

The Japanese Corporate System is Stable

By Matsumoto Koji

1. Appearances aside, the Japanese corporation is not controlled by its shareholders but by the aggregate body of its employees, themselves closely integrated into the company through unique Japanese employment practices.

It is often being reported that the Japanese corporate system, which differs from the orthodox capitalist corporate system, is on the verge of collapse because of the bursting of the economic bubble, and many people in Japan and elsewhere have come to believe this to be true. Before arguing the pros and cons of this notion, however, I think it might be good to remember that discussions of the collapse of the Japanese corporate system have continued practically without halt for the past 40 years.

During a recession, some Japanese companies, including blue-chip ones, begin laying off workers and calling for volunteers to retire early. Then, without fail, Japanese newspapers and magazines pick up the news and stir up a ruckus by saying these actions are clear signs of a collapse of Japanese-style employment practices. They go on to say that if stock prices fall, companies that own one another's shares will not be able to hold on to them and will sell them at a loss, which will lead to a collapse of the system of mutual holding of shares among companies.

Let me paraphrase two paragraphs of media reports—the originals are in Japanese—which discuss the Japanese corporate system.

“Companies have shifted their position and are now competing with each other to reduce the size of their work forces. A look at the terrible methods being introduced makes one think that the recent rationalization steps introduced to ride out the business recession are not merely temporary steps to cope with an emergency situation. They include seconding to other companies, in-company rotation, temporary layoffs, increased retirement payments to

urge early retirement, the introduction of an optional retirement age system, calls for voluntary retirement, designated layoffs, pay reductions, zero pay increases, and various other measures. Until very recently, employers were emphasizing that although they recognized a need to make adjustments to the seniority system, they wanted to maintain the enterprise union and lifetime employment systems because those two are so important for providing a firm foundation to secure management stability. But the large-scale steps toward rationalization that companies have already taken show that management in Japan has begun moving to dismantle the lifetime employment system.”

“As companies have moved to find stable shareholders and to have other companies hold their shares by recapitalizing and issuing shares to them at market price, there has been an accompanying rapid decline in the percentage of corporate shares held by individuals, which has greatly reduced the energy of the stock market. Because the present high stock prices are contrived, once the balance is out of line, as it was this time, the stock market drop becomes severe. What people in the market are concerned about is the all-out selling off of shares by business entities, and yet it is possible that we will soon see an all-out sale of shares by business entities having cash flow problems. If companies sell off shares to raise cash, the balance of mutually held shares between companies will be upset. Some companies would like to sell shares they hold of other companies, but they are concerned that those other companies will then sell their shares. We may soon see the sudden emergence of sell orders for shares that companies could not sell up to now because of that concern.”

Some may read the foregoing two paragraphs and think they refer to the situation in Japan after the economic bubble burst around 1990–91. But actu-

ally, the first paragraph dates from the recession of 19 years ago, while the second dates from the time of a sharp drop in the stock market 23 years ago. Both are quotes from *The Economist*, a leading Japanese economic journal. The first is from the issue dated December 12, 1978; the second is from the issue dated September 10, 1974.

By comparing these remarks with recent comments, one can clearly see that even up until very recently, there has been almost no progress and no changes in the arguments presented by the media.

Why is it that despite the media being wrong so often in predicting a collapse that they make the same predictions again later? I see two principal reasons. One is that rooted deeply among the so-called intelligentsia in Japan is a tendency to view Western methods in economic matters as examples to emulate; the other is the tendency of the mass media in Japan to forget things. In the 1960s, when Japan was experiencing high-level economic growth, many Japanese scholars argued that “During a period of rapid economic growth, irrational systems such as Japan's employment practices will be weeded out.” But once into the 1980s, and when it was generally recognized that Japan had entered a period of low, stable growth, many scholars began to say, “Corporations will not have the wherewithal to maintain Japanese employment practices in a period of low, stable growth.”

Even more recently, examples can be mentioned of directly opposite observations being made to point out causes for the collapse of Japanese employment practices. When the bubble economy first developed, and again when it burst, many individuals presented highly plausible arguments as reasons why the particular situation “will not allow the Japanese corporate system to continue.” In fact, over the past 40 years, the reasons given for the imminent col-

lapse of the Japanese corporate system have changed frequently to fit the particular topics being focused on in the Japanese economy. These include technological innovation, globalization of the economy, aging of the population, the arrival of the information society, the spread of individualistic values among younger Japanese, the entering of women into all areas of employment, and many more.

