

Norio Kambayashi *Editor*

Japanese Management in Change

The Impact of Globalization and Market
Principles

 Springer

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and Market Principles

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Norio Kambayashi
Graduate School of Business
Administration
Kobe University
Kobe, Hyogo, Japan

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Preface

Some 10 years have passed since the beginning of the twenty-first century, and “Japanese-style” management, which once attracted close attention from all over the world as a system that achieved excellent results, has lost its prominence and seems to have fallen into oblivion. As Japanese companies are suffering slumping revenues due to the prolonged economic depression, the Japanese-style system predominant in the 1980s is no longer discussed in a positive context. It is widely known that Japanese companies, on the contrary, are being asked to learn the management systems of newly industrialized Asian countries, including China and India.

It is hardly possible to find academic research on the reality of Japanese companies from the perspective of international comparison in today’s academic society, possibly due to those companies’ prolonged depression. In the first place, stagnant research activities in this field are understandable due to the assumption that “Nothing can be learned from the management of Japanese companies; thus, Japan should introduce the management systems of other Asian countries as soon as possible in order to aid in those companies’ regeneration.” Yet, is this really the correct way to think about this issue?

We understand that nothing can be created by merely recalling the Japanese-style management that prevailed a quarter century ago, and we are not striving to restore Japanese-style management in secret. However, it is clearly not enough for those who are involved in academic research to desperately shout, “Japanese companies have to learn from Asia!” without calmly reviewing Japan’s previous experiences and the resultant realities from those experiences. It is first necessary to precisely understand the present situation faced by Japanese companies from the perspective of academic research. With this problem consciousness in mind, this book discusses the current management system of Japanese companies according to each aspect of management.

The most noteworthy impact on the Japanese company management system that has occurred from the 1980s to the present is the development of market fundamentalism, which has grown widespread with the development of globalization.

This book comprises three parts—(1) Management System, (2) Strategy, and (3) Organization and Personnel Affairs—each of which is divided into four chapters. Focusing on the transformation of Japanese companies in comparison with the golden age of Japanese-style management, each chapter analyzes the specific influence that the development of market fundamentalism, which grew widespread along with globalization, had on the existing management system of Japanese companies. A short summary of each chapter can be found in Sect. 1.5 of the introductory chapter. It is advisable for readers who are eager to quickly note the overall flow of this book to read the short summaries therein.

I would also like to comment on the history that spurred the publication of this book. All of the book's authors are members of the Management Problem 108 Committee, the university–industry cooperation committee affiliated with the Japan Society for the Promotion of Science (JSPS). (A list of members can be found at the end of this section.) As the JSPS website shows, the objective of the 108th Committee on Business Administration, which was established in 1947, is to “contribute to the sound development of Japanese companies by conducting research on important problems involved in corporate management in terms of theory and practice. This is accomplished through the concerted efforts of researchers of management science and related fields (academic members) as well as business managers and related businesspersons (industry members), who reveal the ways in which to solve those problems in accordance with both the philosophy and the actions that companies should practice. We have engaged in these activities by setting appropriate themes whenever the necessity arises in response to the demands of the times.” For the past several years, the committee has held study meetings and open seminars roughly every 3 months, and has organized a camp for intensive discussions every summer under the above-mentioned research theme, “Japanese companies in the age of global market fundamentalism.” It is a great pleasure for the authors of this book to have each chapter seen as a part of the achievements of these discussions.

Committee members visited a number of companies and facilities and interviewed them during study meetings. The committee also held lectures delivered by guest speakers in order to learn about a wide variety of ideas and thoughts specific to their positions. All such surveys are not necessarily referred to directly in this book, but the process and results of each survey were utilized in creating the ideas and inspirations that underlie each chapter. We express our heartfelt gratitude for the cooperation of the people involved in the surveys.

The committee was given publishing subsidies from a “special fund for academic promotion” by the Industry Club of Japan, which greatly contributed to the publication of this book. We are extremely grateful for the Industry Club of Japan's assistance. At the same time, we express profound gratitude to the companies that cooperated with the 108th Committee on Business Administration, as they have always supported the activities of each committee member. The publication of this book was partly subsidized by the membership fees of these cooperating companies. At the same time, we express our deep gratitude to the research project department at JSPS, particularly Ikuko Nakamura, who was directly assigned to

this committee, as well as Toshiko Saito and Hiroko Sugawara, who took charge of this committee before Ikuko Nakamura.

Finally, I would like to express my sincere gratitude to Springer Japan, which readily agreed to publish this academic book, as well as all of the people at Chuokeizai-Sha, Inc., which published the Japanese volume on which this book is based. Above all, I wish to express special gratitude to Nobuyuki Nohmi, in the Editorial Department of Management Books at Chuokeizai-sha, who edited the original Japanese book.

Kobe, Japan
March 2014

Norio Kambayashi

About the Editor

Norio Kambayashi is a professor at Kobe University, Graduate School of Business Administration, in Japan. During the last 20 years, Prof. Kambayashi has taught human resource management in the School's undergraduate and postgraduate courses. He has published a number of books and articles on the subject including: *Cultural Influences on IT Use: A UK–Japanese Comparison* (Palgrave, 2002); *Management Education in Japan* (Chandos Oxford Publishing, 2007, co-authored with M. Morita and Y. Okabe); and *Industrial Innovation in Japan* (Routledge, 2008, co-authored with T. Hara and N. Matsushima).

Prof. Kambayashi is a member of the 108th Committee of Business Administration, University–Industry Research Cooperation, Japan Society for the Promotion of Science (JSPS). He received his Ph.D. in industrial and business studies from the University of Warwick in 2000 and also was awarded a Ph.D. in business administration by Kobe University in 2003.

Contributors

Isao Akaoka President of Seijoh University and Professor, Business Administration, Seijoh University, Tokai, Aichi, Japan

Emeritus Professor, Kyoto University, Kyoto, Kyoto, Japan

Emeritus Professor, Prefectural University of Hiroshima, Hiroshima, Hiroshima, Japan

Sumiko Asai Professor, Micro Economics, School of Political Science and Economics, Meiji University, Chiyoda-ku, Tokyo, Japan

Naoto Fukui Associate Professor, Human Resource Management, Faculty of Economics and Business Administration, The University of Kitakyushu, Kitakyushu, Fukuoka, Japan

Mitsutoshi Hirano Professor, Human Resource Management, Graduate School of Business Administration, Kobe University, Kobe, Hyogo, Japan

Norio Kambayashi Professor, Human Resource Management, Graduate School of Business Administration, Kobe University, Kobe, Hyogo, Japan

Makoto Matsuo Professor, Organization Studies, Graduate School of Economics and Business Administration, Hokkaido University, Sapporo, Hokkaido, Japan

Shinya Miwa Professor, Corporate Governance, Department of Economics, Kokushikan University, Setagaya-ku, Tokyo, Japan

Toshimi Okazaki Associate Professor, Financial Management, Faculty of Management, Otomon Gakuin University, Ibaraki, Osaka, Japan

