Navigating “New Capitalism”

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> The Japanese stock market has suffered an eight-day losing streak unbroken by the election of a new prime minister, an event that typically produces a rally, in what some have dubbed the ‘Kishida shock’. The Nikkei Stock Average has retreated 6.8% since Fumio Kishida won the race to lead the ruling Liberal Democratic Party on Sept. 29. About 80% of the benchmark index’s gains since August have been wiped out... Fueling this anxiety is Kishida’s declared goal of a ‘virtuous cycle of growth and distribution’.[1]

The stock market did not react well to Kishida becoming leader of the LDP and hence prime minister. Investors worried about backsliding on structural reforms, a return to what some called the “bad old days” of industrial policy, and they feared that he would fund “distribution” by raising taxes on investment income. In the following months Kishida moderated his stance and placed greater emphasis on the “growth” part of the virtuous cycle. His “income doubling” plan had become an “investment income doubling” plan, as he sought to make 1 quadrillion yen of household savings held in banks and cash available for investment. By the time his “grand design” was unveiled in June 2022, some economists were questioning what was new about “new capitalism”.[2]

From a historical view, that is a reasonable question, as debates about how to transform capitalism are far from new. And how the age-old tensions over growth and distribution are managed may ultimately decide the success or otherwise of Kishida’s quest. It is not just a matter of policy, moreover; the tensions are at the heart of corporate governance. Any assessment of “new capitalism” must therefore consider both the policy and company – corporate governance and management – level, and their interaction. Can “new capitalism” create a new growth model in which macro- and micro-level institutions complement each other in a sustainable, virtuous cycle?

Echoes from the Past

Current debates about capitalism have echoes in the past, especially the late 19th and early 20th century, similarly an age of (fading) liberalism, globalization and “finance capitalism”.[3] In Japan, Eiichi Shibusawa, whose portrait will soon adorn the 10,000 yen note, helped to legitimize capitalism through his advocacy of *gapponshugi*, or bringing capital, labor and management together to serve the public interest. Not all capitalists were so ethically minded, however. In the turbulent 1920s Riken director Masatoshi Okochi denounced “capitalistic industry” and advocated instead “science-based industry”. His views were reminiscent of Thorstein Veblen’s criticism of emerging large corporations and “captains of industry” in the United States. This era did not end well, in Japan or elsewhere. It created huge wealth disparities, social tensions, and ultimately extreme political reactions, which spilled over into war and revolution as depicted in Karl Polanyi’s 1944 classic *The Great Transformation*.[4]

A new postwar era was erected under “embedded liberalism” and “Unlike the economic nationalism of the thirties it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism.”[5] Under this compromise it was an age of diminishing income and wealth differentials, and it was an age of managerial capitalism. Memories of the 1920s and 1930s faded, however, and neoliberalism and a new shareholder/finance capitalism emerged, and with them growing inequality and eventually political extremism. Unsurprisingly there has been a revival of interest in Polanyi’s “double movement”, especially since the 2007-2008 Global Financial Crisis, and Donald Trump and Brexit.

The Rise & Fall of Japan’s Postwar Productionist Model

In postwar Japan, the newly formed Keizai Doyukai advocated “modified capitalism” (*shūsei shihonshugi*), seeing the company as a community comprising capital, labor and management, with each entitled to a fair share of profit, but ultimately managers as the arbiters of conflict. After considerable industrial relations conflict, Japan emerged with its own version of “managerial capitalism”. The tripartite Japan Productivity Centre was formed in 1955 with three key principles – employment stability, prior consultation and a fair distribution of the fruits between workers, managers and consumers. (Shareholders were not mentioned.) In 1955, too, *Shuntō* (the Spring Wage Offensive) was formalized, creating a mechanism to coordinate wage bargaining and set a wage increase rate which rippled out from leading companies and sectors, and following a meeting between then Prime Minister Hayato Ikeda and Sōhyō leader Kaoru Ota in 1964, encompassed public sector workers as well. Ikeda’s income doubling plan and the micro-macro complementarities inspired Kishida's (initial) income doubling aspiration.