Although some people are likely aware to a degree of the irresponsibility of such arguments, most Japanese are not clearly aware of them. In fact, there are even many individuals in Japan's business community who talk about the imminent collapse

of the Japanese corporate system, perhaps because they want to incite a sense of crisis. And since that is the situation in Japan, it is not surprising to see foreign correspondents or experts who have not been in Japan very long observing what is being said in Japanese newspapers and magazines and thinking something like, "Boy, I happen to be in Japan at an opportune time. The Japanese corporate system, which has not changed for so many years, is starting to collapse."

2.

Some people may say that past predictions about the collapse of the Japanese corporate system were off the mark, but this time is different. Many such individuals, however, said exactly the same thing in the past: "This time it's different." Apart from what such people say, however, there is no actual data to prove in specific terms that the Japanese corporate system is degenerating. Among large corporations, for



Effective and reliable: use of the lifetime employment system is becoming more widespread

example, it is not unusual to hear of calls for volunteers to retire early or of designated layoffs. According to a survey conducted in 1989 by the Institute of Economic and Political Studies, Kansai University, which covered articles published in leading economic journals between 1973 and 1983 mentioning personnel adjustments by 90 of Japan's largest corporations, there were 55 instances of corporations calling for volunteers to retire early or making designated layoffs. Over a period of 10 years, therefore, slightly over 60% of the corporations surveyed introduced such measures. If the Japanese system of employment practices collapsed in every major corporation that introduced such measures, there should be almost no major corporations today using such practices.

Among Japanese employment practices, the guarantee of employment is one of the main principles, but it is not an absolute guarantee. Perhaps such a

guarantee might be possible in a state-managed corporation in a socialist economy, but although a private corporation may say that in principle it will not lay off employees, it cannot promise not to introduce layoffs "no matter what the circumstances." Employees also fully realize that when their company falls into the worst possible situation, it may be necessary to have layoffs in order to ensure that the company survives. If a company makes the efforts necessary to avoid layoffs, and treats persons who lose their jobs in appropriate ways, such as increasing their retirement payments and assisting them in finding new work, and if the employees have a degree of understanding of their company's critical financial situation, they will not interpret this as one where the guarantee of employment was lost.

It should also be pointed out that the employment adjustments introduced after the burst of the bubble economy

were not especially severe when viewed in the historical context of other post-war recessions in Japan.

According to a survey by the Ministry of Labor, called the Survey on Labor Economy Trends, the most authoritative of such surveys in the area of employment adjustments, a comparison between the employment adjustments made during the most severe part of the structural recession following the first oil crisis and that of the recession following the bursting of the economic bubble showed that employment adjustments were made by a much lower percentage of the businesses surveyed in the latter period than those surveyed in the former. The figures were 50% compared to 74%, respectively. Also, the content of measures introduced during the latter period were mainly contained within the framework of the guarantee of employment, including measures such as restrictions on overtime, reductions in or halting of mid-career hiring, in-company rotation of jobs, and seconding to affiliated companies. Only 2% of the companies surveyed in the latter period made calls for volunteers to retire early or made designated layoffs, compared to 7% of the companies surveyed in the former period. Actually, during the period from 1992 to 1994, when economic growth continued at zero level, unemployment was maintained at the 3% level, a substantially lower percentage than in Western countries, which indicates that in overall terms the employment guarantee system was functioning well. The 1995 edition of the White Paper on Labor points out that one of the features of the current recession is that companies have made tremendous efforts to maintain employment, using such methods as work sharing. The conclusion the White Paper reaches is totally different from the so-called 'collapse' theory.

At present, no one is talking about a collapse of the Japanese corporate system due to the recession. But if there is another recession, many people are certain to stubbornly repeat the same theories.

From a somewhat longer-term view-

point, there are many facts that do not fit well with the 'collapse' theory. For example, the percentage of workers in recent years who have changed jobs is about 7%, a very low figure compared to the 10-13% who changed jobs in the ten years between the second half of the 1960s and the first half of the 1970s. This lower number is due to the slowdown in economic growth, and certainly it cannot be said that labor mobility has drastically increased.

The number of employees working long-term at the same company is also increasing. In 1967, the number of employees working 20 years or more in the same company was 7% of the total. In recent years, however, the figure has increased to around 20%. The average number of years worked is also increasing. For males, for example, in 1985 the average was 11.9 years; in 1995, this increased to 12.9 years (from Basic Survey on Wage Structure, Ministry of Labor).

