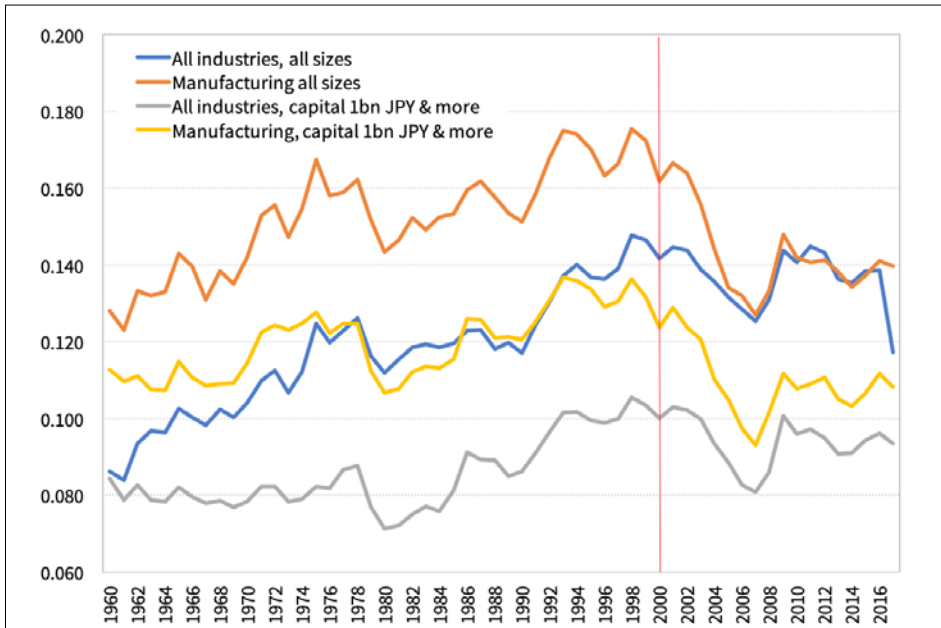
An increasing share of value added, paid out as labour cost (wages, salaries, bonuses, social insurance contributions and fringe benefits) to employees including managers, is an inevitable outcome of treating regular employees as important stakeholders and meeting their expectations towards protecting long-term employment, in particular during recessionary downturns, when the ratio of value added/sales falls.

Actually, Japanese corporations, especially in the manufacturing industries, have been facing a decline in the value added/sales ratio for several

12 Nagano 1996, 24-32; Nitta, Hisamoto 2008, 27-42, 48-56, 89-102.

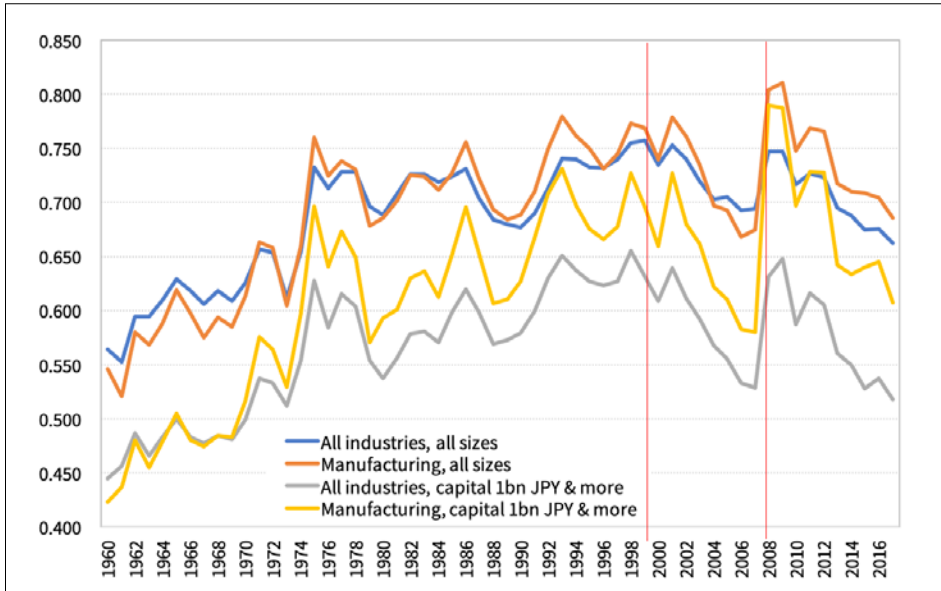


Chart 2.4 Labour cost/sales ratio at Japanese corporations (FY)



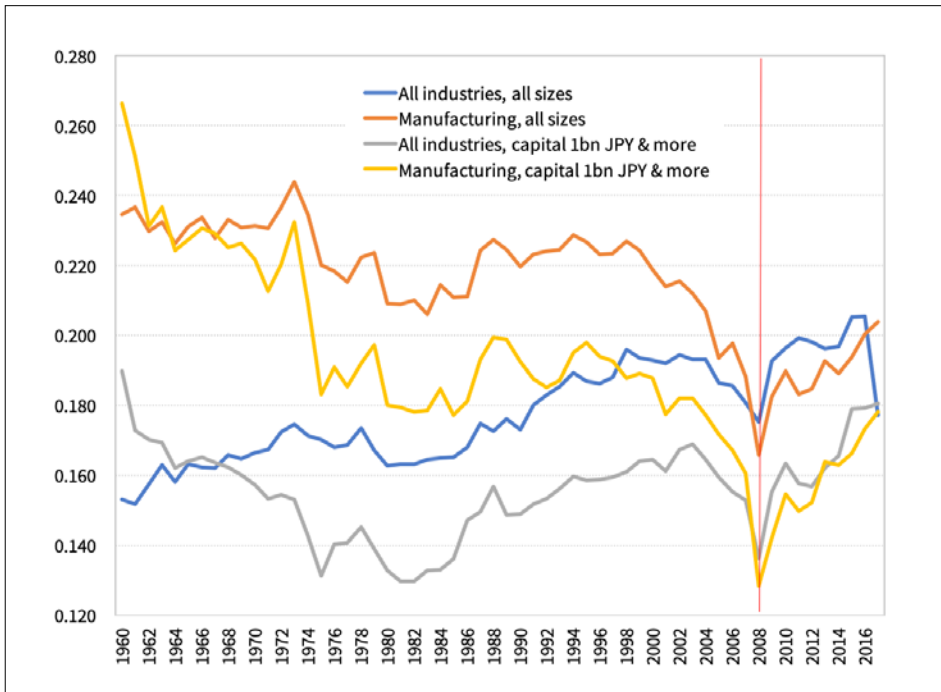
Source: Author, based on MOF 2018b

Chart 2.5 Labour ratio (labour cost/value added) at Japanese corporations (FY)



Source: Author, based on MOF 2018b

Chart 2.6 Value added/sales ratio at Japanese corporations (FY)



Source: Author, based on MOF 2018b

decades. This reflects not only a declining ability to absorb cost, but much more so the inability to set sufficiently high prices in competitive markets.<sup>13</sup> In times of cyclical expansion, prices were kept low to expand sales and market share, and to keep the utilisation rate of capital-intensive facilities high; in times of cyclical contraction and stagnation such as after the burst of the asset bubble in the early '90s, prices had to be reduced to maintain cash inflow and repay debts. But the continuously falling value added/sales ratio indicates a structural problem, which goes beyond the absorption of cyclical volatility: huge investments were made into products, technologies and market segments prone to cost and price competition and increasingly replaceable by supply from domestic or foreign competitors (chart 2.6). This shortcoming in the current business model sways the ability of

**13** The different trend in the category 'all industries' in chart 2.6 reflects the growing weight of IT, media, knowledge and infrastructure related services (utilities: electricity, gas, water, telecommunication, public transport), which have often been controlled by oligopolistic companies or regional monopolies.

Japanese corporations to maintain the traditional corporate governance system with its inherent commitment to regular workforce as a central stakeholder. Declaring the current level of labour cost unsustainable and its fundamental reduction inevitable for corporate survival affects not only the employment system. It neglects also the interest of a central stakeholder and through that a core element of the Japanese corporate governance system.

Asked in an interview about the continuous downwards correction of business results at Fujitsu since his appointment to CEO, Naoyuki Akigusa answered:

It does not go well, because the employees do not work properly. Every year they make business plans and promise to realise them. But, they do not deliver, which is causing the trouble. If they do not achieve the targets, the heads of business units should be replaced. That's what result based management is about... [The CEO] is responsible to the shareholders for managing the funds they have invested. There is no responsibility to the employees. Managing is about ordering employees to do [what has to be done]. (*Shūkan Tōyō Keizai*, 13 October 2001, 94)

Given the deep belief in allegedly Japanese virtues of diligence and consensus, this statement raised shock waves. It stood also in sharp contrast to the common position expressed symbolically by the then Toyota CEO Hiroshi Okuda in his criticism of Moody's explanation of its downgrading of Toyota's capital market rating in 1998: Moody's doubted Toyota's ability to regain and maintain sufficient profitability if the company remained committed to the traditional principle of lifetime employment. Okuda pointed to the difference in social context and corporate governance system between the US and Japan and claimed that Japanese top management has the duty to protect their employees and to find other (sustainable and socially acceptable) ways than simply reducing employment and cutting labour cost (Okuda 1999). The same scepticism towards the implementation of shareholder-centred governance and management was taken by the then CEO of Canon, Fujio Mitarai, and the then CEO of Fuji Xerox, Yōtarō Kobayashi, both top managers at globally leading manufacturing corporations like Okuda (Mitarai 2002; Kobayashi Y. 2002). In contrast, top managers of Japanese corporations that have their core business in non-bank-financing and asset trading like Yoshihiko Miyauchi (then CEO of Orix Co. Ltd.) and Uichirō Niwa (the then CEO of Itochū Co. Ltd.) expressed the opposite opinion regarding a reduction of labour cost and workforce as essential for their business model, necessary in times of crises and chronic underperformance and legitimate to ensure corporate survival (Miyauchi 1999; Niwa 1999).

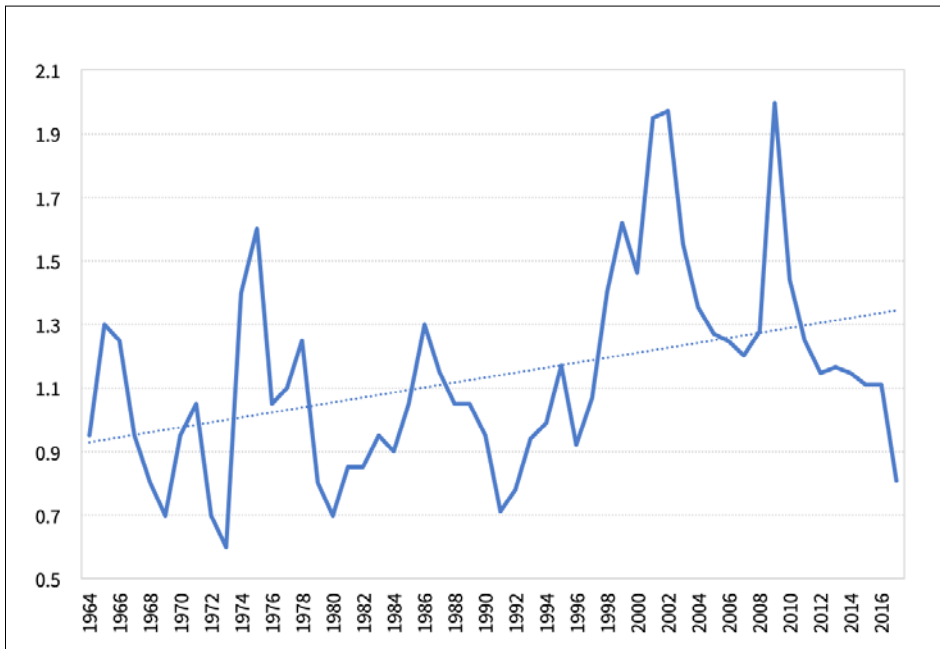
Exploring possibilities for a new combination of shareholders and employees' interest, Inagami distinguished between three types of corporate

governance: (a) the classical model aimed at maximising shareholder value with a short-term and exclusively economic (i.e. financial) orientation and exit (to external markets) as the main form of interest expression; (b) the sophisticated shareholder value model, also aimed at shareholder value maximisation but with a long-term and socio-economic orientation and voice (in internal decision making) as the main form of interest expression; and (c) the pluralistic model, aimed at increasing corporate value with a long-term and societal orientation and voice as main form of interest expression (Inagami, Mori 2004, 4-5). He identified a global trend towards model (b) in the late '90s and early 2000s, combined with shareholder activism and socially responsible investment. Against the backdrop of a shift to post-industrial economies, ageing societies and value diversity, he saw this inclination as a structural response to corporate fraud, excessive executive payment and the risen importance of institutional investors, who are managing huge pension funds. In Japan, Inagami observed a growing advocacy of a type of corporate governance, that is based on the sophisticated shareholder-value model. But shareholder activism and socially responsible investment remained weak in Japan, because the discussion about corporate governance has been dominated by top managers of large corporations, not by shareholders. Drawing on the results of his own questionnaire survey among stock market listed corporations, Inagami concluded, that the majority of corporate top managers in Japan favoured model (b) or (c) and aimed at combining long-term employment with performance-based payment, which - together with employee stock ownership schemes - allows to balance the interests of shareholders and employees (Inagami, Mori 2004, 26-8). Mori addressed the structural shortcomings in the current corporate governance system of stock market listed corporations, namely, the double function of managerial execution and shareholder representation and the related over-concentration of power in the hands of top managers (executive directors). Supervisory boards or audit committees, which are supposed to control, depend on the very top managers who are supposed to be controlled. Mori argued that employees should nominate the members of an internal entity, which observes and supports the supervisory board by providing the information necessary for independent control. In Mori's view, employees are the most committed stakeholders and have access to most of those critical information that are filtered out in vertical reporting lines and managerial hierarchies (Inagami, Mori 2004, 270-3). But can such high expectations towards balancing shareholder and employee interest actually stand up to reality?