Mark E. Parry Ewing Marion Kauffman/Missouri Endowed Chair, Entrepreneurial Leadership, Kansas City, Missouri, USA

Professor, Marketing, Henry W. Bloch School of Management, University of Missouri-Kansas City, Kansas City, Missouri, USA

Ryoko Sakurada Associate Professor, Human Resource Management, Faculty of Economic and Business Administration, Fukushima University, Fukushima, Fukushima, Japan

Yoshinobu Sato Professor, Marketing, Institute of Business and Accounting, Kwansei Gakuin University, Nishinomiya, Hyogo, Japan

Yasunari Takaura Associate Professor, Business Administration, Graduate School of Economics and Management, Tohoku University, Sendai, Miyagi, Japan

Kazuhiro Tanaka Professor, Philosophy of Management, Graduate School of Commerce and Management, Hitotsubashi University, Kunitachi, Tokyo, Japan

Contents

1	Japanese Management in Change: Perspective on the New Japanese-Style Management	1
	Norio Kambayashi	
2	The Perceived Development and Unperceived Decline of Corporate Governance in Japan	17
	Kazuhiro Tanaka	
3	Empirical Analysis of the Influence of Outside Directors on Japanese Firm Performance	35
	Shinya Miwa	
4	The Social Roles of Japanese Companies Under the “New Public” Policy: How They Collaborated with Nonprofit Organizations to Rescue the Areas Affected by the Great East Japan Earthquake of 2011	51
	Yasunari Takaura	
5	Formation of the New Japanese Style Management Strategy	65
	Yoshinobu Sato and Mark E. Parry	
6	Strategy and Interorganizational Relations of Japanese Companies: The Organization-Set Strategy	85
	Isao Akaoka	
7	Financial Market Globalization and Its Influence on Japanese Firms	99
	Toshimi Okazaki	
8	Electronic Book Publishing Formats and the Response of Japanese Publishers	113
	Sumiko Asai	

**9 “Limited Regular Employees” and Boundary of Employment:
An Analysis by the Three-Layered Labor Market Model 123**
Mitsuthoshi Hirano

10 Changes in Performance Appraisal in Japanese Companies 141
Naoto Fukui

**11 Leadership Skills for Enhancing Subordinates’ Ability
to Learn from Experience 159**
Makoto Matsuo

12 The Study of Career and Promotion Systems in Japan 175
Ryoko Sakurada

**13 A Discussion of the Development of Work-Life Balance
in Japan: From Quantity to Quality and Diversity 191**
Norio Kambayashi

**Members of the Management Problem 108 Committee
of the University–Industry Cooperation Research Committee
of the Japan Society for the Promotion of Science 211**

Management Problem 108 Committee 213

Chapter 1

Japanese Management in Change: Perspective on the New Japanese-Style Management

Norio Kambayashi

Abstract The Japanese-style system predominant in the 1980s is no longer discussed in a positive context as Japanese companies are suffering slumping revenues due to the prolonged economic depression. It is widely known that Japanese companies, on the contrary, are being asked to learn the management systems of newly industrialized Asian countries, including China and India. However, it is first necessary to precisely understand the present situation faced by Japanese companies from the perspective of academic research. With this problem consciousness in mind, this introductory chapter discusses the current management system of Japanese companies according to each aspect of management such as management system, business strategy, and organization and human resource management.

Keywords Globalization • Human Resource Management • Japanese-style Management • Management system • Market principle • Organization • Strategy

1.1 Introduction

Many Japanese companies were obliged to reform various aspects of their management system after the “economic bubble” burst of the 1990s. This led to a drastic change in various management aspects related to the market, technology, and the social system. These companies made strenuous efforts to adapt to these changes in the business environment. Several keywords, such as corporate governance reform, rampant merger and acquisition, new strategic alliance, corporate social responsibility (CSR), results-based personnel management, and reward management, indicate these changes that spread after the 1990s.

However, these new trends seem to have subsided over the past several years, and these companies are gradually entering into a new phase where they need to

N. Kambayashi (✉)

Professor, Human Resource Management, Graduate School of Business Administration,
Kobe University, Kobe, Hyogo, Japan

e-mail: nkamba@kobe-u.ac.jp

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build new structures in order to cope with the environmental changes. Simultaneously, issues with the newly established systems have been steadily emerging. Currently, Japanese companies are exploring a new long-term vision in order to prepare for the future and consider these issues.

This book focuses on four aspects of corporate management—system, strategy, organization, and personnel management. It regards the aggregation of the new management system in Japanese companies as the Japanese style management system. With emphasis on these four aspects, research was conducted on the basic structure of the Japanese style management system after changes in the market, technology, and society. Further, specific functions of the basic structure of the Japanese style management system were studied including a discussion and analysis on the direction of future changes.

Reforms of corporate governance were widely discussed in the 1990s in studies on “Japanese management.” It is the author’s basic understanding that the discussions have made little progress since Americanization became apparent in governance and the management system. There have also been few studies conducted on the internal aspects of an organization that practices traditional Japanese management theory from an academic viewpoint.

1.2 The Japanese Management Theory: Stagnancy of Research

In undergraduate human resources management theory, the author rarely uses the phrase “Japanese management” to explain the “three sacred treasures of Japanese management.” Japanese management became popular in countries all over the world (including the U.S.) in the 1980s, due to its ability to achieve excellent results. However, it is rarely mentioned in a positive context as Japanese companies suffer from stagnant results because of the languishing economic slowdown.¹

Japanese management was able to achieve excellent results due to their philosophy of taking employees seriously and the community characteristics specific to Japanese companies (Abegglen 1958, 2006). For volatile American companies, the stagnation of Japanese companies after the bubble burst indicates that Japanese management is obsolete and their success in the 1980s was temporary. In fact, the viewpoint that the management in American companies alone is orthodox and the global standard is widespread in both Japan and the U.S.

There are very few academic counterarguments to this generalization since the changes occurring in Japanese companies have yet to be empirically verified.

¹ The phrase “Japanese management” refers to the management system of Japanese companies that is original and cannot be introduced to foreign countries, and is modified to “Japanese style management” if it is introduced to foreign countries. In this book, readers can use both terms interchangeably unless otherwise specified.

1.3 Modeling the New Japanese Style Management with a Focus on the Theory Advocated by Inagami and Whittaker

Takeshi Inagami and D.H. Whittaker published a book titled *The New Community Firm* in 2005 (Inagami and Whittaker 2005) that aims to fill a void in the research field. They researched Hitachi, Ltd., which Ronald Dore selected as a focal point of research in his book *British Factory-Japanese Factory: The Origins of National Diversity in Industrial Relations*, published in 1973. He analyzed Hitachi thoroughly in order to discuss how a Japanese company maintains its characteristics, even after partial modification. Each chapter of *The New Community Firm* is briefly summarized (Inagami and Whittaker 2005).²

This book consists of 14 chapters that are divided into three parts. The seven chapters (Chaps. 1–7) of Part I discuss the problems indicated in preceding studies pertaining to the community characteristics of Japanese companies. In Part II, the Hitachi case is discussed in detail in six chapters (Chaps. 8–13), and Chap. 14 explores the possibility of constructing a new model of corporate community in Part III.