Whether or not a company has set a clear retirement age reflects to a large degree whether or not the company guarantees lifetime employment. In fact, the percentage of companies with a clear retirement age is increasing steadily, particularly among companies with 30 to 99 employees. Only about half of those companies had retirement age systems in the mid-1970s but today the system has spread to 90% of them (Employment Management Survey, Ministry of Labor). These companies are mainly in the precision machinery, electric machinery, and automobile-related industries. It seems that they have to introduce employment practices on a par with large companies because they need time to train their employees so as to build a strong technological foundation. Use of the lifetime employment system is thus clearly becoming more widespread, and apart from what was true years ago, the idea that general Japanese employment practices are not in effect in small and medium enterprises is today simply not true.

There have also been no particular changes in the system of enterprise unions. Rather, cooperation is being maintained in labor-management rela-

tions, and working days lost from labor disputes is just 1% of the 8 million days lost during the period of structural recession. Since 1992, moreover, there has been a continuous downward trend.

One point the proponents of the 'collapse' theory neglect to mention but which should be mentioned is the progress being made through court decisions in legally clarifying Japanese employment practices. Today, unless four basic conditions are met, the dismissal of employees is considered an abuse of power and its legality is not recognized. The four conditions are a financial situation so critical that it affects the existence of a company, a sincere attempt to use measures other than dismissals, efforts to gain the understanding of the employees, and the rationality of the standards for choosing specific persons to dismiss. The original decision in this area, now accepted as an established precedent, was made in the Nagasaki District Court in 1975, and related court decisions made since then were based on that decision. Japanese employment practices began as exactly that—practices. Now, however, they have been given a legal basis and have a firm systematic foundation.

3.

In Japan, business corporations and the financial institutions they have dealings with hold each other's shares, resulting in a network of mutual shareholdings. This leads to a structure of stable shareholders, establishing de facto independence of corporate management from capitalist control. This independence of corporate management from capitalist control, based on the structure of stable shareholders, is a feature of the average large corporation in Japan that surfaces only during discussions of ownership. After the bursting of the economic bubble, the breakdown of the system of mutual shareholding was the subject of frequent discussions. What is the actual situation today?

An authoritative research institution in Japan, the Shoji Homu Kenkyukai, conducted surveys in 1992 and 1993 of all companies listed on Japan's eight

stock markets to determine the actual situation regarding the mutual holding of shares (see White Paper on General Stockholders' Meetings for 1992 and 1993).

The survey conducted in 1992, right after the bursting of the economic bubble, clearly showed that 82% of the 1,638 companies surveyed felt that the majority of their outstanding shares were in the hands of stable share holders. This is a surprisingly high percentage. Actually, the same type of survey was also conducted in 1979 and the figure at that time was only 68%, despite the fact that no one at the time had any doubt concerning the propriety of companies continuing to mutually hold shares. Viewed from these figures, it can be said that over the dozen or so years since the 1979 survey, and despite passing through the bursting of the bubble economy, the mutual holding of shares by companies has increased.

Of the 1,638 companies surveyed, 1,161 companies (71% of the respondents) said there had been no changes from the previous year concerning the percentage of their shares held by stable shareholders. 12% said the percentage had dropped, but that was lower than the 14% who said the percentage had increased.

As for company policy regarding the mutual holding of shares, which comprises the core of the shares held by stable shareholders, 1,094 companies (67% of the respondents) said they would maintain the present level, 87 companies (5%) said they would bolster their shareholdings, and 38 companies (2%) said they would reduce their share holdings. Only one company said it would substantially reduce its share holdings. The same survey conducted in the following year (1993) showed similar results.

**Other surveys (such as one by the Fuji Research Institute in 1993) reveal the same strong structure of a mutual holding of stable shares among companies. Not much change can be seen in the way stock corporations have turned into mere formalities, reflecting the fact that shareholder ownership is not functioning and fitting the actual situation.

In recent years, the shares held by shareholders attending 80% or more of the general shareholders' meetings of corporations have accounted for only 30% or less of the total issued shares of the corporations. The other shareholders generally turn in blank proxies, and general shareholders' meetings thus continue to be conducted de facto using the blank proxies.

The tendency for general shareholders' meetings to be held on specific days is also becoming more noticeable. In 1996, for example, of the 2,530 companies scheduled to hold general shareholders' meetings in June, 2,235 companies held them on June 27. Part of the reason for concentrating on a certain day is as a countermeasure against *sokaiya*, individuals who own a small number of shares and who often disrupt shareholders' meetings. It is also clear, however, that the companies are not paying much attention to the interests or convenience of their shareholders.