The Japanese management system has consisted of an employment portfolio similar to modern industrial employment and management systems in the US and Europe, composed of a core workforce or regular employees and a peripheral workforce, or non-regular employees. The first was sup-

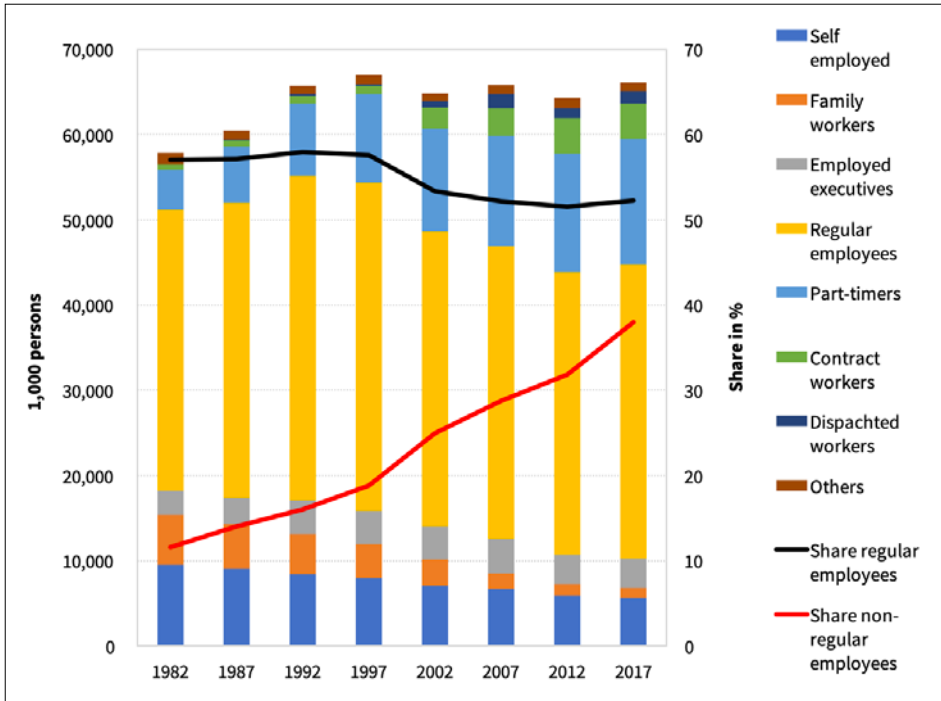
posed to be a central stakeholder, while the latter was utilised as capacity buffer, being paid lower wages and exempted from fringe benefits, bonuses, promotion and regular raise. As Nitta has pointed out, Japanese corporations tended to restrict regular employment, suppress the increase of fixed labour cost and cope with growing demand by expanding the peripheral workforce already during the cyclical recoveries of the '30s, '50s and '70s after long periods of recession (Nitta, Hisamoto 2008, 48-52, 58). Therefore, similar responses by Japanese corporations from the '90s onwards are no sufficient evidence for a fundamental departure from former practice. But the extent to which Japanese corporations have lowered labour cost after 2000 (chart 2.4) by reducing their core workforce and enlarging peripheral workforce has exceeded the previous trend by far: 32% of all working persons and 40% of all employed persons are more or less excluded from long-term job security, comprehensive fringe benefits, access to internal career building and regularly rises in working income (charts 1.23, 2.7, 2.8).

Chart 2.7 Dismissal rate at Japanese corporations (dismissals/permanent workforce × 100, in %, CY)



Source: Author, based on MHLW 2018c

Chart 2.8 Employment by status in Japan (FY)



Source: Author, based on MIC 2018c

But the labour cost of regular employees, too, have become subject to change, shifting from the promotion of long-term capability building through permanent assessment and incentives hierarchies to actual short-term performance: regular wage increases were reduced, eliminated or replaced by short-term variables and bandwidths; capability-based wage ranks were substituted by role-based ranks. These changes have led to a faster widening of wage gaps among regular employees. Statistical analysis by Yokoyama et al. (2016) shows that in the '90s all layers of (low, middle and high) wage workers had enjoyed wage increases, whereas in the 2000s middle-wage workers experienced bigger cuts than workers on the high and low wage levels. Umezaki explains this as an indication of the systematic slimming of middle layers, a general cutting of labour cost and a prioritization of a few supposedly high performers. All other employees were not treated as specific human capital, worthy of long-term investment anymore. However, the growing focus on short-term financial results and the simultaneously introduced performance-based wage system have been falling short of competency, building opportunities for almost all employee

groups and time resources needed for defining and assessing work tasks in the operational management (Umezaki 2017, 86-8). Attempts to implement new wage schemes have not been widely accepted in the operating field – due to mistrust with regard to performance assessment as well as their impact on motivation, collaboration and competence building in Japanese corporations. The new schemes often failed because they appeared more as a hidden form of labour cost reduction rather than incentives for new behaviour.<sup>14</sup> Occurring in US corporations already in the '80s, these trends have been interpreted as signs of a low-road strategy, aimed at short-term maximisation of profits and shareholder returns by minimising total cost through low payment for labour and outside contractors. Interestingly, many practices (such as long-term employment, multi-functional working teams, job rotation and quality circles) had been proposed as central features of 'high performance work organisations' in the US in the late '90s for absorbing negative effects on retention, loyalty, commitment and skill development and for increasing productivity through enhancing horizontal communication, collaboration and mutual gain sharing under the conditions of a market-driven employment system.<sup>15</sup>

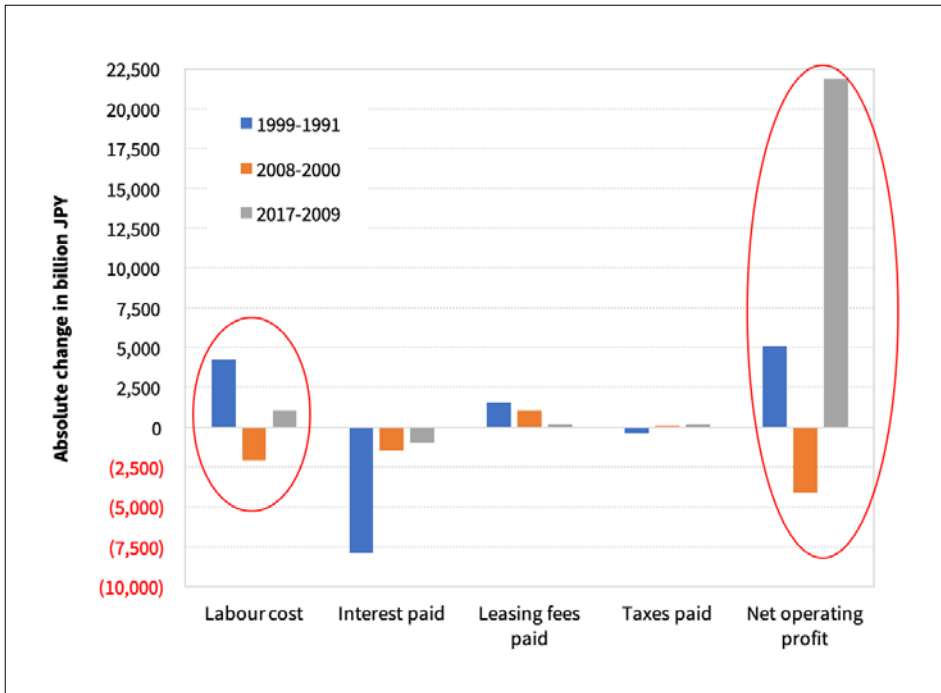
In the 2000s, Japanese corporations reversed the previous trend of increasing the ratios of labour cost/sales and labour cost/added value (charts 2.4, 2.5). But was this only another modification of the Japanese management system under changed external conditions? Or did the core of the traditional Japanese management system render the preference for a balance between different stakeholder interests insubstantial? All measures for labour cost reduction have been justified as an inevitable response towards crisis, a necessary adoption to a changed environment. Are they still compatible with the principles of a 'Human Centric Corporation', a characterisation once proposed by Itami ([1987] 2002) to explain the rise of the J-Firm in the '80s? Do they not induce the abolition of the Japanese corporate governance with its commitment to long-term corporate growth and investment, internalisation of central resources and gain (loss) sharing among the main stakeholders? Finding an answer to these questions requires to examine how Japanese corporations have actually acted after the recovery of their profitability in the 2000s. Chapter 1 of this book demonstrated that macro-economic productivity has been increasing, while labour cost and employment income have been falling (chart 1.22b).

At the micro-economic level, the added value/sales ratio has been detached from the labour cost/added value (labour) ratio and the labour cost/sales ratio,

<sup>14</sup> Nitta, Hisamoto 2008, 102-6; Jōe 2004; Takahashi, Nobuō 2004; Kusuda 2002; Kumazawa 1997; Imano 1998; Kuroda, Yamamoto 2006; Miyajima et al. 2011, 215-43; Satō 2012; Ogura 2013, 145-225; Umezaki 2017, 85-99.

<sup>15</sup> Levine 1995, 115-21; Cappelli et al. 1997, 15-88, 173-207; Cappelli 1999, 17-157; Osterman 1999, 20-70; Kochan 2015, 69-73.

Chart 2.9 Change of added value components at Japanese corporations of all industries with capital more than 1 billion JPY (in billion JPY, FY)



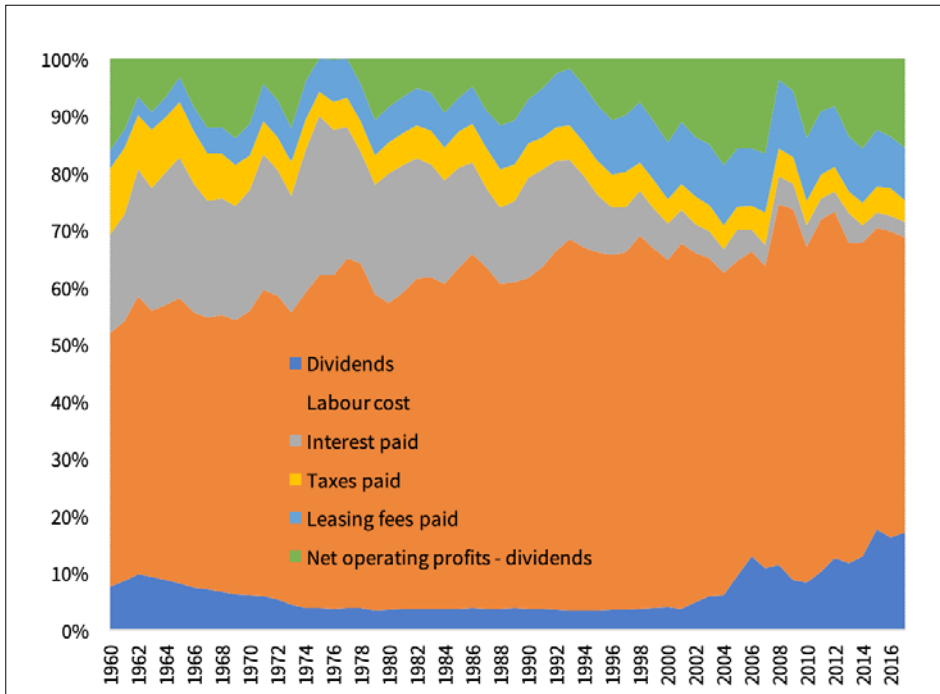
Source: Author, based on MOF 2018b

and while the first has seen both a relative and an absolute rise, labour cost has fallen relative to sales and added value. This is to say, employees and their working conditions have been sacrificed for improving corporate productivity and profitability (charts 2.4, 2.5, 2.6). The total change of added value can be decomposed into the changes of labour cost, interest paid, leasing fees paid, taxes paid and net operating profits. Doing this for Japan’s large corporations in the periods of 1990-1998, 1999-2007 and 2008-2016 shows that the increase of corporate profits was achieved mainly at the expense of labour cost in the second period. It also indicates that net operating profits have still grown considerably faster than labour cost during 2008-2017, resulting in a further reduced share of labour cost among added value (chart 2.9).

Japan’s large corporations have maintained a high level of retaining profits, while clearly preferring shareholders over all other stakeholders. This becomes obvious, if the added value of large corporations is broken down into all stakeholder income components, that is, labour cost for employees and executives, dividends for shareholders, interest paid to banks, taxes



Chart 2.10a Breakdown of added value by stakeholders at Japanese corporations of all industries with capital of more than 1 billion JPY (FY)

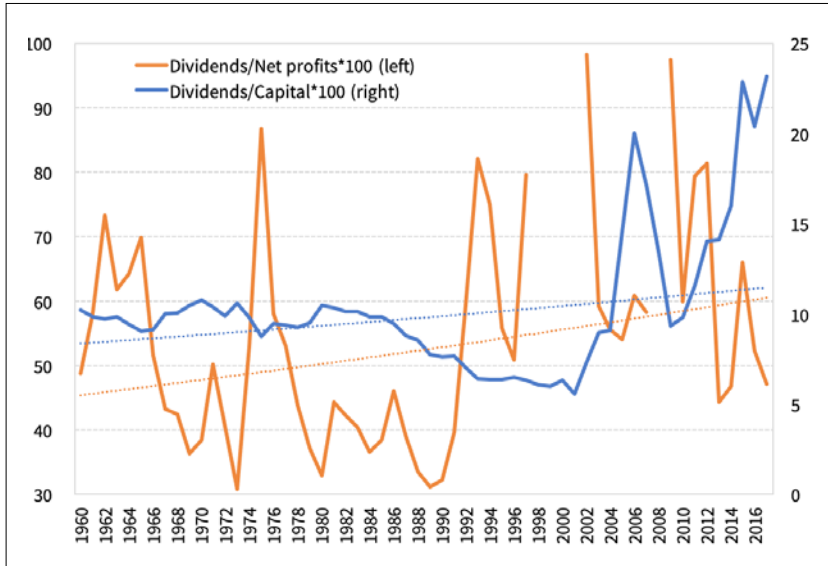


Source: Author, based on MOF 2018b

paid to the central government and local communities, leasing fees paid to real estate providers and net operating profits minus dividends as approximation for retained profits at the corporations for the long-term period 1960-2016. The trend towards corporate saving indicates an unwillingness or inability to invest into future-orientated business models, technologies and supply capacities. The trend towards increasing shareholder pay-out has to be seen as evidence for the shift from a balanced stakeholder system towards a shareholder-centred one (charts 2.10a-b).