1.3.1 *The Community Characteristics of Japanese Companies and Their Transformation*

In each chapter of Part I entitled “The End of the Community Firm?”, there is a discussion on whether the same underlying change in the foundation that transformed the paternalistic management based on the unity of labor and management widespread in the prewar, wartime, and postwar periods can be observed in Japanese companies after the 1990s. It discusses the issue of whether the Japanese corporate community was dissolved by the progress of the market principle and transformation of social values and if the proposal is worth discussing.

Chapter 1, “Company as Community,” studies how the central theme of this book, the concept of corporate community, was understood in preceding studies and the problems this book should propose considering. Masumi Tsuda mentioned that viewing a company as a community is not observed in Japan alone, as it is a viewpoint shared by modern companies worldwide (Tsuda 1977). However, both domestic and international literature reviews clarified that Tsuda later considered community characteristics as one of the important traits of Japanese management. He regarded them as the characteristic that distinguishes the Japanese management system from management systems of other countries, and pointed out that the

²The descriptions of Chap. 3 are written by Norio Kambayashi (2005) with additions and modification made to them.

community trait is relatively understood as the most important factor that distinguishes Japanese management. What the authors especially noted is the fact that the trait of corporate community relatively shared by western companies has been clearly and gradually eroded by the market principle in recent years. Consequently, the book discusses if “erosion by the market principle” can be observed in Japanese companies as it was observed in western companies. This book argues that it is possible to analyze this issue from three aspects of a Japanese company: employment practice, corporate governance, and manager’s code of conduct.

Chapter 2, “The Classic Model: Benchmarking for Change,” mentions that the fundamental traits of the original corporate community model is necessary to judge whether the corporate community of a Japanese company is actually transforming. (The term “classic model” is used in contrast to the “reform model” mentioned in Chap. 14.) The authors indicate that the core members of a company in the classic model are only regular male employees. No female employees, irregular employees, and stakeholders (shareholders) are regarded as core members. Lifetime employment, seniority wage system, and on-the-job training are available only for the core members in the classic model’s foundation, and these practices are supported by the close relationship between yearly pay increases, improved technological levels, and the cooperative relationship between labor and management. It also discusses that business managers take on the characteristics of the employees, not of shareholders, in the classic model because they become top executives with the help of internal promotion systems. Combined with the main-bank system and reciprocal shareholdings, this characteristic suggests that the top executive tends to aim to improve corporate value from a relatively long-term viewpoint.

Chapter 3, “Change and Continuity,” provides an in-depth discussion on the aspects that have changed and remain unchanged in the employment practice central to the community characteristics of Japanese companies between 1975 and 2000. Research suggests that there is no sufficient evidence indicating the collapse of this employment practice as a whole, although the idea of maintaining the lifetime employment system seems to have subsided. This is evident by the increasing amount of female regular employees and irregular employees and the implementation of an early retirement program, indicating that the lifetime employment system has been partially revised. The lifetime employment system seems to be less favorable based on the attitudes of business managers because changes in the economic and social environments, such as ongoing deflation and aging of the boomer generation, caused some companies to temporarily diversify their employment makeup. Likewise, the seniority wage system seems to have declined. The seniority wage curve of a company’s core members, namely, male regular employees, is growing less steep and an increasing intergenerational difference is present. However, the seniority wage curve of male production workers of small and medium-sized companies has been steeper over the past several years, but it is too early to conclude that the seniority wage practice has completely disappeared, although it is difficult to holistically summarize the trend. In addition, the idea of the “company man” has not disappeared completely because employees improve

their skill levels as they get older through on-the-job training in most Japanese companies, and they generally have high levels of work ethic accompanied by high degrees of satisfaction with working in a company with a community organization.

Chapter 4, "Company Professionals and Creative Work," examines the employment practice of Japanese companies undergoing partial changes with the emphasis on the progress of aspiring for professionalism and resultantly increase creative work. In large Japanese companies, the number of white-collar workers, professionals and engineers, is presently increasing. This chapter discusses if this trend is compatible with the survival of the classic model. A survey clarified, however, that white-collar workers engaged in creative work in large Japanese big companies rarely move to another company to seek more challenging work or higher wages. They tend to stay in the same company for the long-term and have a high degree of belongingness, contrary to the general impression of a "professional." Although professionals in large Japanese companies do not wish to be promoted as strongly as those in the idealistic bureaucratic organization, they clearly tend to obtain skills through internal education and training and are promoted with accumulated knowledge and skills, compared with other professionals such as attorneys and medical doctors. Professionals and creative workers frequently attract much attention as a new trend of today's Japanese companies. However, the rise of these new professions and creative work does not contradict the classic model discussed in Chap. 2.

Chapter 5, "Corporate Governance and Manager's Ideologies," describes a series of reforms of the corporate governance system in Japan in the late 1990s and managers' responses to them. The authors state that the revision of the Commercial Code in 2002 approved the establishment of a committee where external directors are the majority on the board of directors and allowed the board of directors to supervise the top executive and entrust the operating officer with execution of business operations. The authors stated that the 2002 revision made a great step forward to emulating American governance in the legal system compared with previous legal system revisions. However, their study clarifies that only 36 Japanese companies introduced the American governance mechanism as of mid-2003, and a majority of Japanese companies was only conducting a gradual reform of the existing governance system framework. Above all, many large companies wish to maintain mutual shareholding and the main banking system. In addition, only a small number of Japanese companies have introduced the external board member system. The authors analyzed that the reform is gradual because managers of large Japanese companies tend to maintain long-term and stable business relations with other companies as they are doing now. Simultaneously, it should be noted that many managers place greater importance on building a mechanism to secure employees' interest and their morale instead of trying to maximize shareholders profits, even in the reformed governance system. Hence, the authors conclude that the ongoing reform of the governance system does not instantly indicate the collapse of the classic model.

Chapter 6, "Consolidated Management and Quasi Internal Labor Markets," discusses the Nippon Steel and Toray cases and explains the trend and evaluation

of the so-called consolidated management that spread in Japan after the late 1990s. The quasi-internal labor markets refer to labor markets created in group companies. Each company inside a group needs to perform business activities that contribute to the entire group's profits, while keeping the identity of an individual company. Japanese companies have been exchanging human resources between group companies in the form of external assignments and employment transfers since the 1950s, and they have been promoting reforms with a desire to increase financial self-sufficiency of each group company after the bubble burst and, in particular, on the introduction of the new accounting standards in 2000. The reform apparently facilitated the erosion of the market principle to shrink the quasi-internal labor market within the group companies, resulting in the expansion of the external labor market. However, it should be noted that there is a growing tendency in personnel management to develop future executive trainees uniformly for the profit of the entire group. If emphasis is placed on the aspect of intensifying personnel exchanges inside the group, the expansion of consolidated management can even be evaluated as the expansion of the quasi-internal labor markets instead of unilateral expansion of the external labor market. Here again, the new trend of consolidated management alone does not allow for the simplism that the "wave" of the market principle invaded management practice and unilaterally eroded the characteristics of the classic model.