The combination of "Japanese-style management" or employment, technological innovation and "patient capital" through tiered institutions, combined with supportive government policies, fostered strong growth and rising living standards in postwar Japan. But it also generated intense trade friction, and the seeds of its own demise, through internal and external pressures. The Plaza Accord of 1985 resulted in a massive appreciation of the yen, and the 1989-1990 US-Japan Structural Impediments Initiative pressured Japan to dismantle elements of its model. Financial dis-intermediation and tentative deregulation began to modify the institutional complementarities, especially after the burst of the asset bubble in 1989-1990.

The "lost decades" have been endlessly discussed, and are not our concern here, except to note a growing tension between those who accepted that change was necessary but wished to preserve key elements of the postwar model, and those who wanted more far-reaching reform, and took inspiration from a resurgent US. In this see-saw, the institutional coherence which marked the postwar model was further lost. "Japanese-style management" or employment, which had been at its core, was effectively renounced in Nikkeiren's (1995) *Shinjidai no Nihonteki keiei* (Japanese-style Management for a New Era), but its employment portfolio vision was an expression of changes underway rather than a cause. It was followed by substantial labor market de-regulation, rising non-regular employment, a declining labor share of value added… and deflation.

The Search for a New Economic Growth Model

Sustained recovery proved elusive. When he returned to power in late 2012, Prime Minister Shinzō Abe boldly declared that "Japan is back" and unleashed his "three arrows" of "bold monetary policy", "flexible fiscal policy" and a "growth strategy to promote private investment". While not necessarily new in themselves, their combination and scope, combined with concrete targets and timelines were distinctive. They helped Japan to exit deflation, but did not create a new growth model.

Abe's bid to attract overseas investors rested on raising returns on their investments, from a Topix average of 6% (and mode of 3-4%) – half the MSCI World Index average – to "at least" 8%. He promoted corporate governance reform and strengthening of investor relations through a two-pronged strategy – a Stewardship Code (2014) and a Corporate Governance Code (2015), which urged fund managers and corporate managers to work together to grow "corporate value". These "soft law" codes with comply or explain provisions were subsequently expanded and deepened; for example, in 2022 prime-listed companies were expected to have at least one-third independent external directors. Higher investor returns would also alleviate growing pressure on public finances, as the giant Government Pension Investment Fund (GPIF) doubled the share of its portfolio held in domestic shares in 2015 from 12% to 25%. The GPIF became a lever of other changes, notably the insertion of the environmental, social and governance (ESG) into Japanese corporate governance.

Other consequential developments were also taking shape. The Fifth Science, Technology and Innovation Basic Plan (2016-2020) signalled a shift in STI policy towards solving social problems, prompted in part by the 2011 triple earthquake, tsunami and nuclear disaster. Its "Society 5.0" concept was adopted by government ministries, and Keidanren (Japan Business Federation), which drew up a roadmap in its 2017 report "Revitalizing Japan by Realizing Society 5.0". Society 5.0, the Sustainable Development Goals (SDGs) and ESG were brought together in a joint Keidanren-GPIF-University of Tokyo report in 2020.[6]

Society 5.0 envisages the fusion of cyber and physical systems through digital transformation (DX), extended to green transformation. The problem, according to the Ministry of Economy, Trade and Industry (METI), is that Japan is lagging in DX. A report it commissioned warned that Japanese companies are heading towards a 2025 "digital cliff", in which the cost of maintaining legacy systems will outweigh any value they create, and lack of expertise and investment in new systems could doom them in the digital age.[7] If, on the other hand, companies wake up to the challenge, they could create new value and boost Japan's GDP in 2030 by 130 trillion yen. METI subsequently introduced "DX Promotion Indicators and Guidance", and in 2020 it launched a Digital Governance Code, to sit alongside the Stewardship and Corporate Governance Codes, which stated:

> A company must understand its business and IT system as a unit, develop a management vision in consideration of the effects (risks/opportunities) on the company caused by changes in society and the competitive environment due to digital technologies, design a business model for realizing the management vision, and show this business model to its stakeholders as a value creation story.[8]

The Digital Governance Code placed the onus on the Board of Directors to ensure these measures are carried out. Significantly, it also hinted at the implications of DX for corporate governance itself, suggesting that it creates an imperative for companies to engage with a wider range of stakeholders. This is reminiscent of Filatotchev and Lanzolla (forthcoming),[9] who argue that DX requires companies to shift from "legacy" corporate governance focused on financial performance to "open source" corporate governance encompassing broader objectives.

Relatedly, green transformation (GX) also loomed larger, especially after Prime Minister Yoshihide Suga committed Japan to carbon neutrality by 2050, and a 46% (minimum) reduction of greenhouse gas emissions by 2030. A cross-ministry Green Growth Strategy asserted the compatibility between green and growth, to be achieved by a mix of policy tools, and targeted investment in 14 green "growth sectors", such as offshore wind, ammonia and hydrogen, and carbon capture.[10] Society 5.0, DX and SX are an important backdrop for the growth model of "new capitalism".

Growing Calls to Reform Capitalism

There has been a backlash in recent years against neoliberalism and shareholder or finance capitalism, even from within its own citadels. In 2018 BlackRock CEO Larry Fink wrote to CEOs telling them that every company needs a social purpose and not just a financial one. Shortly afterwards the British Academy published its "Principles for Purposeful Business", arguing that shareholder primacy is an anachronism and that corporations should state a social purpose in return for the legal and other benefits they receive, and be judged on how well they achieve their stated purposes. In 2019 the US Business Roundtable asserted that the corporation's role goes beyond making profits for its shareholders, and should encompass other stakeholders, including communities, while in the United Kingdom *The Financial Times* began to advocate for a "better form of capitalism". Stakeholder capitalism became part of the World Economic Forum agenda as the institutional vehicle for the "fourth industrial revolution".

Within Japan, too, there were growing calls for the reform of capitalism. The views of Silicon Valley entrepreneur and venture capitalist Joji (George) Hara are said to have influenced Kishida. In 2009 Hara published a book titled *Atarashii shihonshugi* (New Capitalism)[11] that was highly critical of US finance capitalism, and called on Japan to build on its strengths, provide tax incentives for innovation, and rediscover social purpose. His "public interest capitalism" advocates concrete measures such as restrictions on share buybacks and on decision-making rights of short-term shareholders, introducing class shares (like Toyota's AA shares), and abolishing quarterly reporting requirements.[12]

Keidanren declared its support for stakeholder-oriented "sustainable capitalism" in 2020 as "a new form of capitalism".[13] Intriguingly, the stakeholders it listed were consumers, employees, local communities, environment and "the global community". Investors were not mentioned, presumably because they would be part of a central axis of investors and managers. That centrality appears to have been taken for granted, and employees, while listed as a stakeholder, appear less central. In fact, while proposing to "bring together the wisdom of diverse stakeholders and establish sustainable capitalism with Society 5.0, which creates diverse value through DX", it had very little to say about corporate governance, or how implementing DX might push companies towards stakeholder governance and capitalism.

An Underlying Tension

Corporate governance in Japan, then, harbors a fundamental tension. On the one hand, the Stewardship and Corporate Governance Codes, reform of the Tokyo Stock Exchange and the goal of making Tokyo a more attractive financial center have elevated investor relations. The Codes do not stipulate shareholder interest *maximization*, and coming together to pursue "sustainable corporate growth and increased corporate value over the mid- to long-term" could restrain investors from pursuing short-term gains, but in practice the obligations and constraints fall on companies. Similarly, ESG asserts overlapping investor and management interests, seeing investor relations as the best means of aligning corporations with the strategic development goals (SDGs), but the same tension can be seen here as well.