Nonetheless, top managers of stock market listed corporations have been protecting their own power base through keeping the total pay-out ratio of dividends and share buy-backs stable at an average of 40% of net profits, and they have been maintaining managerial discretion over an expanding capital base instead of paying out net profits primarily to shareholders as dividends and share buy-backs as US corporations did at a continuously high level of 80% of net profits (charts 2.11a-b).

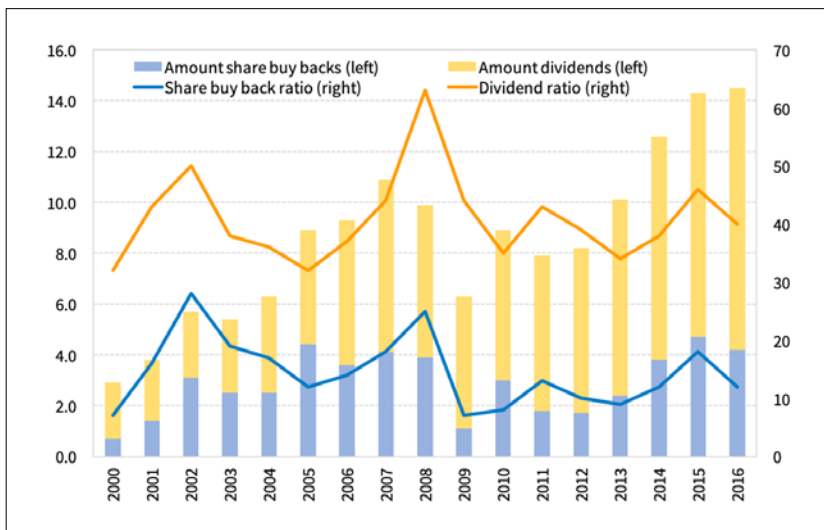
Chart 2.10b Dividend pay-out ratio (dividends/net profits) and dividend rate (dividends/capital) at large corporation in Japan with capital of 1 billion JPY and more (both in %, FY)



Note: The dividend pay-out ratio for 1998-2001 was excluded as it exceeded 100%.

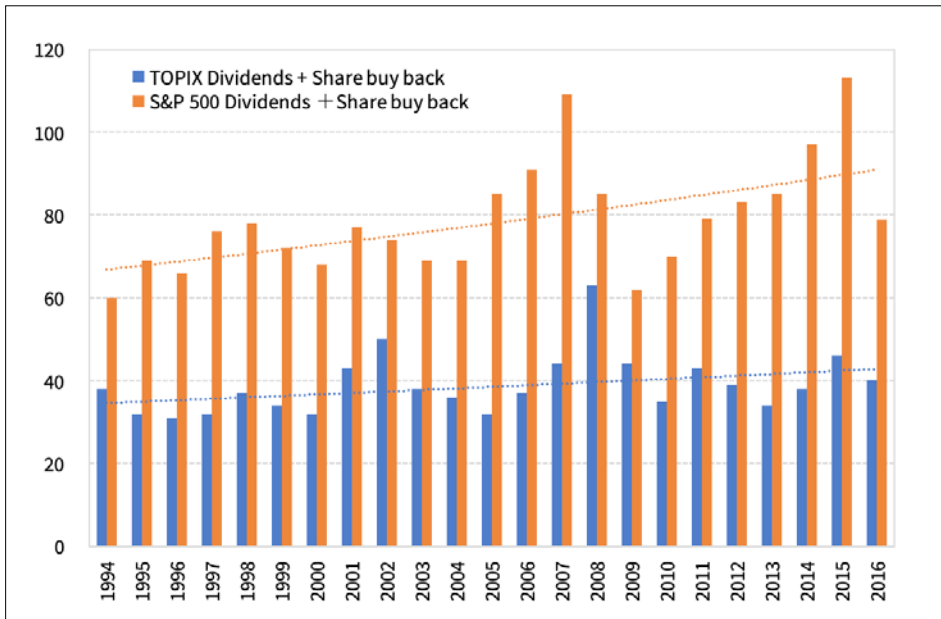
Source: Author, based on MOF 2018b

Chart 2.11a Amounts of dividends and share buy-backs by listed corporations (TOPIX) in trillion JPY and ratios as % of net profits (FY)



Source: Author, based on LIAJ 2014, 23; 2017, 29; 2018, 33

Chart 2.11b Dividends and share buy backs as % of net profits at TOPIX (Japan) and S&P 500 (US) composite corporations



Source: Author, based on Sugishita (2015, 7) for 1994-2002; LIAJ (2014, 23; 2017, 29; 2018, 33) for 2003-2016

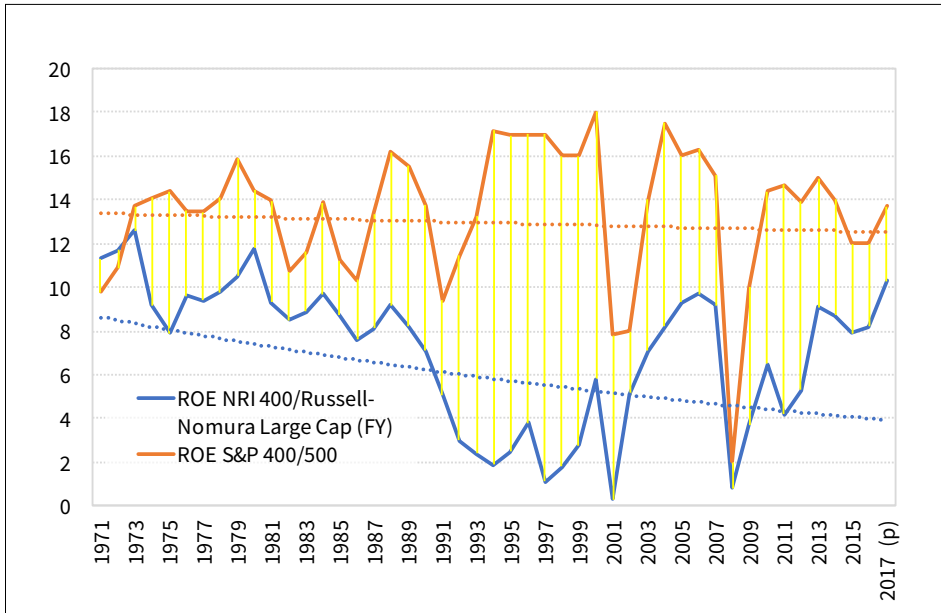
Thus, the majority of Japan’s large corporations have abandoned their traditional commitment to employees in favour of shareholders or equity capital providers – ignoring that employees are those whose living conditions are most exposed to their corporation, who take the highest risk as stakeholders as they lack switching opportunities on the labour market, but who know the business reality in the operating field best through their close relation to clients.

### 2.3.4 Adaptability and Conformity as Self-Protection

Since the 2000s, but especially since the financial crisis of 2008, top managers at Japan’s large corporations have been defending their own power positions in the name of corporate survival by boosting capital efficiency mainly through cost cutting at the expense of employees and suppliers. The accumulated macro-economic outcome has been the main cause for the deflationary stagnation of Japan’s economy since the burst of the asset

bubble. This has also been justified as inevitable compliance to globalisation and the need to better serve shareholder interest: foreign investors have become the biggest shareholders in Japan’s listed corporations and therefore more influential as ever before (chart 1.20b). They are less silent shareholders and evaluate corporate managerial performance against global benchmarks for return on investment alternatives.

Chart 2.12 ROE of Nomura Research Institute (NRI) 400 and Standard & Poors (S&P) 400/500 composite companies (in %)



Source: Author, based on Reily (1997, 5-6) for S&P 1971-1995; IDCf (2017) for S&P 500 1996-2017; Nomura Holdings (2018) for NRI 400

The gap in the level of ROE between US and Japanese listed corporations is often presented as a reason for further efforts towards increasing corporate profitability by Japanese corporations (chart 2.12). The level of expected ROE or cost of equity capital (COE) is seen as a yardstick for assessing, whether an achieved ROE sufficiently exceeds its cost and generates added value for investors. However, the actual level depends on the context, that is, differently structured economies and industries.

Frequently referred to by both proponents and critics of a stronger shareholder orientation in Japan<sup>16</sup> is the so-called Itō Report (METI 2014b). It was released by the Ministry of Economy, Trade and Industry (METI) as the outcome of a project meeting series with corporate executives, investment bankers, institutional investors and academics, and it paved the way for the Corporate Governance Code, which has been applied as guiding principle by Japan's financial and stock markets since June 2015.<sup>17</sup> The Itō Report points to the importance of achieving a level of ROE that exceeds COE or return expected by equity capital investors: due to the lack of commitment to sufficient capital efficiency and increased corporate value, corporate management in Japan has ended up in chronically low profitability without long-term strategic consistency. But the latter is needed to attract long-term committed capital investment from outside. Failing to meet equity capital investors' requirements would mean to lose out on competitiveness and innovation. It appears somewhat paradoxical that Japan's corporate profitability has remained at a low level for the last twenty years, while Japan achieved highest ranks in the category 'capacity for innovation' of the WEF Global Competitive Report (WEF 2017; METI 2014b, 10-11). The recent decline in this category is traced back by the authors of the Itō Report not to the ongoing shift from stakeholder to shareholder-orientated corporate governance and management. To the contrary, the lower reputation of Japan's innovation capacity is taken as evidence for a lack of commitment to sufficient capital efficiency and increased corporate value. But according to the Japanese National Innovation Survey 2012, issued after the turn towards a stronger shareholder orientation had been declared, the

ratios of firms that realised product, process, organisational and marketing innovations were 15.8%, 15.6%, 28.3% and 22.5% respectively and almost all of these ratios were lower than those of the US, Canada, UK, France, Germany, Italy, China and South Korea. The ratio of activities for product or process innovation in Japan was also lower than that of most foreign countries. Many Japanese firms have experienced a lack of qualified personnel and information on technology related to their product or process innovation. (NISTP 2014, 3)

The Japanese National Innovation Survey 2015, published after the turn towards a stronger shareholder orientation had been accepted by a significant number of executives at large corporations, stated that "financial factors, including lack of internal finance and difficulties in obtaining ex-

16 Takahashi 2015, 154; Yanagi 2015; Mizuno 2016, 17-20.

17 Yufu 2015; Oguchi 2015; Nishiyama 2016a, 2016b, 2017.

ternal finance, were experienced by less enterprises than other hampering factors and reasons" (NISTP 2016, 16).

Thus, the crucial question is whether capital actually represents the most critical resource for innovation. Takuma Takahashi, Iwai and Hirota (2012) are pointing out that, historically seen, the shareholder capital-based corporation was the adequate form of capital for the age of industrialisation with huge production plants as the technological base for mass production and mass consumption of physical goods and an economy of scale (decreasing unit cost by increasing total output volume). But in the current post-industrial phase with its growing uncertainty and complexity, the source for profits has shifted from quantitative expansion to differentiation, from access to huge capital funds for refinancing production capacity to human creativity, from material quantities and measurable results to immaterial qualities of behaviour, relationship and affection (Hirota 2012, 15-21). According to Takuma Takahashi, a new age of information and knowledge origination has evolved since the mid-'80s, with foregrounding human and organizational resources as collective creators and intellectual property rights to secure returns on the invested capital. Consequently, the weight of intangible assets in corporate accounting and corporate valuation through capital markets has increased.<sup>18</sup> Marx has envisaged this 160 years ago as a consequence of competitively driven progression to science-based automation, undermining the basis of industrial capitalism, where machinery dominates human labour and productivity gains are used only to gain more profit by reducing the time and cost, which is necessary to reproduce the value of the resource input (Marx [1857-1858] 2018, 574, 577, 581-2). In an international survey, based on interviews with top managers at 230 Japanese, 229 US and 112 German stock market listed corporations in 2005, 91.7% of the Japanese, 83.4% of the US and 93.7% of the German executives answered that the most important sources of their own competitiveness are the motivation, capability and competence of their employees and not tangible assets like capital investments (e.g. plants, machinery) (Hirota 2012, 81-2). Even if a bias towards political correctness, social harmony and acceptance in the answers is to be considered, this majority among corporate executives in all three countries is a striking evidence for the importance of human creativity in business. Correspondingly, the Japanese National Innovation Survey 2015 has shown that "lack of competent employees was the most prevalent hampering factor and increasingly indicated reason for the absence of innovation in comparison with that in the last round of the survey (the reference period: FY2009-FY2011)" (NISTP 2016, 16). Blair and Kochan (2000, 1-2) calcu-

18 Takahashi T. 2004, 2-19; Iwai et al. 2005, 16-36; Hirota 2012, 1-8, 81-2; Takahashi T. 2015, 180-6.

lated the weight of tangible assets in US stock market listed non-financial corporations at 31% of the corporate value<sup>19</sup> in 1998, which compares to 83% in 1978. By the end of FY 2016, the book value of tangibles assets in the corporations, which were listed in the first division of the Tōkyō Stock Exchange (TSE), represented 35.2% (2001: 39%) of the corporate value.<sup>20</sup> Against the backdrop of a declining importance of physical assets, Blair and Kochan emphasise that human and organizational capital, although still ignored by the traditional (mainstream) theory of accounting, are actually to be recognised as an increasingly important source of corporate value (Blair, Kochan 2000, 1-3, 334-82).