1.3.2 Hitachi: "Here, the Future"

Part II discusses the Hitachi Group (hereafter referred to as Hitachi) as the case most suitable and applicable to the classic model and describes its characteristics of a company community and its historical trend faithfully and minutely. Chapter 8, "Hitachi: A Dancing Giant," analyzes the factors that allowed Hitachi to become a giant and builds an analysis model for the case study. Figure 1.1 shows the authors' analysis model.

The authors stated environmental factors shown at the bottom of Fig. 1.1, namely, industrialization, stable macroeconomy, protected growing markets, rising asset values, sound basic education, and support for technological resource accumulation that allowed Hitachi to grow. They also stated that Hitachi continued to grow, making the best use of specific factors such as entrepreneurial culture, management, and innovative processes (shown inside the circle at the center of Fig. 1.1). Additionally, its stable and long-established relations in the labor market (with employees), in the capital market (with banks and shareholders), and in the product market (with customers) mainly contributed to its growth between the 1960s and 1980s.

Chapter 9 analyzes in detail the change of environment factors especially up to 1998 and Hitachi's response to them by using this analysis model as a reference. The analysis results were summarized in the same way as Fig. 1.1, and Fig. 1.2 provides the summary. Figure 1.2 illustrates what organizational problems Hitachi

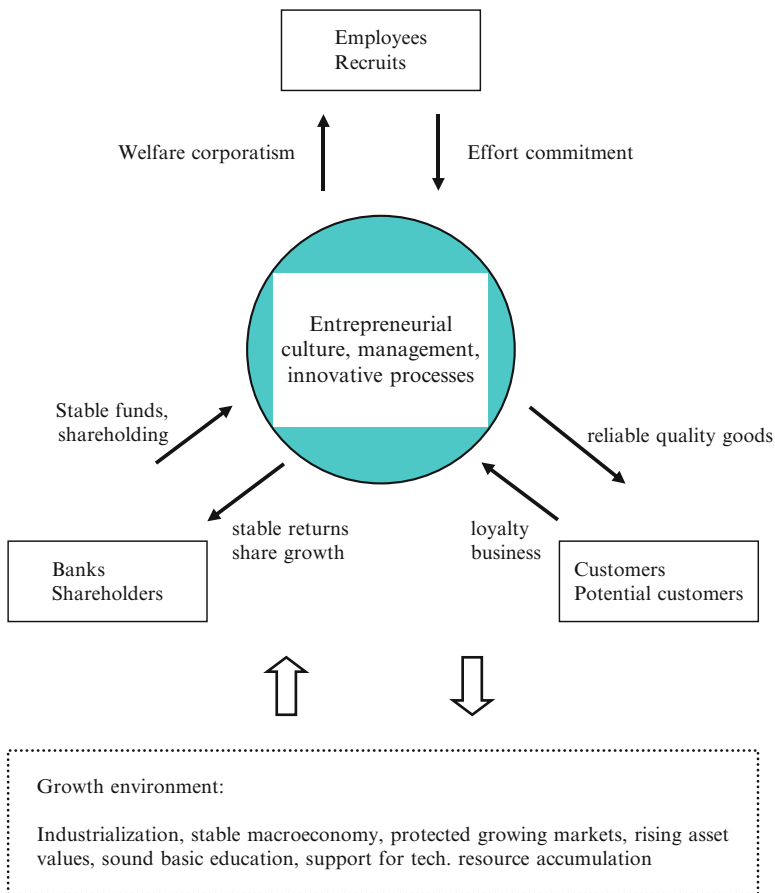


Fig. 1.1 Hitachi: A dancing giant. *Source:* Figure 8.4 on page 138 of Inagami and Whittaker (2005)

faced under the changing environmental factors in the 1990s, and for easy reference, it is contrasted with Fig. 1.1.

Likewise, Fig. 1.3 summarizes how Hitachi tried to adapt to a new environment by solving various problems indicated in Fig. 1.2, specifically the crisis in 1998 when it recorded the biggest deficit in its history, and how it successfully adapted by following the format used in Figs. 1.1 and 1.2. From Fig. 1.3, it will be possible to learn how Hitachi took measures to overcome problems in the markets of employment, capital, and product shown in Fig. 1.2, elevated declining entrepreneurship and strengthened weakening strategic management, and improved operating efficiency under the change of environment factors, such as post-industrial (servicization) transition, financialization, globalization and competition intensification, accelerating pace of scientific and technological innovation, and social change (changing perception of equality, fairness).

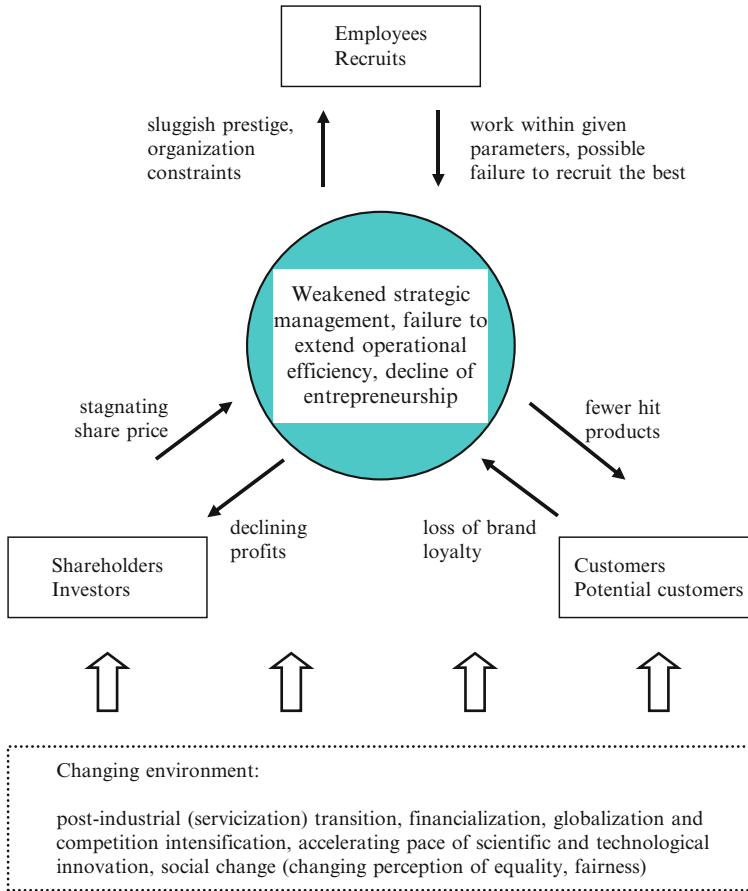


Fig. 1.2 Management problems in the 1990s. *Source:* Figure 9.1 on page 144 of Inagami and Whittaker (2005)

In order to explain the specific actions taken by Hitachi, illustrated in Fig. 1.3, Chap. 10 discusses and analyzes in detail the organization reforms and the governance system between 1998 and 2004. Chapter 11 discusses the innovation of human resources management in the same period, and Chap. 12 discusses the influence of these reforms over the labor-management relations. Although this book review cannot discuss every detail, the three figures are very interesting because they vividly depict how Hitachi recognized the crisis in 1998, what organizational response it took to cope with the crisis based on the three aspects of employment relations, relations in the capital market, and relations in the product market using the authors' micro data.