In any given year, only 1% or fewer of the total number of general shareholders' meetings see the minutes revised or votes made of nonconfidence in the chairperson. In recent years, in fact, almost no such motions or any other motions have been made at any general shareholders' meeting. The system established in 1981 of allowing proposals from shareholders is thus not functioning very well. Up to now, there has never been more than 1% of the general shareholders' meetings in any year where proposals made by shareholders were discussed. Half of those proposals were made by shareholders opposing the construction of nuclear power plants, persons holding a small number of shares and who had ideas different from those of the corporate officers. Beginning in 1993, there was an easing of regulations concerning the viewing and copying of accounting records, but most of the shareholders making such requests since then have been professionals (*sokaiya*).

There is also no change in the trend for important decisions to be made elsewhere than at the board of directors, such as at managing director and

management council meetings. Directors often serve concurrently as department managers, and promotions to director in Japanese companies are made inside the company much more often than in Western companies. Moreover, officers in Japanese companies are in fact extensions of regular employee positions, which, again, has not changed from before.

The percentage of the outstanding shares of companies held by individuals has decreased continually for close to 50 years. In 1949, the figure was 73%, and in 1994 it had fallen to 23%. In contrast, more legal entities have become shareholders and shareholder functions have been gradually weakened. Looking at the various systems inside a company as described above, it is not possible to see signs of change in the relationship between companies and their shareholders. There will likely be continued reports in the future in Japanese newspapers and magazines about the collapse of the system of mutual holding of shares, but before deciding on what the actual situation is, I think it might be best to wait for a while after such articles appear until the results of surveys appear that cover not individual companies but the overall situation.

4.

Not so many years ago, American companies were criticizing the Japanese *keiretsu* system. Today, however, Western companies in the assembly industry are now using the same system. Also, the use of production methods that were advanced in Japan, such as JIT, TQC, QC circles, cellular manufacture, quality at source, continuous improvement, operator responsibility for quality, and so forth, is spreading widely in other countries. The introduction of such production methods in the West has led to some changes in employment and in the relationships among companies. In viewing such developments in overseas countries, it is a strange contrast indeed to think of the loud voices in Japan still talking about the end of Japanese employment practices and the collapse of the Japanese corporate system.



Unchanging system: cooperation is being maintained in labor-management relations

The Japanese corporate system will not be affected one way or the other by what journalists or scholars say. Meanwhile, progress is being made in administrative reform and deregulation, and public opinion has contributed much to that progress—even though it had already been decided to introduce changes in those areas. The financial “big bang” is an example where success can be achieved if laws and administrative methods are changed. But the Japanese corporate system should not be discussed in the same category.

The Japanese corporate system is basically formed quite separate from government action and law. For example, there are no laws that obligate companies to provide lifetime employment, or to hold one another's shares to ensure management stability. In fact, Article 627 of the Civil Code supports the right of a company to dismiss employees, and Article 20 of the

Labor Standard Law says merely that a company should give an employee one month's notice before dismissal. The government, meanwhile, views adversely the matter of companies holding one another's shares, and it has made various kinds of efforts, including two large-scale revisions of the Commercial Law, which were aimed at but failed to restore the rights of shareholders, which have become vacuous. The Japanese corporate system is the product of everyday decisions made by corporations and the persons involved in them. It has no relationship to government actions or intentions, and in effect has been maintained contrary to those actions and intentions.

Because employees are integrated into corporations, the corporations trust them. Although there may be no orders or rules, the employees can be expected to take the initiative and participate in the corporations on their own, and even confidential information can be passed

to employees without concern. Moreover, because the employees can be expected to remain with the company for many years, the company can eventually recover the cost it has invested in employee education and training through the employees improving their abilities and thus contributing more to the company's earnings. Rotation and reassignment inside the corporation are done easily, making it possible to build a flexible organization that can respond quickly to needs. Rather than shareholders who might hold a company's shares for just a few weeks, the aggregate body of employees directly participates in decision

making that influences the future of the corporation. And whether they like it or not, the employees must be greatly concerned about the corporation because of their vested interests. That is why Japanese corporations also think it is best for their employees to be essentially responsible for managing the companies.

Although the Japanese media will likely continue in the future to talk about the collapse of the Japanese corporate system, as long as Japanese companies are able to continue finding a basic rationality in the present system, it is difficult to imagine a major change in the system in the near future.

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