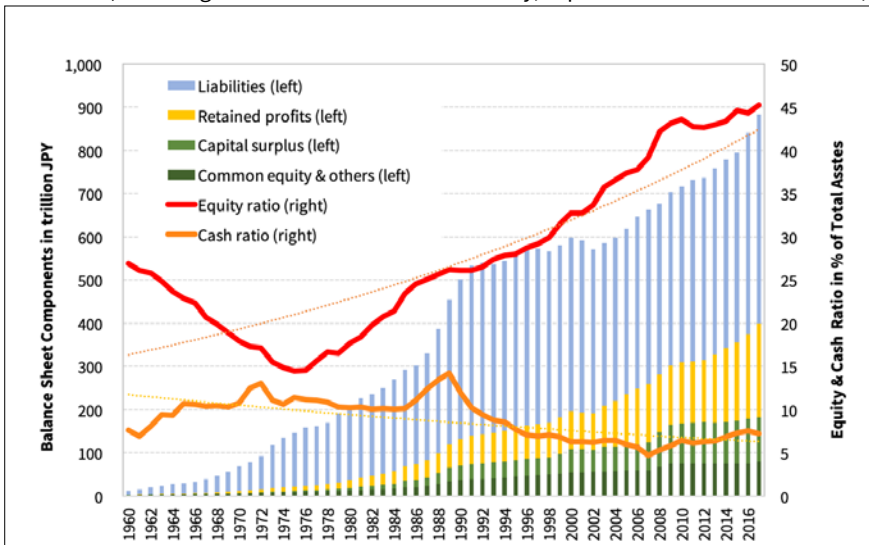
Another central argument of the Itō Report of 2014 is that Japan's large corporations will be in danger of losing sufficient access to capital funds, if they continue to neglect shareholder value. This is questionable. Japan's large corporations are currently holding cash positions, which fall only a little below the relatively high historical average of 8.9% of total assets (2017: 7.25%). They have deleveraged their balance sheets by reducing liabilities and increasing the weight of equity capital to a historical peak of 45.2% of total assets (2017). But they have been criticised for neither investing into more profitable business nor paying out abundant capital funds consequently to their shareholders (chart 2.13a). Further, the total amount of capital flowing back to shareholders as dividends and share buy-backs has exceeded the volume of equity capital raised through shareholder and public offerings, private placements, exercising of options and warrants and issuing of preferred and tracking stocks since 2000, except 2009 (chart 2.13b). This means that equity capital investors have been draining more capital from corporations than they have been providing to them.

Porter et al. (2000) once criticised Japanese corporations for depending too much on operational effectiveness and fuelling huge capital investment into scale effects, which results in even more competitive convergence towards lowering price and cost and a deteriorating profitability. In other words, not the loss of sufficient access to capital to finance supposedly innovative activities, but the lack of strategic differentiation and innovation was identified as the fundamental problem of Japanese corporations. Porter et al. saw insufficient pressure from shareholders towards higher capital effectiveness as the main factor that led to this convergence (2000, 76-91). Later Porter and Kramer (2006, 2011) recognised that prioritizing shareholders' demands at the expense of all other stakeholders is not a sustainable response to competitive challenge. To escape from the downward spiral of competitive congruence, corporations were advised to build

19 Corporate value is calculated as the sum of market capitalisation or market value of equity plus long-term debt.

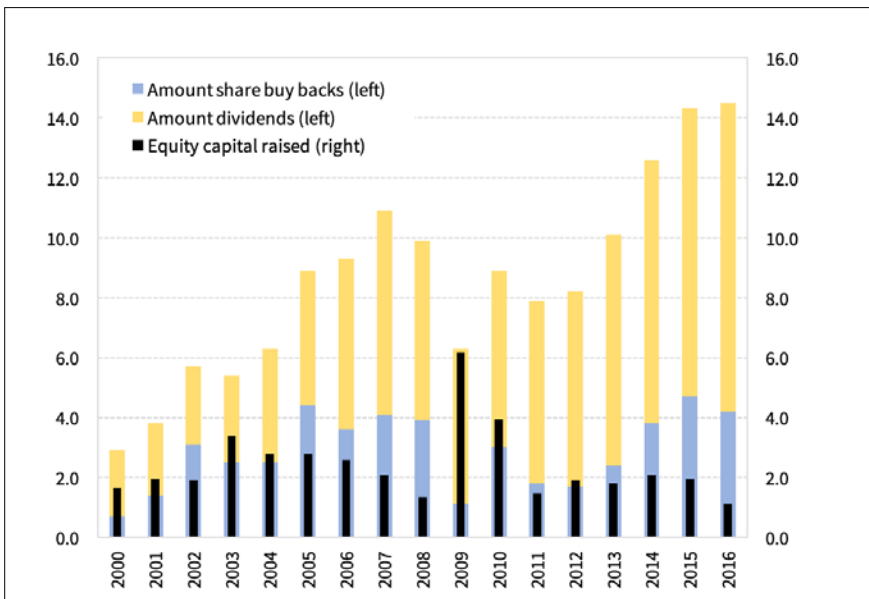
20 Author's own calculation.

Chart 2.13a Balance sheet composition of Japanese corporations (excluding financial and insurance industry, capital of 1 billion JPY and more, FY)



Source: Author, based on MOF 2018b

Chart 2.13b Amounts of dividends and share buy backs vs. equity capital raised by listed corporations (TOPIX) in trillion JPY (FY)



Source: Author, based on LIAJ 2014, 23; 2017, 29; 2018, 33; JPX 2018

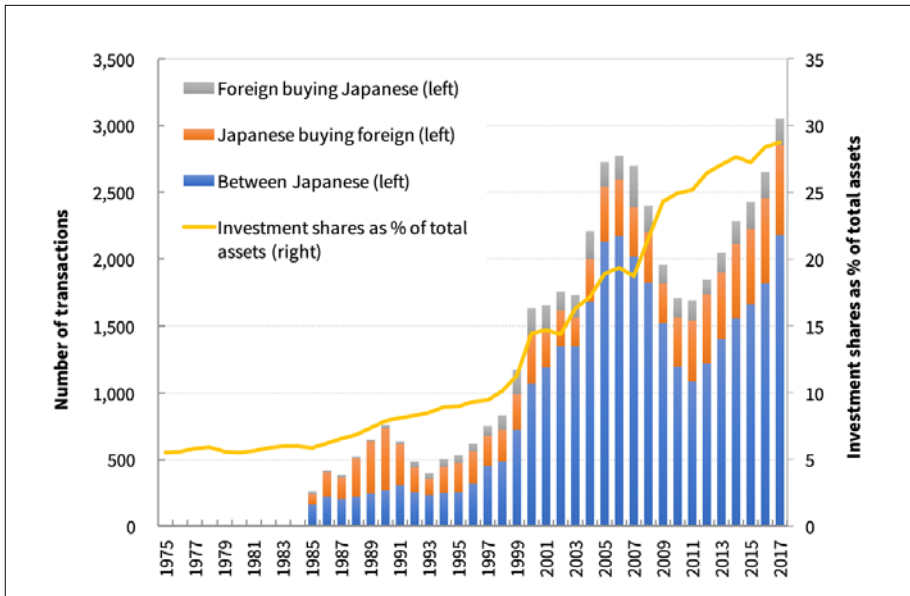


distinctive long-term strategies, to choose either different activities or perform activities differently (Porter et al. 2000, 162-74). Mergers & Acquisition (M&A) is supposed to be one solution. Proponents of an external control of corporate management regard capital markets, including M&A, or corporate takeovers as a market for corporate control and an important mechanism for implementing discipline and commitment to the creation of shareholder value: corporate management that allows the share price to drop to a level enabling others to take over will lose the right to manage corporate resources (Jensen, Ruback 1983; Miyajima et al. 2011, 151-77). In general, M&A is a time-saving, but often expensive shortcut for expansion: one acquires assets for quick expansion of existing business (horizontally) or enlargement of business along the existing value chain (vertically). In most cases, M&A is about keeping an established business model expanding in saturated markets rather than furthering fundamental transformation or innovation.

Since the late '90s, Japan's large corporations have been investing increasingly into M&A of other corporations in order to expand domestically and abroad; they paid huge premiums but hardly achieved their initial targets, particularly abroad (Takahashi T. 2012, 291-305; Matsumoto 2015, iii-iv). The biggest capital funds were spent on cross-border M&A by large corporations that are positioned in oligopolistic industries and protected from foreign competition, such as telecommunications, pharmaceuticals, tobacco and beverages. These corporations used their price setting power and extra profits extracted from a saturated domestic market in order to invest into regions, markets and corporate assets with supposed growth potential. Actually, they have invested into prolonging the life expectancy of existing (often socially problematic) business models (Matsumoto 2015, 4-10) (charts 2.14a-b).

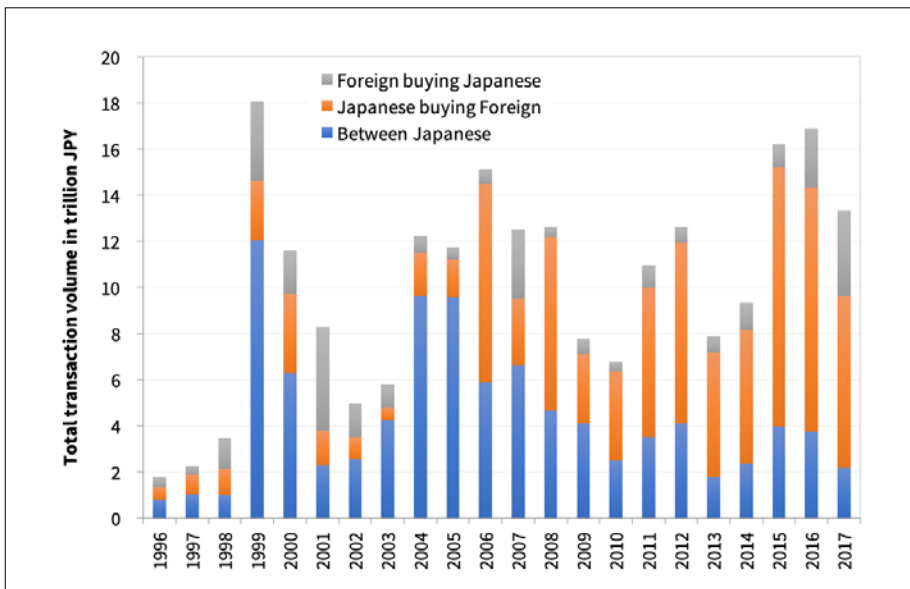
With respect to the increased weight of financial investment into shares among the total assets (chart 2.14a) or the flow of capital funds, Japan's large corporations tend to focus on M&A, while boosting ROE by buying back own shares instead of raising fresh equity capital and investing actively into their own business model or its transformation (Matsumura 2016, 2-12-3) (tab. 2.5).

Chart 2.14a M&A transactions with Japanese companies involved and investment shares as % of total assets of large corporations



Source: Author, based on RECOF Corporation 2018

Chart 2.14b Total M&A transaction volume with Japanese companies involved (in trillion JPY)



Source: Author, based on RECOF Corporation 2018

Table 2.5 Raise and investment of capital by Japanese corporations FY2006-2016 (in trillion JPY)

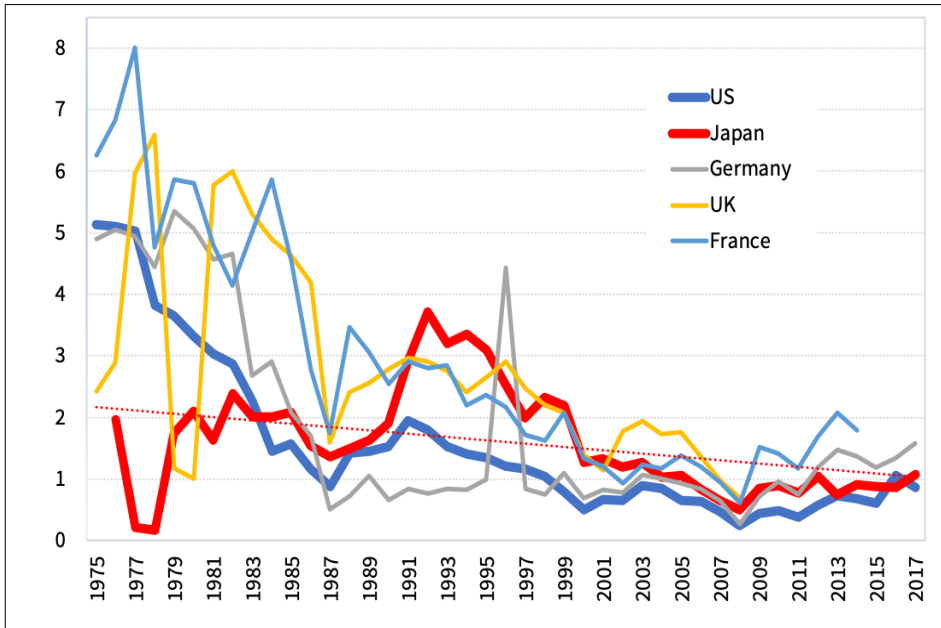
Large Companies				All Companies			
Raise		Investment		Raise		Investment	
Equity	12.5	Plant & equipment	214.8	Bonds	8.4	Plant & equipment	411.3
Bonds	11.9	Land	10.9	Long borrowing	35.8	Land	20.6
Long-borrowing	38.7	Shares & bonds	67.7	Retained profits	275.5	Shares & bonds	21.2
Short-borrowing	16.0	Long-lending	30.9	Depreciation	435.6	Long-term lending	49.0
Retained profits	100.3	Intangibles	2.6			Intangibles	3.3
Depreciation	222.1	Intra-credits	7.8			Intra-credits	12.3
		Other assets	37.9			Other assets	45.9
		Cash & savings	21.8			Cash & savings	52.7
		Inventory	4.3			Inventory	11.0
		Temp. securities	2.8			Equity redemption	122.6
						Temp. securities	1.8
						Repay short-debt	3.6
	401.5		401.5		755.3		755.3

Source: Author, based on MOF 2018b

Likewise questionable is the argument that serving shareholders’s interest is essential for a long-term orientation in corporate management and inevitable for securing long-term capital funds that are to be invested into innovation: the majority of shares of stock market listed corporations are held by institutional investors and managed by professionals, whose performance is generally measured quarterly and rewarded according to financial returns on the total investment under their management. Globally, this results in a higher turnover in shares and a continuously shorter holding period of less than one year on average (Bower, Paine 2017, 53-4) (chart 2.15).