As the conclusion of the case study, Chap. 13 evaluates the transition in Hitachi's history, which is reviewed in Part II, and discusses whether it led to the collapse of the classic model of a community company. It highlights that Hitachi's

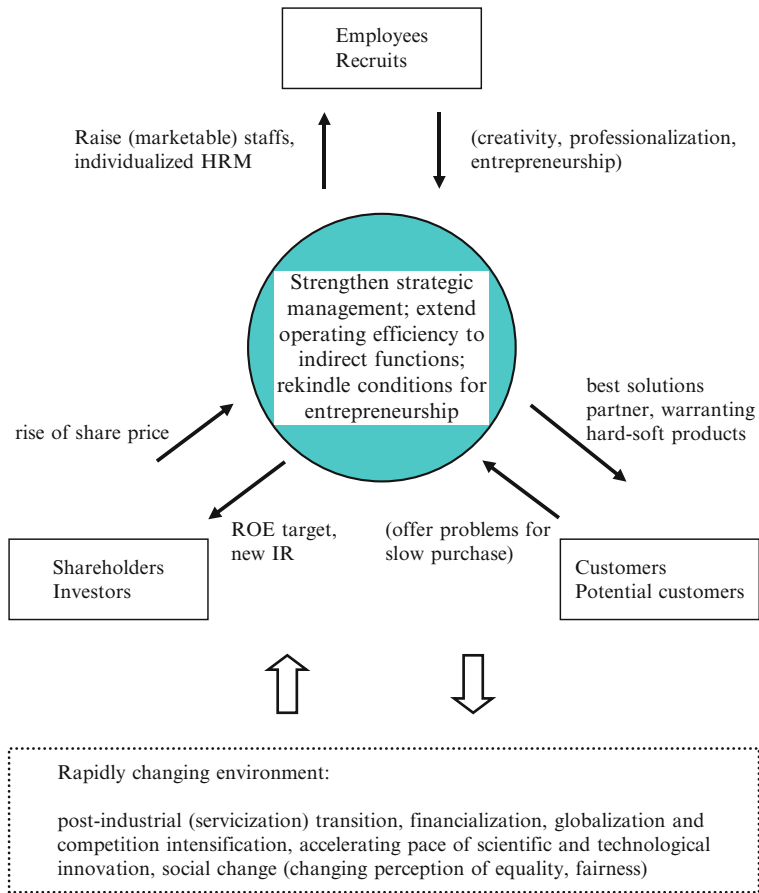


Fig. 1.3 (Re)learning to ‘dance’ in a new environment. *Source:* Figure 9.4 on page 154 of Inagami and Whittaker (2005)

organizational reform was only a partial success as of the mid-2004 and that Hitachi and GE greatly differed in their systematic approaches for the formulation and execution of strategy and restructuring the corporate culture, though they both suffered from a grave situation called “big company disease.” Above all, the greatest difference between the two companies is that while GE achieved downsizing by consolidation of business, personnel reduction, and demotion, Hitachi, in contrast, did not close the business. Hitachi had a competitive edge and retained strategically important business areas. They also took ambitious measures in order to prevent personnel reduction as much as possible, avoid demotion, and mitigate the friction inside the organization. Judging from these facts, the book concludes that Hitachi still has characteristics of a community firm present in the framework of the classic model, even after undergoing a series of reforms.

1.3.3 The Possibility of a New Model of Japanese Management

In Part III, Chap. 14, “New Model in the Making?” concludes this book. It summarizes the community characteristics of Japanese companies discussed so far and provides insight on the future Japanese corporate society with the emphasis on whether a new model (revised model) can replace the classic model. The authors indicate that the classic model in support of big companies in postwar Japan truly needs some revisions because of various changes in the management environment. In fact, the market principle developed largely in the banking and financial business, and it can be said that the classic model in favor of company community completely collapsed in these two business fields. However, most large Japanese manufacturing companies, like Hitachi, maintained the community characteristics even in the face of the crisis in the late 1990s. If the organizational reforms introduced to cope with the crisis are analyzed using the two axes of “market” and “community,” they move from the community extremity to the market extremity. However, the basic mindset underlying these reforms is the intention to introduce a change in a form compatible with the community characteristics centered by the existing community, even during the reform and introduction of a new system. Viewed differently, it is possible to mention that Japanese companies conducted a series of organizational reforms to maintain the community characteristics in face of the crisis in the 1990s. In fact, many Japanese companies coped with environmental changes far more successfully than many western companies that reduced personnel by thoroughly shifting the focus to the market extremity in the 1980s and 1990s.

The fact remains, however, that Japanese companies have retained the basic characteristics of the classic model despite partial revision, meaning that the negative legacies, namely, long working hours due to overwork and employment practices centered on regular employees, continue to be a feature of Japanese companies in the future. This book mentions the necessity to review this point by balancing economic viability and social fairness/justice.

1.4 Evaluation by Inagami and Whittaker and the Problem Awareness of This Book

It has been a while since the collapse of the three sacred treasures of Japanese management proposed by James C. Abegglen became widely known. Research has accumulated suggesting the personnel aspect of employment management, fund management, human resources development, and internal labor-management relations as the future direction of the Japanese style management system. Inagami and Whittaker (2005) critically examined if the management systems adopted by Japanese companies since the bubble burst were heading for the American

standards, based on the viewpoints of maintaining company community and reforming governance.

However, there are still several problems with this work. The first problem is its analysis that the community characteristics of Japanese companies are generally maintained despite partial revision. Although it discussed specific revisions and concluded that they do not support transformation of the community characteristics but rather partial changes, the basis of this argument is not necessarily clear.

The second problem is about the specification of the cause that promoted the “change” from the classic model to the revised model. The authors indicated that the community characteristics of Japanese companies are moving to the revised model with partial revisions while maintaining the community in general. Then, there is also a question as to what factors facilitated the transition from the classic model to the revised model. The specific factors that promoted the transition are somewhat ambiguous.

The third problem is with the recent trend of western companies (especially American companies) becoming involved in the progress of the market principle. Since this book examines whether the community characteristics of Japanese companies changed after the 1990s, it naturally does not discuss in detail the trends of western companies. Therefore, readers are liable to get the impression that only Japanese companies began to shift from the community extremity to the market extremity (at least slightly) and American companies are still in the market side, namely, at the point very close to extremity. In fact, Inagami and Whittaker (2005) ignored the fact that management of American companies also tried to introduce a form of sociality under the influence of Japanese management.³

This book “Japanese Management in Change” intends to discuss the present situation of each aspect of management in Japanese companies from the theory of management, while sharing the same problem awareness with Inagami and Whittaker (2005). The book primarily aims to analyze the manner and extent to which the wave of the market principle and globalization permeated in areas such as management systems (governance), strategy, organization, and human resources from the viewpoint of the researchers in these respective fields.