CEOs who have pursued sustainability too enthusiastically have been pushed out of companies (like the French multinational Danone) by investors who believe they should be focusing on delivering returns to shareholders. BlackRock's own former head of sustainable investment created a stir when in 2021 he declared ESG investment a "dangerous placebo". BlackRock Investment Stewardship created further uncertainty when it noted that "many of the climate-related shareholder proposals coming to a vote in 2022 are more prescriptive or constraining on companies and may not promote long-term shareholder value." Little wonder that Japanese executives were left scratching their heads entering the 2022 AGM season.[14]

Tension is not necessarily a bad thing, and perhaps more is needed, but to whose benefit? Among the materials considered by the Council of New Form of Capitalism Realization were many sobering statistics, including the following. Between 2000 and 2020 labor costs of large firms (capitalized at 1 billion yen or more) declined (from 51.8 trillion yen to 51.6 trillion yen), as did capital investment (21.8 trillion yen to 20.7 trillion yen). Meanwhile operating profits almost doubled (19.4 trillion yen to 37.1 trillion yen), dividends rose sixfold (3.5 trillion yen to 20.2 trillion yen, almost equalling capital investment), internal reserves almost trebled (88.0 trillion yen to 242.1 trillion yen), and cash and deposits almost doubled (48.8 trillion yen to 90.4 trillion yen).[15] Investment in employee education and training, already low by international comparisons, declined further. This is hardly sustainable, and there is clearly a problem of investment in innovation and people.

People, Investment & Sustainable Growth

Given all of this, it is not surprising that "new capitalism" has four priorities: people; science, technology and innovation (STI); startups; and DX and GX, with emphasis on the first – people. As Kishida put it in his Guildhall speech in London in May 2022, "Investment in human capital is at the heart of the growth strategy of the Kishida administration." It was also at the heart of Japan's postwar productionist model, in which Japan's schools produced highly literate and numerate leavers who entered factories where they received further training, and status and wage differences between blue collar and white collar workers were narrowed.

The model was undermined in the 1990s as companies struggled to restore their balance sheets, and to cope with rising labor costs and changes in their competitive environment. In his Guildhall speech Kishida referred to the need to expand investment in people in terms of “flow” and “stock”, the former focused on wage increases, and the latter in terms of investment in vocational training and recurrent education, to which he had already allocated 400 billion yen in a three-year package which is expected to address the chronic shortage in IT and digital skills. This in turn is linked to STI. As companies cut back on R&D spending in the 1990s, universities were unable to fill the gap. The number of Ph.D graduates plunged[16] as Japanese universities fell in global rankings. The government announced a massive 10 trillion yen university endowment fund in 2021, with the proviso that recipient universities carry out governance reforms (long a source of friction between the government and universities) and seek sources of other funds as well.

Universities are more central to STI and skill formation now than in the postwar period, as are science-based startups, but Japan will not achieve a new growth model without major companies/employers also playing a leading role. What is needed from Nikkeiren’s successor is a new *Shinjidai no Nihonteki keiei* vision, which takes us beyond the current regular/non-regular employee divide, a divide which could easily expand in the digital economy. Keidanren contrasts Society 4.0, which places many constraints on human potential, with Society 5.0, which will unleash “the imagination and creativity of diverse people”. In its NEW Growth Strategy people “will command digital technologies with rich imagination and creativity and will create value through flexible work styles that are not confined by time or space.” Just how that will happen is not yet clear (although in 2019 Keidanren began promoting “job-based” employment), nor is it clear how the “flow” part of Kishida’s formula will be addressed.

A new model of capitalism will require a comprehensive re-thinking of institutions and their compatibility at the macro- and micro-levels. Institutions are seldom constructed from a blueprint, however, but emerge over time from responses to new challenges. This essay has identified an underlying tension in corporate governance, and investment in people. Joseph Schumpeter identified innovation as capitalism’s driving force, and bankers (financiers) as critical enablers, or “ephors”.[17] Shibusawa played that role superbly as head of the First National Bank, and in nurturing entrepreneurs. It remains to be seen whether contemporary Japan can recreate this balance and bring people back to the center of its economic model.

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