It can be concluded that privileging shareholders and serving their interest above all others will not be effective in coping with the fundamental challenges for Japanese corporations, namely, strategic differentiation, innovation and new business models; not to mention socio-economic consequences like rising inequality, declining solidarity, growing short-termism and mistrust. Nevertheless, Japan’s corporate management has pledged its support to transforming corporate governance from traditional stakeholder balance and long-term expansion towards shareholder value orientation. Rather than reluctantly responding to pressure from foreign

Chart 2.15 Average holding period of domestically listed shares (years)



Source: Author, based on World Bank 2018

institutional shareholders, based on their increased shareholdings and voting power, corporate management has changed its orientation willingly, but with an unchanged attitude: protecting themselves by following the mainstream, that is the government as well as the domestic and foreign financial industry and their lobbyists in politics, mass media and academia. This does not mean that Japan’s top management subscribes unconditionally to a system of corporate governance, where shareholders play the unquestioned principal and corporate managers the role of an agent, who serves the interest of its principal. But as long as change is understood as prescribed and externally imposed, rather than self-constructed and open to responsible choice (van de Ven, Poole 1995, 520) passivity prevails. This passivity facilitates a corporate culture that generates more destructive congruence (instead of constructive or creative differentiation) by prioritizing (a) adaption to the external environment as the dominant way of external orientation exerting change and flexibility, and (b) internal integration based on formal-processual consistency or compliance to common standards and rules as the dominant way of maintaining stability and direction (tab. 2.6).

Table 2.6 Traits of corporate culture

<b>External orientation</b>	<i>Adaptability</i>	<i>Mission</i>
<b>Internal integration</b>	<i>Involvement</i>	<i>Consistency</i>
	<b>Change and flexibility</b>	<b>Stability and direction</b>

Source: Author based on Denison, Mishra 1995, 216

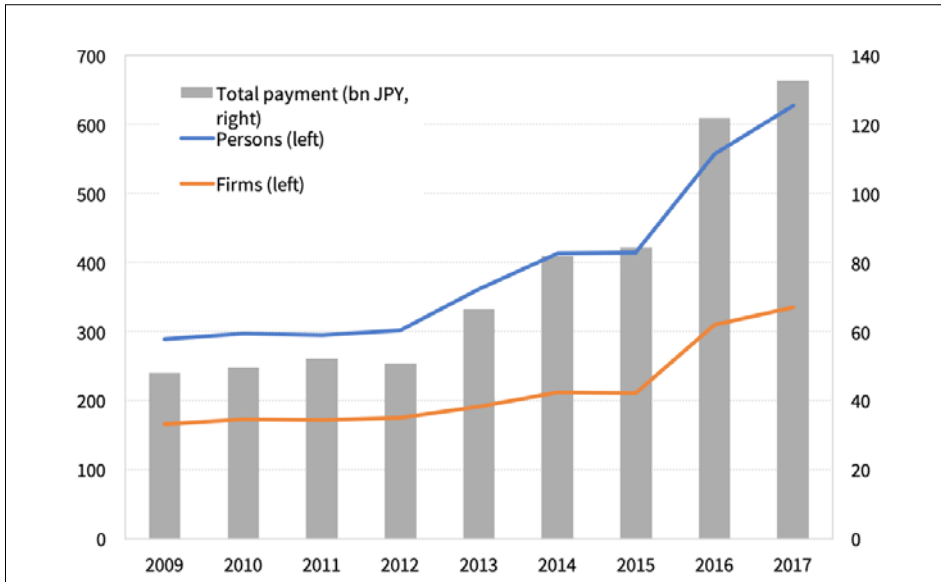
Setting the vectors of organizational culture alongside flexible adaption towards external change and internal integration through processual consistency attaches a great importance to capital markets and share prices, not only as the yardstick for evaluating the quality of corporate managing. Such a corporate culture turns the means into the final end and legitimises managerial decisions against the interest of all other stakeholders (Aoki 2007, 436-7, 440-3).

Finally, it should be noted that corporate executives have increased their own financial benefits. In Japan corporate executive payment, measured as average per person, is still relatively low in comparison to that of US executives. But it is growing faster than that of an average employee. The number of listed corporations in Japan, which pay executives 100 million JPY and more per year, has increased from 166 in 2009 to 335 in 2017. In the same period, the number of highly paid executives has risen from 289 persons to 627 persons, the total amount paid to them from 48 billion JPY to 133 billion JPY. As a result, the simple average amount paid per executive of this category has been raised from 166 million JPY (29 times of the average employee payment at listed corporations) in 2009 to 211 million JPY (35 times of the average employee payment at listed corporations) in 2017 (charts 2.16a-b).

## 2.4 Collateral Damages

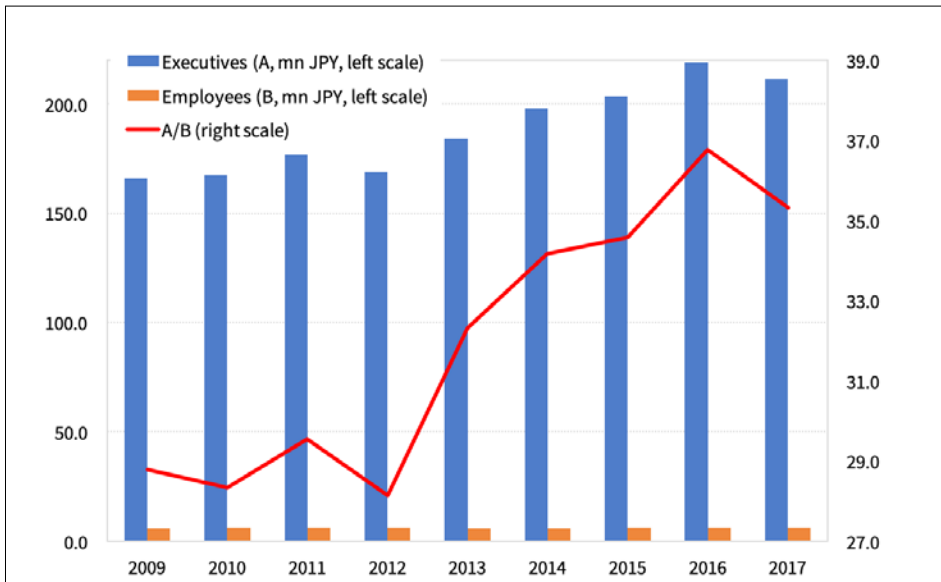
As explained above, Japan’s large corporations have responded primarily by leaving their business model more or less unchanged, while reducing cost and thereby creating the root cause for continuous deflation in Japan’s economy. This was justified as an inevitable effort to ensure survival through compliance to global standards and new requirements for capital efficiency. Academics facilitated the argument leaning on agency theory. This theory claims that a focus on maximising corporate value generates maximum social welfare, because not only shareholder value, but also the value of all other financial claims will increase and with it the economic source for satisfying the interest of other stakeholders. But even such proponents admit that corporate value cannot be maximised, if stakeholder interests are ignored, and that corporate management, committed

Chart 2.16a Number of Japanese listed firms paying single executives more than 100 million JPY, number of those executives and the total amount paid to them



Source: Author, based on TSR 2018

Chart 2.16b Average payment of employees (A) and executives (B) with more than 100 million JPY at Japanese listed firms



Source: Author, based on TSR 2018

to shareholder value, should utilise long-term value maximisation as the criterion for decisions on trade-offs among its stakeholders (Jensen 2001, 299). Below, I shall discuss how employees' competency and motivation, internal communication and collaboration, cooperation and non-market-based coordination have been affected by the decisions that executives of large corporations made.

#### 2.4.1 Collapse of Trust Among Employees

Trusting each other means to rely on positive reciprocity, e.g. to expect predictable and reliable interaction without coercion. As such, trust is characteristic of organizational cultures that provide members with an integrative frame and a general orientation, while leaving to them whether and how to act. Weick and Sutcliffe (2001) have identified a number of practices at high-reliability organisations (HRO) for coping with uncertainty, volatility and complexity, namely, preoccupation with failure (encouraging communication about errors and failures), reluctance to simplify interpretations (considering complex views and diverse sources), sensitivity to operations (being aware of imperfectness and supporting improvement of operations), commitment to resilience (i.e. a culture of intelligent improvisation based on excess capabilities) and deference to expertise (empowering those with the greatest knowledge and experience).

It goes without saying that processual qualities and their subjective perception can be hardly grasped by questionnaire surveys, measured statistically or quantified in time series. Such reservation notwithstanding, several international surveys from recent years indicate a level of employees' trust towards their firms that is surprisingly low in Japan compared to other developed countries. With all due caution these results seem to confirm the cultural damage caused by Japanese corporations and their executives, when unilaterally declaring former conventions obsolete: the Kenexa/IBM Work Trends Survey, which attempts to measure pride, satisfaction, advocacy and commitment and compiles these criteria in an employee engagement index for the period of 2008-2012, ranks Japan worldwide lowest with only 31% and a negative difference of 26% from the global average of 57% (IBM Software 2014, 2-4). In 2016, the IBM Smarter Workforce Institute and Globoforce's WorkHuman Research Institute tried to measure belonging, purpose, achievement, happiness and vigour worldwide and condensed them into the Global Employee Experience Index, where Japan ranked lowest in Asia and second lowest worldwide with a score of 51% and a negative difference of 18% from the global average of 69% (IBM Software, Globoforce 2017, 2, 5). The 2017 Edelman Global Trust Barometer revealed that only 18% of Japanese respondents assessed corporate executive officers (CEO) as extremely or very credible, which

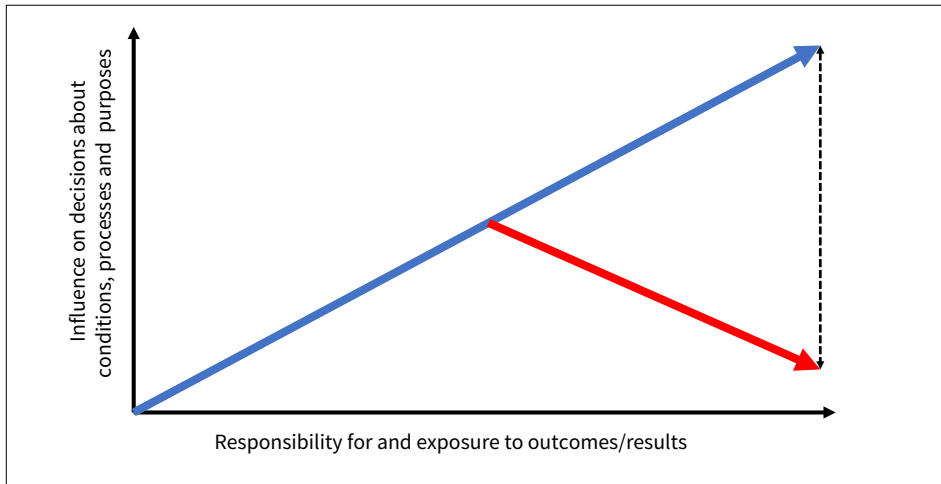
is 17% below global average and worldwide the lowest score (Edelman 2017, 15, 17, 23). Other surveys indicate the same continuously low and under-average level of employee satisfaction, engagement and trust in Japan (Ōta 2017, 60-5).

Almost ninety years ago, Mayo ([1933] 2003) and Roethlisberger (1939) recognised the importance of human relations for blue-collar employee productivity, questioning Taylorism. More than forty years ago, Rohlen (1974) attempted to fill the gap between 'functional (change-orientated)' and 'cultural (tradition-orientated)' explanations for the economic performance of Japan's business organisations in the '60s from a context- and diversity-sensitive perspective informed by cultural anthropology. He had observed how important human relations were for a Japanese bank (as an example of a white-collar organisation) and how central these relations and the sharing of related value were for the livelihood of the employees (2-4). Current studies reconfirm the positive impact of employees' high job satisfaction on Japanese corporations' financial and stock price performance (Yamada et al. 2017). Thus, it does not come as a surprise that the ongoing reduction of labour cost (causing a lack of distributional legitimacy) and the decline of job security since the '90s have led to a low level of trust among Japanese employees. But distributional illegitimacy and lack of perspective are not the only reasons for the loss of trust. Changes in work organisation, which resulted from the new vectors of corporate governance and organizational culture, are also crucial. Prioritizing compliance to formal rules and consistency of procedures in order to warrant internal integration and stability means practically that the operational field has to cope with centralised budgets, reports and controls, which again reduces operational discretion as well as possibilities for improvisation and local initiative. In short, centralisation has become dominant, just when the increased complexity of the external environment calls for decentralisation. Middle management and operational levels, which have been expropriated of opportunities to decide what and how it will be done, are now increasingly charged for the outcomes under the label of performance-based management. Being held responsible for the results on the one hand and losing operational autonomy on the other hand naturally generates dissatisfaction and distrust among employees (fig. 2.1).

Although business model and competitive position are in many cases challenged by foreign competition as well as societal and technological change, culturally, the Japanese management system has fostered a mid- and long-term orientation based on stable employment, strong horizontal linkages created by the rotation of generalists through the whole organisation, shared priorities and a common language among employees and managers (Srivastava, Goldberg 2017), which eases decision-making and promotes proactive employees. Precisely these patterns of collective behaviour have



Figure 2.1 Growing centralisation, performance-based management and gap between increased exposure and reduced influence resulting in chronic distrust



Source: Author

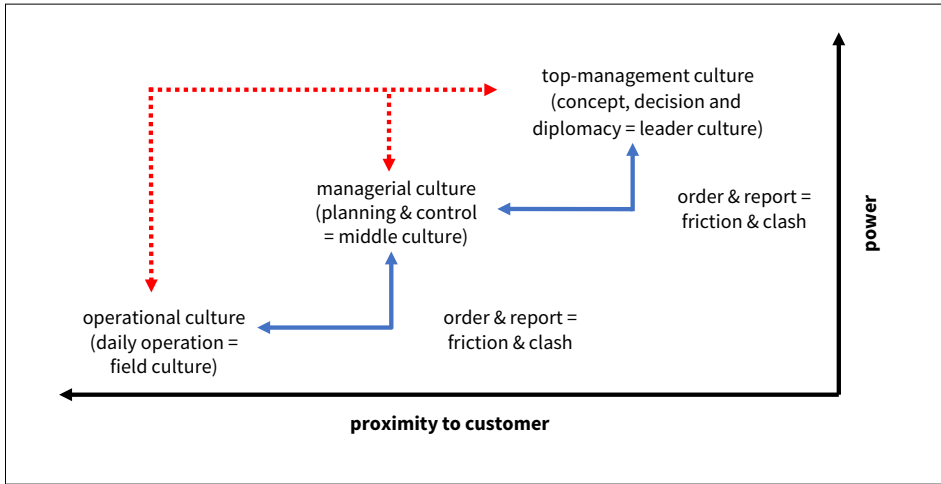
enabled the generation of tacit (i.e. non-formalised, context- or organisation-specific) knowledge as described by Nonaka and Takeuchi (1995).<sup>21</sup>

Although linked to the old business model, which is reaching its limit, a reset of the cultural vectors to external adaptability and internal consistency means to eliminate horizontal communication and informal collaboration. Formalised procedures of centralised decision-making and control come to replace intangibles by tangibles and tacit knowledge by formalised knowledge. This implies the loss of what Schein (1996) once called intra-organizational learning consortia or informal links between top executives, middle managers and the operational field with their respective subcultures. These links complemented the formalised vertical lines of order and report, which all too often cause friction, clashes and opportunistic or selective (dis)information (fig. 2.2).