The organization and overview of this book are introduced in the following section.

1.5 The Organization of This Book

1.5.1 *Brief Summary of the Analysis of Each Chapter*

The first three chapters in this book discuss the present situation of the management system in Japanese companies.

³This point is described on pages 51–55 of the aforementioned book review.

Chapter 2, “The Perceived Development and Unperceived Decline of Corporate Governance in Japan,” (Kazuhiro Tanaka) insists that Japanese corporate governance has strengthened over the last decade (the perceived development) though this is only one aspect of this change. By distinguishing between “vertical governance” and “horizontal governance,” the author argues that Japanese corporate governance has the potential to undermine the foundation of horizontal governance of Japanese firms since the 1990s. Caution is necessary in assuming that these changes portend improvements in overall Japanese corporate governance.

Chapter 3, “Empirical Analysis of the Influence of Outside Directors on Japanese Firm Performance,” (Shinya Miwa) uses substantiated data collected by the author to state that the number of external directors are expected to increase and they have a great role in the reform of governance mechanisms. The analysis indicates that managers of companies listed on the Tokyo Share Exchange are satisfied with the present governing system, and they do not strongly feel that it is necessary to recruit external directors. At the same time, it mentions that external directors do not perform the monitoring function completely and their role in the improvement of corporate results may be limited.

Chapter 4, “The Social Roles of Japanese Companies under the ‘New Public’” (Yasunari Takaura) indicates that a company can be a player in creating the “new public” by showing the collaboration between Japanese companies and the nonprofit sectors, including nonprofit organizations in support activities. Although traditional Japanese companies are community organizations that are closed and scarcely related to the external society, their existing value structure began to sway with the bubble burst and globalization, resulting in the new moves of Japanese companies.

In the following four chapters, this book discusses the reality of Japanese companies and their recent changes in management strategy, taking changes in the management system into consideration.

Chapter 5, “Formation of the New Japanese Style Management Strategy,” (Yoshinobu Sato and Park Terry) discusses the problems with management strategy of Japanese companies and their future direction. The authors argue that some characteristics of the Japanese management style are ill-suited to the demands of the global and information economy. To support this argument, the authors analyze key Japanese management practices from four perspectives, the high-context culture, explorative versus exploitative product development, the experiential learning model, and the market sensing component of strategic flexibility. Under the Japanese “high context” culture, many Japanese companies often bring sentiment to the forefront during the construction and implementation of a strategy. They are not good at theorization, generalization, and logical thinking necessary for decision-making. However, this indicates that it has become possible for Japanese companies to acquire logicity while utilizing the strength of traditional Japanese management. Additionally, they can use the “empirical learning model” with well-organized integration of individual learning and organizational learning, resulting in the foundation of the new Japanese style management strategy.

Chapter 6, “Strategy and Interorganizational Relations of Japanese Companies,” (Isao Akaoka) describes the history of the intensifying function of the market

principle and growing interest in corporate profit instead of sociality (employee-orientation) when managing Japanese companies during globalization. It states that today's Japanese companies began to place importance on interorganizational strategy (organization-set strategy) that deals with the relations with subsidiaries, affiliated companies, and customers in addition to the strategy of each company, including product and market strategy and diversification.

Chapter 7, "Financial Market Globalization and Its Influence on Japanese Firms," (Toshimi Okazaki) argues the globalization trend influence of the financial market over Japanese companies. It explains specifically that ad hoc measures were repeated in Japan during the time when the American style market was positioned as the "success model" after the bubble burst and that Japanese companies gradually aspired for management that attaches importance to share prices.

Chapter 8, "Electronic Book Publishing Formats and Response of Japanese Publishers," (Sumiko Asai) analyzes the response of Japanese companies to the "file format" in the electronic book market. In this market, a common "file format" to store electronic data is one of the problems that participating countries cannot agree on, along with the copyright protection period, and the contract between the publisher and the author. Since the domestic publishing market cannot grow due to the falling population, selling electronic books to foreign countries is becoming increasingly important. This chapter points out the necessity to foster mutual adjustment by clarifying the fields that need international agreement and those that allow Japan to preserve its own methods.

The following five chapters of this book analyze recent changes in organization and personnel management and highlight Japan's unique idiosyncrasy when considering change in Japanese companies in terms of management systems and strategy.

Chapter 9, "'Limited Regular Employees' and Boundary of Employment," (Mitsutoshi Hirano) insists that it is possible to set up new classifications of "core irregular employee" and "diverse regular employee" as middle labor markets aside from the "regular employee" in the internal labor markets, which is historically recognized in Japanese companies; irregular employees are recognized in the external labor market. Here, the "diverse regular employee" refers to an irregular employee whose employment period is indefinite (with limitations on the working place, type of job, and working hours). The "regular employees" supported Japanese management, but "irregular employees" are playing a very important role in the management activities of today's Japanese companies. This chapter indicates the possibility of further classification of "irregular employees" instead of generalizing them in one segment.

Chapter 10, "Changes in Performance Appraisal in Japanese Companies," (Naoto Fukui) analyzes the change in employee evaluation in Japanese companies. In the 1970s, when the effectiveness of Japanese management was widely known, the treatment of employees was virtually the only important function of the employee evaluation department of a Japanese company. However, the necessity to design an evaluation system that has the function to develop human resources is being recognized. This chapter also makes it clear that some Japanese companies have already adopted a system close to the cost performance management

(continuous activities to increase performance instead of the case-by-case evaluation activities) system introduced in many American companies.

Chapter 11, “Leadership skills for enhancing subordinates’ ability to learn from experience,” (Makoto Matsuo) discusses managers’ leadership skills for enhancing subordinates’ ability to learn from experience. Using data from an open-ended questionnaire given to middle managers (n=51) at a Japanese manufacturer, I found that excellent managers with capabilities to develop their subordinates have the following leadership skills: they (1) help subordinates understand the meaning of tasks and goals, (2) accept proposals from subordinates, and (3) encourage subordinates to think and complete their tasks by themselves. The results suggest that excellent managers develop their subordinates by facilitating their “sense-making” and “knowing.”

Chapter 12, “The Study of Career and Promotion Systems in Japan” (Ryoko Sakurada) discusses the need for a new career framework that assumes a de-layered and flat organizational structure and an unstable business environment. Traditional organization and career research investigated the framework of growth and stability in the middle and latter twentieth century. However, a highly unstable global business environment has resulted in company downsizing and delayering. The delayering organizational structure has caused a new relationship between organizations and individuals. We assume that it has led to the career plateauing of middle managers, though few previous studies, especially in Japan, have examined the relationship between the de-layered hierarchies and career plateauing. This chapter surveys this topic and determines which organizational factor and HRM practice can help plateaued managers succeed in Japanese companies.