Ōta (2017) has identified a different reason for the low trust, which is also directly related to work organisation, but seems to contradict one of the reasons given above. An essential part of Japanese human resource management is to not conclude formal employment contracts with regular employees and thereby not to define particular tasks and duties. Regular employees are often, without individual consent, rotated to a different divi-

21 See also Seely-Brown, Duguid 2000, 117-46; Stewart 1997, 71-4.

Figure 2.2 Losing linkages between top, middle management and operational field



Source: Author, based on Schein 1996

sion with different tasks and duties every three years. But in many cases even current tasks and duties are not formally specified. This allows to allocate labour flexibly without legal restrictions or objections by individual employees. Apart from suppressing legally based dissent, such flexibility in utilising the internal workforce pool effectuates high dependence of individual employees on their organisation, because their competencies remain organisation-specific, even if comprehensive. A work organisation that is based on unspecified individual job-design causes dissatisfaction and mistrust, especially among ambitious, talented and high performing employees: it limits (a) their individual discretion and autonomy (their voice option), (b) their ability to accumulate organisation-unspecific capabilities, which are acknowledged in external labour markets (their exit option), and (c) the possibilities to protect their health and private life against non-specified and unlimited demands by the organisation. Under such conditions, the necessity to change business models fast and fundamentally stays unaddressed and productivity stagnates due to an extreme fragmentation of activities (Öta 2017, 59-97). The prevailing conservative logic of organizational flexibility forms the background for both centralised decision-making and non-specification of job assignments, which evokes demotivation.

## 2.4.2 Deteriorating Quality of Processes and Products

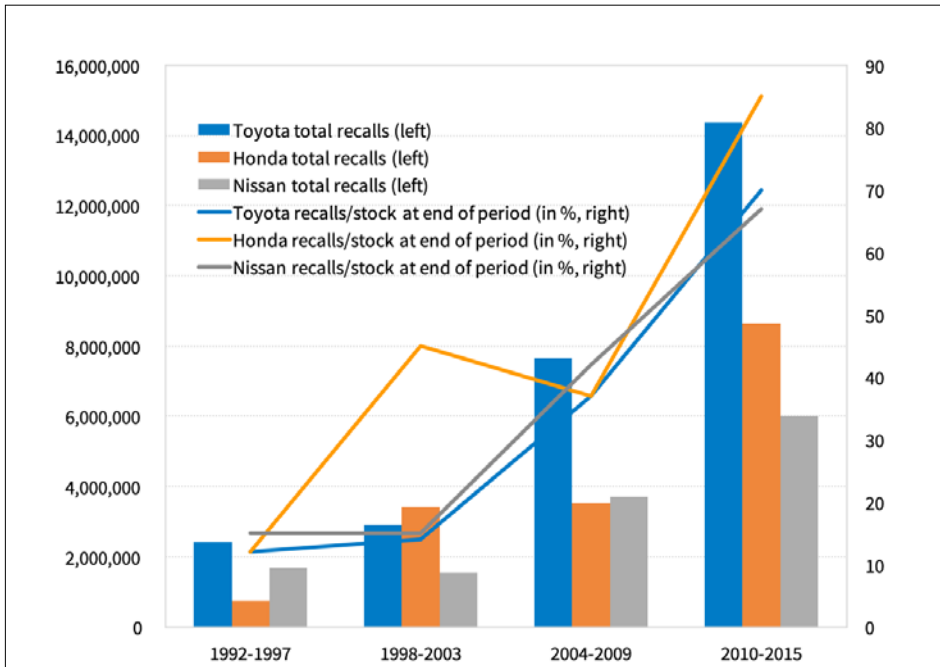
Acting and deciding in business organisations means to connect and balance different ways of thinking and behaviour: on the one hand, resources and routines are to be optimised within existing structures; on the other hand, new forms of designing, manufacturing, selling and consuming products are to be developed (March 1991; Leonard-Barton 1992). The operation of systems necessitates rules defining in advance which functions are to be fulfilled by which components and how these components are to be connected with each other.

Defining the configuration of the interfaces and their output performance *ex ante* involves the strategic advantage to select components through market mechanisms. Flexibility arises from choosing among various options, allowing competition for the best partial solutions (as long as the competitors are isolated from each other) and reducing transaction costs (Aoki, Andō 2002, 8-9). But as long as the system rests on a fixed framework and lacks the opportunity to optimise itself, adjustments will apply only to components. This becomes disadvantageous the more complex the system or its context is (Aoki, Andō 2002, 24-6). If products have to be developed to average standard functionality, proprietary-integral structures are needed, because optimisation and functionality can only be improved if all elements are internally defined and controlled. Once technologically matured, open systems are more effective (Chesbrough, Teece 2002).

Issues of configuration have been addressed under the name of industrial architecture. In the related discussion, Fujimoto (2001, 2002) is a proponent who opposes convergence to open architecture, or modularisation, for manufacturing industries with products like cars, which consist of several thousand parts. Fujimoto warns that the logic of modularisation cannot be applied unconditionally. Historical strengths and path dependencies are to be considered as both potentials and limits. He points in particular to the role of organizational learning for optimisation in Japan's automotive industry with its closed, integrative architecture. In contrast, open modular systems predominate in the global IT industries. Here optimisation results from a radical reconfiguration of resources, products and processes (Fujimoto 2002). Under conditions of growing complexity and uncertainty, business organisations as well as individuals are required to be increasingly flexible. Flexibility is – according to Fujimoto – the extent to which conflicting demands for high product quality, low costs and short delivery times can be balanced and kept unimpeded by changes in external conditions or product variance. At the product level, flexibility is advanced as interface standardisation and use of equal parts in different products, and at the process level as non-specification of work tasks and machinery functions (Fujimoto 2001, 308-9). Japan's manufacturing firms need flexibility,

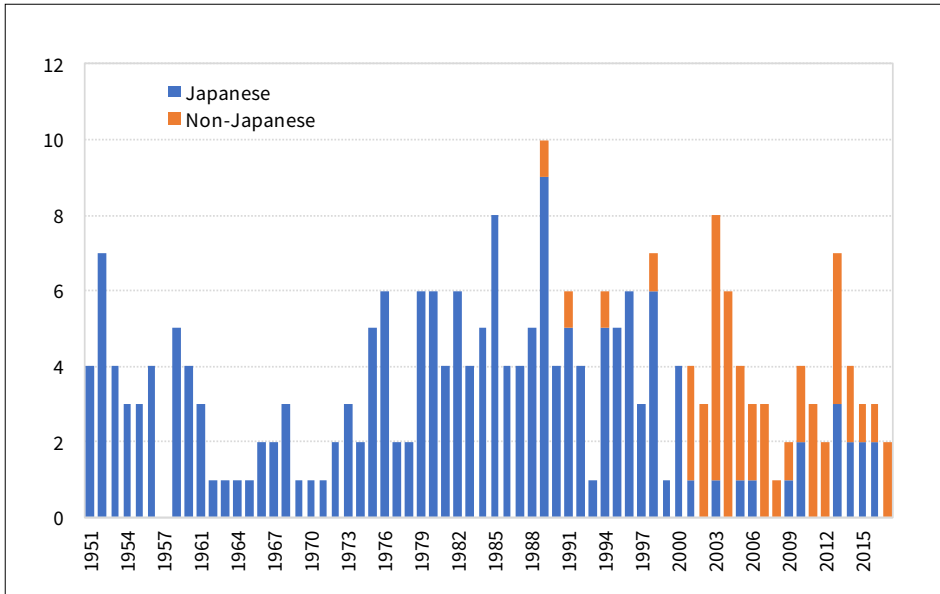
because expansion of the total output and, relatedly, scale-based effects of optimisation can be gained only through absorbing an increased variance of products or product parameters. Flexibility is therefore not an end in itself or a categorical imperative, but a means to reducing cost. Process flexibility amounts to operations that are always determined by the next step and ultimately the final stage, as well as to work tasks and machinery functions that are not exactly anticipated. In other words, the conditions for the use of men and machine are kept unspecified. So far flexibilisation has mainly applied to human work, with work tasks, locations and quantities constantly changing. Slack or easily accessible pools of human labour, time and other resources are necessary to absorb external and internal volatility. Forced into the dilemma between complexity and cost reduction, or external adaptability and internal consistence, organisations have come to regard slack as waste since around 2000, but particularly in response to the economic crisis of 2008. Indicative of this trend is the exploding number of recalled cars: in total and as weight of running stock, recalls by the three biggest Japanese automotive manufacturers, Toyota, Honda and Nissan, have increased from 1992-1997 to 2010-2015 by more than five times (chart 2.17a).

Chart 2.17a Total number of recalled cars in Japan from Toyota, Honda and Nissan in 6-year periods from 1992-2015



Source: Author, based on MLIT 2018

Chart 2.17b Number of Deming Prize winning firms



Source: Author, based on JUSE 2018, 67-72

Instead of treating quality management as an organisation-wide process task and investing into the extension and preservation of required slack, the acquisition of formal standard certification (ISO) was declared to be the objective in many corporations and seen as sufficient to comply with external demands and internal challenges. Unsurprisingly, the once highly regarded quality level of Japanese products entered a critical state: trust in it was shaken by a series of quality control related scandals (e.g. Tōkyō Electric Power, Tōyō Rubber, Hitachi High Technologies, Asahi Kasei, Kōbe Steel, Nissan, Subaru, Mitsubishi Motors), reaching a preliminary low with the bankruptcy of Takata Corporation in June 2017. This corporation, previously no. 2 in the global market share ranking of airbag producers, had hidden and delayed recalls of defective airbag inflators, linked to at least 17 dead car drivers worldwide. Ultimately, they had to recall an estimated 100 million cars since 2007.<sup>22</sup> In addition, the number of Japanese corporations being awarded the prestigious Deming Quality Prize has significantly declined since 2000, while the number of award winners from outside of Japan, mainly from India and Taiwan, has risen (chart 2.17b).

22 See: <http://www.bbc.com/news/business-40401471> (2018-10-11).

Obviously, the current quality problems at Japanese corporations cannot be explained only as a failure of single organisations or related groups and individuals. Rather, they indicate the declining importance attached to process and product quality and the related interest of customers as stakeholders, in addition to a deteriorating communication between top management, middle management and the operational field. Thus, they have to be regarded as collateral damage in close relation to the change of corporate governance and organizational culture at Japanese corporations after 2000.

### 2.4.3 Increasing Risk of Corporate Misconduct

In December 2001, Enron Corporation, which had been named America's most innovative company by the US business magazine *Fortune* consecutively from 1995 to 2000, filed for bankruptcy: the company had hidden losses and kept huge debts off balance by using current value-based accounting (mark-to-market) and special purpose entities in order to meet profit projections and stock market expectations. Thousands of employees lost their jobs. Market capitalisation of Enron shares of several tens of billion USD and related pension plans for employees evaporated.<sup>23</sup> A few months later, in July 2002, WorldCom Inc. filed for bankruptcy and laid off 17,000 employees due to overstated sales income of about 9 billion USD<sup>24</sup> (Sidlak 2003; Pandey, Verma 2004). In the same year the Sarbanes-Oxley Act was put into force to recover trust in capital market-based corporate governance by introducing stricter requirements for financial disclosure and prevention of accounting fraud. Nevertheless, even years later corporate fraud occurred, only at a bigger scale and with much more destructive consequences, i.e. in the cases of Fannie May and Freddie Mac, American Insurance Group (AIG) and Lehman Brothers. All these cases have in common that corporate executives, focused on short-term maximisation of share prices and meeting profit projections, manipulated income statements and balance sheets. Here again, the root cause is not merely individual misconduct as the 'bad apple theory' would have it, but the interrelation of systemic, organizational, collective and individual factors. At the systemic level, corporate fraud is tied to a governance system that defines the nature of stock market listed corporations simply as a bundle of contracts with shareholders, who are the ultimate principal. It

23 Chandra 2003; Seeger, Ulmer 2003; Gillan, Martin 2007.

24 The top management of WorldCom too had improperly released reserves and reduced operating expenses by accounting them as capital investments in order to meet profit projections.

sets maximisation of the principal's benefit as the ultimate corporate goal, and share price as the most effective measurement of the performance of corporate management and M&A as the market for corporate control. The stock market does not provide price-relevant information completely, simultaneously and equally to all market participants; it is not protected against price overshooting and manipulation by insiders at the expense of other stakeholders, and it does not reflect mid- and long-term implications of corporate decisions (Kuhn, Ashcraft 2003; Hara 2017, 66-8).

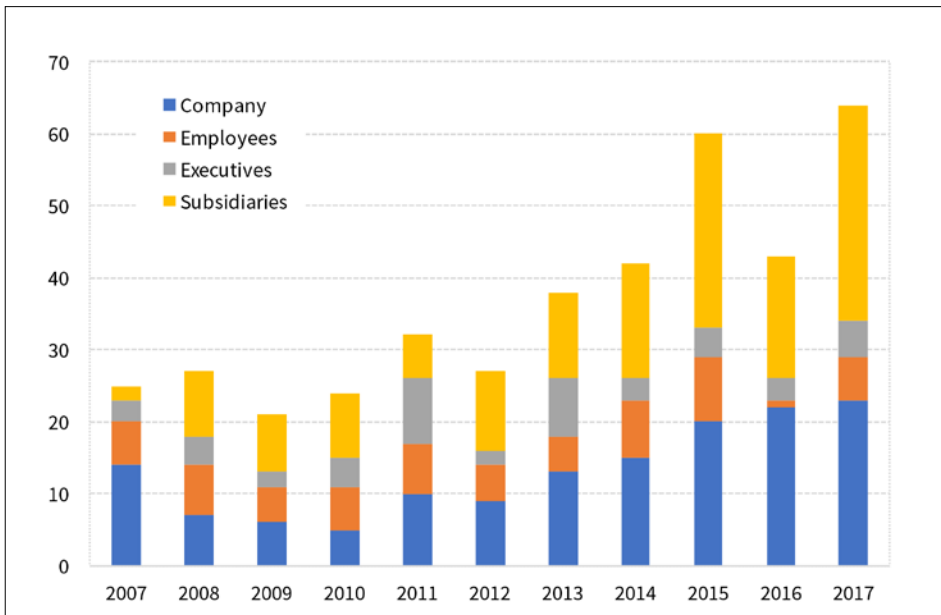
As Marx stated, "Hegel remarks somewhere that all great world-historical facts and personages occur, as it were, twice. He has forgotten to add: the first time as tragedy, the second as farce"<sup>25</sup> (Marx [1852] 1960, 115). So, what happened first in the US happened second in Japan: after a series of accounting and financial report frauds by stock market listed corporations like Seibu Railways/Kokudo in 2004, Kanebō in 2000-2004 (Takeuchi et al. 2015, 80-1), Livedoor in 2004-2006 (86-7), Nikkei Cordial in 2005 (Higuchi 2012, 177-80) and Olympus in 1999-2011 (Higuchi 2015, 130-51), the Japanese government urged capital market participants to comply with the new rules of the Stewardship Code (released in February 2014, revised in May 2016) and the Corporate Governance Code (introduced by the Tōkyō Stock Exchange in June 2015). Together with the Itō Report of 2014, these guidelines aimed at strengthening corporate governance through shareholder monitoring and a corporate management that would be committed to the increase of corporate value. Matsumura (2016) criticises that the underlying notion of corporate governance is biased by an oversimplified and one-directional route of cause and effect from monitoring capital providers to corporations, and that the latter are held responsible for delivering the requested results. Such an approach leaves the nature of corporation, i.e. generating value through organised interaction of several stakeholders, in a black box. It overlooks that investors only provide capital, and that coping with shareholders demands from the right (lending) sight of the balance sheet creates cost, while managing should focus on generating value and profit on the left (borrowing) side by organising activities of all stakeholders (Matsumura 2016, 2-12-7). But corporate managers put themselves under short-term pressure to meet external expectations. Thus, the new guidelines might even work to the opposite inviting pressured managers to avoid failure by 'cooking the books', not only occasionally, but systematically. Tōshiba's accounting fraud represents the preliminary low. Their illegal practices had already begun in 2008 and brought the firm close to the brink of bankruptcy, when made public 2015-2016. In the aftermath, the firm had to sell almost all valuable

25 Cf. <https://www.marxists.org/archive/marx/works/1852/18th-brumaire/ch01.htm> (2018-11-07).

assets to survive as nuclear plant builder with the help of the Japanese government (see chapter 3). It comes as no surprise that Tōshiba executives were accused of having falsified accounting reports for years, first of all to hide the heavily overpriced acquisition of US nuclear plant builder Westinghouse in 2006 and the related losses. In the '90s Tōshiba top managers had declared themselves true followers of the management system and corporate culture of General Electric under CEO Jack Welch and for that they were celebrated by capital market participants, mass media and academia in the US and Japan. And they were praised in Japan as pioneers of adopting a market-driven management style, a (decentralised) internal company system, a work-position and short-term result-based payment policy and US standards for accounting.<sup>26</sup>

But accounting fraud is not limited to a few spectacular cases of large stock market listed corporations. Data indicate that respective cases are increasing (chart 2.18a). Whether due to stricter prosecution of such offenses or an actual increase, fraud cases occur simultaneously with the diffusion of corporate governance structures and elements that are supposed to serve the interest of shareholders by keeping their agents aligned through share price-based compensation (chart 2.18b).

Chart 2.18a Irregular accounting cases at listed corporations in Japan by main culprit (FY)

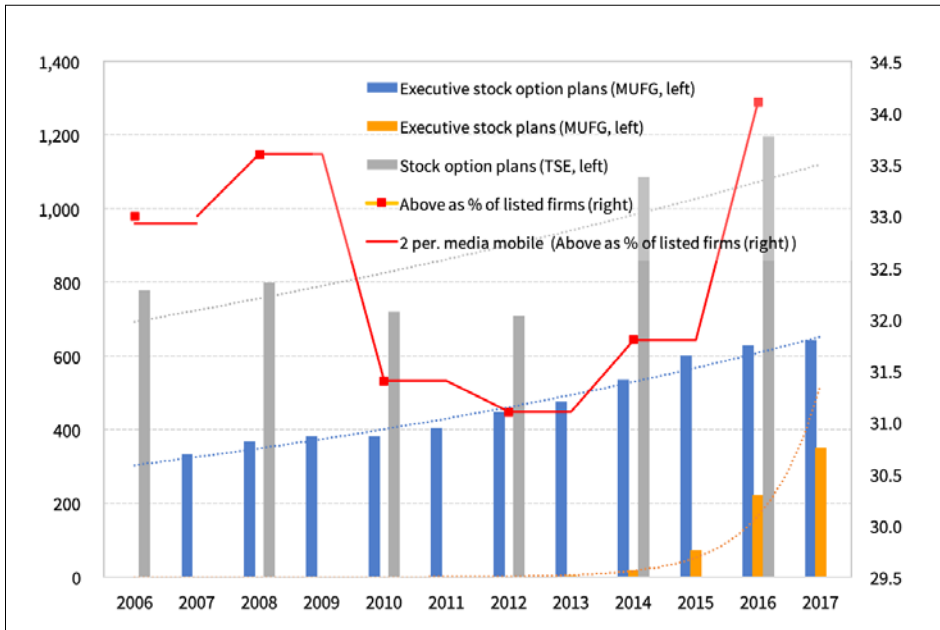


Source: Author, based on TSR 2018

26 FACTA 2017; Matsumura 2017; Higuchi 2017a, 6-38; Higuchi 2017b, 103-23.



Chart 2.18b Number of listed companies with executive stock option and stock compensation plans in Japan



Source: Author, based on TSE 2018; MUFG 2017

Higuchi (2012) points out, that most analysed cases of corporate misconduct in Japan are tied to outsourcing, cost reduction, performance-based payment (i.e. weakening of internal integration) and a specific corporate culture of homogenisation, overriding legal and other social rules (97, 149, 187, 236, 264). Obviously, all these factors became reinforced, once corporate governance and culture attached more weight to external orientation and control.

## 2.5 ‘Politically Correct’ Response: Itō Report 2.0

In response to a shift of emphasis towards social value or social-problem solution as the source of sustainable corporate value generation (Porter, Kramer 2011), and probably also to criticism against the Itō Report of 2014, a new report was released in October 2017, the ‘Itō Report 2.0 - Final Report of the Study Group on Long-term Investment toward Sustainable Growth (Investment Evaluating ESG Factors and Intangible Assets)’ (METI 2017c; Itō 2017, 8-31; Callon, Yoshida 2017; Itō et al. 2017). First the report outlined the importance of innovation and intangible assets for growth in profitability (capital efficiency) and meeting international demands for

contributions from corporations and their investors to the solution of social problems (METI 2017c, 9-14). Then it assessed that Japanese corporations have invested relatively much in R&D, but have been unable to translate these expenses into persistently higher operation profits. Instead of investments in innovation, R&D expenses have been treated as cost and therefore directed at short-term improvement of existing technologies, products and business models. For the same reason Japan's corporations have been lagging behind in their investment into intangible assets and human resources (METI 2017c, 15-20). In order to make such investment mid- and long-term and promote innovation as key to higher capital efficiency, Japanese corporations were to attract long-term orientated equity capital investors, which are often public or semi-public institutions (like pension funds and central banks). These institutional investors comply increasingly with the UN Principles for Responsible Investments (PRI) of 2006, which address Environment, Society/Social and Governance (ESG) as crucial criteria. ESG have been perceived as both risk and opportunity, even though ESG-committed investments have not earned shareholder returns above average in the past (METI 2017c, 26-31). Nevertheless, the Itō Report 2.0 implicitly assumes that (a) the valuation of corporations by capital markets<sup>27</sup> is of prime importance; (b) the relatively low price-book-value ratio<sup>28</sup> of Japanese public corporations reflects a relatively low capital efficiency<sup>29</sup> and growth expectation,<sup>30</sup> and (c) that these are caused by the still prevailing passivity of related long-term shareholders in Japan (banks, life insurances and other corporations) and the lack of a market for corporate control, i.e. the threat of a take-over and of sacking of executives when the share price is too low (METI 2017c, 32-7). In their view, corporations have to show commitment to higher capital efficiency and future growth by entering a dialogue with shareholders and other capital market participants about a permanently change-orientated corporate culture, an ESG-compliant business model generating sustainable growth, a corporate strategy for investing into critically important resources such as human capital, technology, software and brand, a performance orientation and an understanding of governance as disciplinary frame to realise their commitment and deliver the expected results (METI 2017c, 44-60).

A constructive dialogue requires equality among the discussants, not a relation of subordination between principals and their agents. And if the outcome is to go beyond reconfirming the status quo, contributions from

27 Market Capitalisation (MC) = issued shares × share price.

28 Price Book Value Ratio (PBR) = share price/net assets per share.

29 Return on Equity (ROE) = net profits/equity capital.

30 Price Earning Ratio (PER) = share price/net earnings per share.

all involved sides are needed. But the Itō Report 2.0 maintains previous positions, namely, that the ultimate end of stock market listed corporations is to generate an increase in corporate value and to deliver above-average returns on investment for equity capital providers. Price movements on capital markets are seen as the most rational criteria for assessing success. The proposed corporate culture prioritizes high adaptability to a changing environment and consistency in serving the interest of equity capital providers, while fundamental questions remain unaddressed, for example, inherent irrationalities of capital markets, the short-term bias of institutional investors, social and environmental problems directly and indirectly caused by corporative activities and capital markets, trade offs and balancing between stakeholder interests under external pressure to maximise financial return and participation of stakeholders in decisions about corporate goals, processes, outcomes and investments. Thus, stressing the importance of innovation, intangible assets, ESG compliance and long-term orientation of investment appears to be a politically correct disguise of an unchanged end. This does not come as a surprise in view of the report's authors and members of the study group: they were mainly executives of Japanese stock market listed corporations, financial institutions and institutional investors, with the METI as hosting coordinator and some ministries of the central government as well as the *Keidanren* as observers.

## 2.6 What is the Alternative?

The current mainstream of corporate management prioritizes adaptability to the environment as the main source of change and flexibility. In contrast to that, firms could set a mission that expresses a specific reason for the existence of the very firm and a related goal as the anchor of stability and direction under increasingly complex conditions. In order to provide stability and direction to the organisation, the mainstream calls for consistency in compliance, while the alternative counts on participation and involvement of all stakeholder parties as sources of internal integration, change and flexibility. In short, the mainstream appears responsive, urging to comply with external demands from capital market participants, whereas the alternative appears active, generating stability and flexibility from inside the firm by setting a specific goal and enhancing involvement of its diverse stakeholders (tab. 2.7).

Table 2.7 Alternative traits of corporate culture

External orientation	<i>Adaptability</i>	<b>Mission</b>
Internal integration	<b>Involvement</b>	<i>Consistency</i>
	Change and flexibility	Stability and direction

Source: Author, based on Denison, Mishra 1995, 216

But what is the nature of a corporate mission that generates stability and direction in response to increasingly complex external conditions? Necessarily, it has to be focused on providing products or services that are not in oversupply and thus not prone to destructive cost cutting, something which does not answer already addressed problems and therefore has a high demand potential. This requires a business model that generates sufficient added value to reward all stakeholders and that promotes innovation to the advantage of all who are involved. Such a mission puts innovation at its centre as distinct from the mainstream, which exploits innovation as a means to the traditional end of higher capital efficiency. It distinguishes itself also fundamentally from business models that are based on the economy of scale and actually cause environmental and societal problems. As such, the alternative model enables firms and their stakeholders to shift from serving saturated markets towards addressing environmental, societal and individual needs, including a radical reduction of paid working time made possible by technological progress, i.e. artificial intelligence and automation. Providing a sufficient basic income to all citizens instead of increasing the administration of poverty and unemployment will absorb frictions that are likely to occur in the process of transition from cost-driven to innovation-seeking business models. Last but not least, it will encourage risk-taking that is needed for innovation.

### 2.6.1 The Importance of Ownership

Equity capital investors are granted several rights: to vote on board members, executive payment, fundamental changes of structures and goals, stock issues, options and splits, mergers and acquisitions; to buy and sell their shares; to participate in profits through dividend payment and, in case of liquidation, receive assets and income, after demands of creditors, bondholders and preferred shareholders have been satisfied. Shareholders do not have a say in the operation of a corporation. In return for being only limited liable, shareholders cede also possession of corporate assets or incomes. General ownership exceeds the limited rights of shareholders: it implies responsibility for and autonomy of the business with respect to decisions about products, processes and results. A non-mainstream type

of ownership is needed, if the aim is to generate products and services that are not in oversupply, are not socially and environmentally harmful and are not prone to destructive cost reduction, and a corporate culture is required, which provides orientation and stability by means of a mission and generates flexibility through participation of all stakeholders.