Finally, Chap. 13, “A Discussion of the Development of Work-Life Balance in Japan,” (Norio Kambayashi) analyzes the trend of Japanese companies improving the currently growing presence of the work-life balance, based on the author’s interview survey. These results conclude that measures taken in Japanese companies to promote the work-life balance are concerned mostly with quantitative aspects, including labor hours and vacation days. The mind-set underlying these measures is rooted in western values. This chapter, however, indicates that introducing measures with a greater importance to qualitative aspects and diversity will agree with the Japanese context.

1.5.2 Hypotheses Derived from the Analyses

It is not easy to summarize the messages of this book because its contents and issues are diverse, and the analytical method varies with each chapter. However, the contents of this book can be summarized as follows:

1. Japanese companies clearly changed from the 1980s, when “Japanese management” attracted attention.

2. The change can be attributed to the progress of globalization in management activities, in particular, the influence of the American style of business management system.
3. The degree of change for the management system in Japanese companies varies with each aspect of management.
4. Even Japanese companies aspired for the American management system (governance, in particular), but the reverse function has become clear in the companies that introduced the American governance system.
5. With respect to strategy, the market principle has become widespread, and a system to increase profit in the global market is desired. Above all, there is an intention to adjust the strategy to the global standard, in particular, in finance and information technology.
6. In the fields of organization and human resource management, Japanese companies introduced a mechanism close to the American style. At the same time, however, they preserve the “Japanese style” and attempt to explore a mechanism suitable to Japanese companies.

The above six points are hypotheses instead of conclusions derived from the analysis of this book. To verify these hypotheses, I wish to further study this book in the future.

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Chapter 2

The Perceived Development and Unperceived Decline of Corporate Governance in Japan

Kazuhiro Tanaka

Abstract Japanese corporate governance has strengthened over the last decade (the perceived development); however, this is only one aspect of this change. Another aspect requires some analysis to determine the essence and reality of Japanese corporate governance. I use the terms “vertical governance” and “horizontal governance” in the analysis for this paper. Vertical governance, which can be summarized as forced CEO discipline, is the dominant perspective of the current global governance debate. Horizontal governance is introduced in this paper and is a concept summarized as voluntary CEO discipline. I argue that horizontal governance has been a salient characteristic of traditional Japanese corporate systems for decades, although it is relatively new in terms of its theoretical perspective. The significant changes in Japanese corporate governance since the late 1990s have the potential to undermine the foundation of horizontal governance of Japanese firms (the unperceived decline). Caution is necessary in assuming that these changes portend improvements in overall Japanese corporate governance.

Keywords Catalyst • Horizontal governance • Mutual consideration • Self-discipline • Vertical governance

2.1 Introduction

Japanese corporate governance has changed considerably since the mid-1990s, particularly the governance by shareholders and stock markets (markets for corporate control). With the unwinding of cross shareholdings, foreign institutional investors increased their presence as major shareholders in Japanese companies, which both enabled and required these investors to actively engage in the governance of Japanese corporations. These changes in ownership structure led to

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K. Tanaka (✉)

Professor, Philosophy of Management, Graduate School of Commerce and Management, Hitotsubashi University, Kunitachi, Tokyo, Japan

e-mail: tana.kaz@r.hit-u.ac.jp

aggressive investment fund attempts to levy hostile takeover bids with respect to certain Japanese public companies. Although almost all of the attempts were unsuccessful, the psychological impact was sufficient to make threats of TOB real and acute for corporate executives.

The last decade also witnessed advancements in the role of the board of directors in Japanese corporate governance. The 2003 Commercial Code reform presented Japanese companies with the alternative option of a US-style board. This type of board consists of three board committees: audit, nomination, and remuneration committees, each of which must be led by outside directors. Although the number of corporations that have adopted this committee system is limited, the governance-enhancing board is well established within Commercial Code (now the Companies Act).

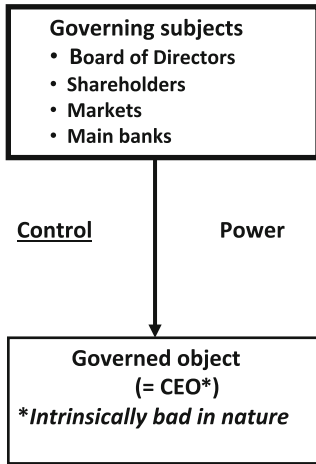
Japanese corporate governance, therefore, has strengthened over the last decade; however, another aspect of corporate governance requires analysis to reveal the current essence and reality of Japanese corporate governance. This paper examines two aspects: vertical governance and horizontal governance. Vertical governance often prevails as the main factor in the current corporate governance debate, but I will argue that horizontal governance is the key, critical element with respect to Japanese corporate governance.

Section 2.2 introduces the concept of horizontal governance, which is minimally addressed in the ongoing corporate governance debate. Section 2.3 suggests that horizontal governance has been the typical mode of governance in the Japanese corporate system. Section 2.4 notes the significant changes in ownership and board structure characterized by strengthened vertical governance. I address the Japanese corporate governance system from the mid-1990s to present day. In the last section, I argue that current Japanese corporate governance, as mentioned in Sect. 2.4, has the potential to significantly alter the underpinnings of horizontal governance and cause an unperceived decline in the effectiveness of the nation's corporate governance.

2.2 Two Types of Corporate Governance: Vertical Governance and Horizontal Governance

I define corporate governance as the systems and processes that make CEO faithful to his duty. The goal of corporate governance is to preserve and promote appropriate CEO conduct. The CEO should strive to maintain and develop the affiliated corporation in compliance with rules and laws, without subordinating the interests of other stakeholders (including those of broader society) in favor of personal interest. Arguably, there are two different types of corporate governance. Vertical governance is the predominant perspective of the ongoing global governance debate. Textbooks, academic papers, and media articles concerning corporate governance are based on this perspective. It can be summarized as the forced discipline or involuntary control of the CEO (see Fig. 2.1). Horizontal governance,

Vertical Governance



Horizontal Governance

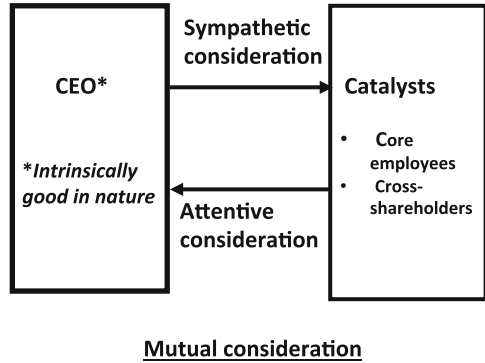


Fig. 2.1 Vertical governance vs. horizontal governance

which I introduce as a new perspective of corporate governance, can be summarized as the voluntary exercising of CEO discipline. It is relatively new in terms of its theoretical perspective; however, horizontal governance is not a new phenomenon and has existed along with vertical governance for decades. I argue that horizontal governance has long been a salient feature within traditional Japanese corporate governance.