At the same time, financial capital is not critical anymore, but rather externally and internally abundant as indicated by extremely low long-term interest rates and overpriced asset markets. If so, there is no logical reason to privilege shareholders with a dominant stakeholder position. To the contrary, stock market listed corporations that hold on to the mainstream, inherently expand their power and, once obtained, establish oligopolistic or monopolistic market control, prevent competition, exploit suppliers and consumers, pressure states, governments and communities and finally get subjected to anti-monopoly measures, takeovers and delisting. Interestingly, recent research about firms with a short corporate lifespan scale shows that a considerable number of start-ups in the US failed, not despite but due to external funding, because external investors had not provided sufficient time for these firms to develop and refine their business model (Quartz 2016). Responsible ownership means to protect the firm and its stakeholders against unjustified claims from external parties. And ownership has to be practiced by the most contributing stakeholders. These are normally the employees, because they encounter most of the challenges, risks and consequences of doing business, not the capital providers. Fortunately, new technologies such as 3D-printers and digital networks are beginning to free businesses from the necessity to scale up under all circumstances and to obtain huge funding for capital investments. Whatever scale and scope are required, they can be achieved through intra-local networks of firms – easier and faster with less capital investment and external funding.

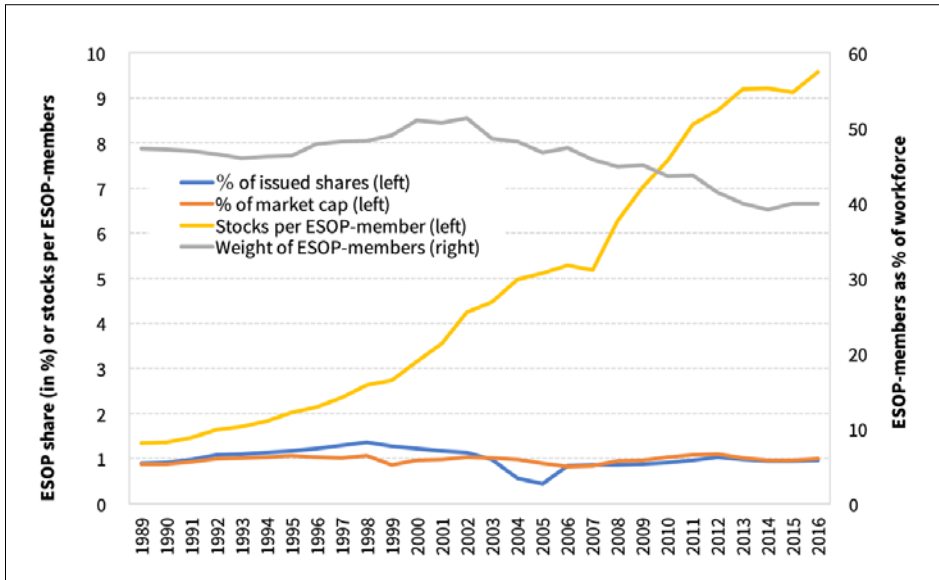
## 2.6.2 Employment Security, Participation and Payment

Fear of unemployment causes passivity, short-term opportunism and distrust among employees. Thus, employment security is essential, if innovation and productivity are to be taken seriously, as such central elements cannot be achieved without long-term committed, collaborative and creative employees. Pfeffer (1994, 1998, 2015) pointed out, that employment security not only helps to avoid short-termism and loss of talented employees to competitors, including prior investment into their training; it also enhances careful hiring, promotes a deep understanding of corporate goals and the sharing of informal rules and rights, mutual expectations and general demands. Furthermore, it enables long-term investment into professional qualification and a decentralisation of organizational design based on self-managing

teams, which includes broad information sharing and the reduction of organizational layers as well as status differences. These features of human-resource management become especially productive if linked with not necessarily high, but compressed compensation schemes, which are contingent on team and organizational performance and sometimes combined with stock options. Pfeffer (1994, 30-59; 1998, 64-98; 2015, 189-90) illustrated how human-centred practices of high performance management systems affected the corporate performance in such prominent cases as AMD, New United Motor Manufacturing, Lincoln Electric, Southwest Airlines, AES and SAS Institute. Their practices were called features of 'responsible corporations' (cf. Osterman 1999, 146-78), 'partnership capitalism' (cf. Kochan, Osterman 1994; Blair, Kochan 2000), combining Employee Stock Ownership Plans (ESOP), profit sharing, broad-based stock options and employee participation, or 'new corporation' (cf. Blasi et al. 2003). These human-centred practices could be found at many start-ups in Silicon Valley (such as Intel). They have proven effective for winning over talent and stimulating creativity among employees (Blasi et al. 2003, 31-61, 153-76, 205-21). Job security, long-term contracts and compensation schemes, regular feedback, a tolerant bankruptcy law and structural protection against short-term biased performance demands by outside directors and shareholders are essential for enhancing explorative behaviour and strengthening a corporate culture that is committed to innovation as well as inherent learning through failures and risk taking - this has been shown by Manso (2017) in several empirical studies on public corporations and medical R&D organisations as well as in scientific experiments. His cases stand in sharp contrast to the legions of contemporary employees, who are urged to behave like internal entrepreneurs in mission statements and reports on corporate social responsibility (CSR), but are finally treated as cost positions by executives and, accordingly, highly frustrated.

Particular cases cannot be taken directly as proof for the existence of something new, but they can stimulate the conception of alternatives (Flyvberg 2006). The cases mentioned above show literally that alternatives are possible. Such cases exist also in Japan. Some of the features raised and described by Pfeffer (1994, 1998, 2015), such as long-term employment, bottom-up decision making and gainsharing, were once even common parts of human resource management and organizational culture at Japanese corporations. But they belonged to the traditional business model of industrial production, not post-industrial knowledge-based innovation of product, process and management. And neither did they involve employee ownership (Iwai 2009, 340-2). Most employee stock ownership plans (ESOP) in Japan have not gone beyond a symbolic level (chart 2.19).

Chart 2.19 Weight of employee owned stocks (ESOP) in Japan



Source: Author, based on JPX 2017

The recently most prominent Japanese firm, which puts its employees first, grants them ownership-based gainsharing, practices participation and sustains high performance, is Japan Laser Corporation (JLC). Being a small trading company specialised in laser, with 49 employees and annual sales of 3.3 billion JPY by now, it began as a start-up in 1968, then converted into a subsidiary of Japan Electron Optics Laboratory (JEOL) Co. Ltd., and as a result of Japan’s first Management and Employee Buy Out (MEBO) in 2007 turned into joint ownership of JEOL (14.9%), JLC directors (53.1%) and JLC employees (32.0%).<sup>31</sup> JLC and its management under President and CEO Nobuyuki Kondō acknowledge that only motivated and respected employees satisfy the firm’s customers. Accordingly, JLC has done everything to protect employment. In return, it has been rewarded by its employees with initiative, commitment and the kind of service that is necessary to keep a small trading company, which belongs to the endangered species of mediator, highly appreciated by laser technology manufacturers outside Japan and users in Japan. The once lossmaking dependent subsidiary of a large corporation has been independent for more than a decade and accomplished

31 See JCL company homepage [online]. URL <https://www.japanlaser.co.jp/EnglishTop/Company/tabid/90/Default.aspx> (2018-06-08).

a job turnover rate close to 0%. 30% of all managerial positions are held by women and 20% of all employees are older than 60 years of age. Furthermore, JCL has been without any financial losses for 23 consecutive years (Kondō 2017). Thus, it can be seen as a pioneering example for an alternative alignment of strategy, governance and culture, not pursuing expansion under all circumstances, but its own specific way of providing value to the good of its stakeholders and the society it is embedded in.

### 2.6.3 Governance and Culture of the Post-Industrial Firm

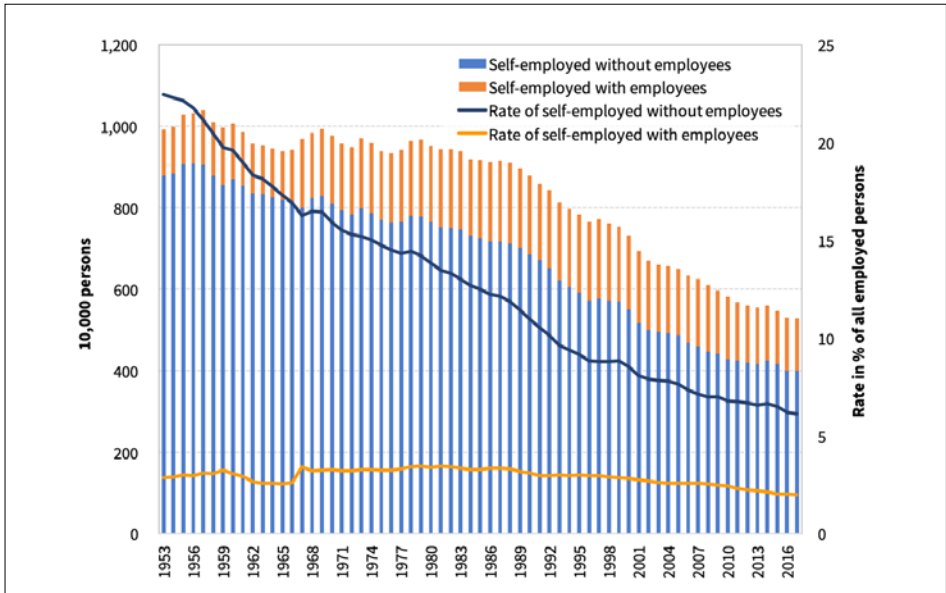
If today access to huge capital funds is not primary for sustainable success in business, then there is no reason for separating ownership and management, privileging shareholders with limited liability and corporations with income tax benefits as well as access to public subsidies over individuals and private forms of business. Some proponents demand the break-up of large stock market listed corporations into locally committed and simply organised firms, which are directly interconnected with their customers, prioritize subsidiarity and sustainability over expansion and pay dividends to their shareholders not in cash, but in products. The reasons they raise are the growing cost of internal control and external manipulation (including advertisement and lobbying), the huge losses due to mismanagement and the declining ability to both innovate and address broader social interests (Okumura 1992, 211-29; Mizuno 2016, 212-8). The alternative is to have firms owned by those who manage the central process of knowledge creation, and to be managed by those who generate, share and link human knowledge, organise collaboration between diverse individuals and collectively create connections between different, formerly unconnected elements, which is the very essence of innovating. Iwai (2009) predicts a revival of the classical firm as a clear sign of post-industrial capitalism, where ownership and management are not separated anymore. He sees the increasing number of self-employed persons in the economies of most OECD-member countries as indicative of an entrepreneurial renaissance.

But in Japan the number of self-employed persons with employees and new business entries (vs. business exits) has been going down since 1990 (charts 2.20a-b). This is seen by some as a result of the long-lasting macro-economic stagnation, by others as evidence for a lack of entrepreneurial spirit. But it should not be overlooked that the increase of self-employed persons in the US and Western Europe was partly boosted by an outsourcing boom of large corporations orientated at cost-cutting.

Seely-Brown, Duguid (2000) and Iwai point out that firms as corporate organisations will not become extinct: formal organisation and structure, division of labour and specialisation will still be required, even if less rigid, i.e. informal and spontaneous practices room. External capital funding

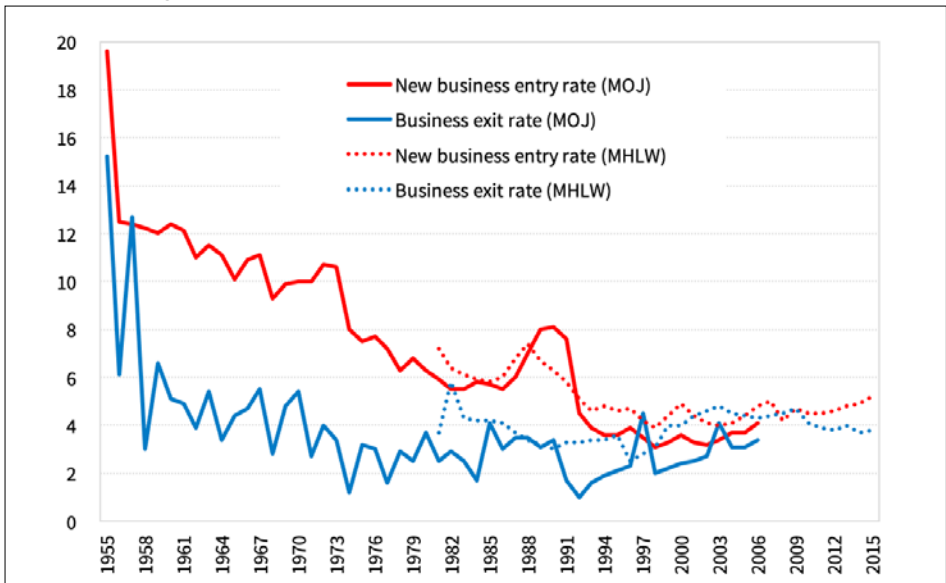


Chart 2.20a Self-employed persons with and without employees and their weight as % of all employed persons in Japan (CY)



Source: Author, based on MIC 2018c

Chart 2.20b Rate of business entries and exits in Japan (in % of the previously registered total stock)



Source: Author, based on METI 2018a

will be needed until cash flows are generated from new business ideas. Furthermore, legal protection of ideas and knowledge for the sake of commercialisation includes the dilemma of how to decide which prices and margins are for how long legitimate and meaningful (Seely-Brown, Duguid 2000, 167-72; Iwai 2009, 311-2). But the biggest challenge for these firms remains how to keep those who generate ideas and knowledge through their communication and collaboration motivated to do it within and for the firm (Stewart 1997, 79-108; Iwai 2009, 321-39). Precisely this makes an innovative and participation-friendly linkage of ownership, management and culture inevitable (Manso 2017, 23).

All the ideas about how business may be organised in the post-industrial era let Japan's alliance of large corporations, central government and public bureaucracy appear as a cartel that blocks moves towards alternatives at rising cost for the majority. The next chapter analyses the electric power generating industry of Japan, exemplifying how and why this backbone industry has become a costly burden and life-threatening risk for Japan's future under the eyes and in the interest of the above alliance.