2.2.1 Vertical Governance

The vertical governance mechanism allows governing subjects to control the governed object by exercising controlling power. Governing subjects, or governing entities, can include the board of directors, shareholders, or other stakeholders. The governed object is typically the CEO of the company. The board of directors monitors the CEO under this system and, if he fails to deliver sufficient results, the board will exercise legal punitive powers. The textbook scenario is that to avoid disciplinary measures the CEO will faithfully perform management duties.

Vertical governance is built upon two presuppositions concerning the discipline of top management: the pessimistic view of human nature (1A), and the dominance of governing subjects over governed objects (1B). Assumed under the pessimistic view of human nature is that corporate managers are selfish and unconscientious to the extent that they will pursue their own interests without regard for others and will fail to work diligently.

Dominance of governing subjects over governed objects implies that governing entities, such as boards of directors and shareholders, possess controlling power over the object of governance (the CEO) and wield unilateral power. The CEO does not possess (at least formally) the power to override the board of directors or the shareholders. The governing subjects are assumed infallible and the governed object fallible.

Presuppositions (1A) and (1B) present the traditional corporate governance model where the board and shareholders (the subjects) enforce discipline on the CEO (the object) by means of control. The “good” subjects and the “evil” object form a vertical relationship with the former situated above the latter (Fig. 2.1). The control, which ranges from introducing incentives, monitoring mechanisms, and to the firing of a CEO, is based upon the power instilled in the governing subjects.

The stronger the subject’s power and the greater the likelihood of that power being exercised, the more effective (vertical) governance function will be. Therefore, recent changes to the framework and processes of Japanese corporate governance have been considered to strengthen Japanese governance. However, this opinion is the product of just one aspect of corporate governance, vertical governance.

2.2.2 Horizontal Governance

Horizontal governance is in sharp contrast to vertical governance. The horizontal governance mechanism allows the self-discipline of the CEO through mutual consideration between the CEO and catalysts. Catalysts refer to particular groups of stakeholders who do not possess effective or anticipated power over the CEO but, instead, inspire his sympathetic consideration.

Mutual consideration is central to this type of governance and consists of two bilateral considerations (see Fig. 2.1). The first is the sympathetic consideration by the CEO towards catalysts (which will be explained later). The CEO considers empathetically the effect of his actions on the stakeholder (i.e., catalysts). For example, the CEO might consider the stakeholders’ disappointment that could result from a short-term management strategy that benefits the CEO but not the company. Alternatively, the CEO may consider the stakeholders’ happiness that his management achievement might bring. Sympathetic consideration is part and parcel of horizontal governance.

However, it is unlikely that the CEO is aware of certain stakeholders that have no concern or expectations for the CEO, which highlights the second consideration—attentive consideration from catalysts towards the CEO. Catalysts should pay considerable attention to CEO actions, specifically, with respect to decision making and behavior. This attention must be free of any intention to exercise power over the CEO, which will lead to vertical governance. Attentive consideration is quite useful, and even indispensable, to the enactment and enhancement of sympathetic consideration.

Obviously, horizontal governance presuppositions are in stark contrast to vertical governance presuppositions. They are the optimistic view of human nature (2A), and the non-dominance of governing subjects over a governed object (2B). The optimistic view of human nature (presupposition (2A)) assumes that a corporate manager has a conscience and considers the interests of others, as well as the individual's own interests, without assigning higher priority to the latter. This management portrayal is not less realistic than that of the self-interested manager upon which the majority of contemporary corporate governance theories have developed. In fact, the optimistic perspective is arguably even more realistic than the assumption that corporate managers are determined to pursue their own self-interests with totally no regard to duty, unless they are monitored and controlled by others with over-ruling regulative powers.

Non-dominance (presupposition (2B)) refers to the situation where the exercising of power by the governing subjects such as the board of directors or shareholders is not anticipated even if the governing subjects do possess a degree of power over the governed object (the CEO). If a CEO considers others only by virtue of the power possessed by the governing subjects, this consideration is based on fear and not sympathetic consideration. Sympathetic consideration does not require (or is not compatible with) the power of others, but it does require the existence of attentive others as a necessary condition.

Presuppositions (2A) and (2B) suggest a horizontal relationship between the governing subjects and the CEO. Management discipline by mutual consideration, which I call horizontal governance, emerges from this relationship. In this case, it is not governing subjects who discipline the CEO. Rather, it is the CEO who exercises self-discipline that is caused by sympathetic consideration of governing subject views and emotions. However, the stakeholders who inspire CEO's sympathetic consideration are indispensable as catalysts of horizontal self-governance. Therefore, in the context of horizontal governance, they should be described as catalysts for, rather than subjects of, corporate governance.

2.2.3 The Horizontal and Vertical Governance Mix

Vertical governance has been the only perspective of the current corporate governance debate. Therefore, the nature and extent of corporate governance in a particular country is evaluated solely based on vertical governance. However, horizontal governance is also valid perspective of corporate governance.

I suggest that vertical governance and horizontal governance coexist in a widely diverse mix in every country, with the United States and (traditional) Japan as polar extremes on a continuum from vertical governance-dominance to horizontal governance-dominance (see Fig. 2.2). I argue that horizontal governance has not only existed among Japanese companies, as I will discuss in the next section, but has also been the typical mode of corporate governance in Japan. However, a CEO does not always exert sufficient self-discipline because human nature is inherently

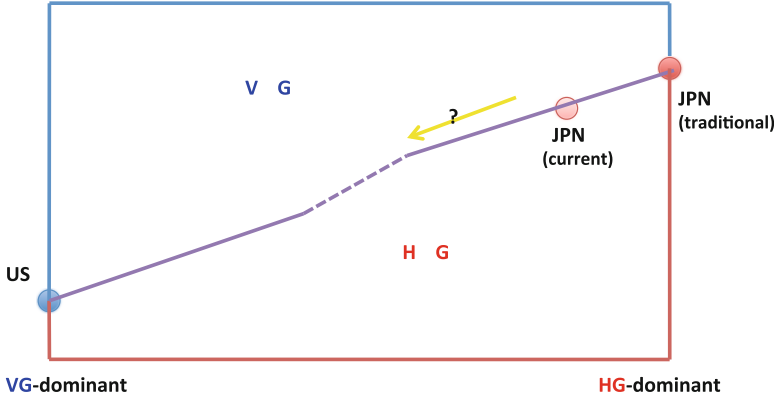


Fig. 2.2 Vertical and horizontal governance mix

weak. Thus, there are cases when the horizontally-governed, self-disciplined approach will not be effective and control-oriented vertical governance is required. However, my opinion is that such cases are more the exception rather than the rule in Japan, and it is the more typical mode of horizontal governance that I would like to address. Although horizontal governance is observed in other countries as well, it is most salient in Japan. However, with the exception of Dore (2006, 2007) and Learmount (2002), research concerning Japanese corporate governance has failed to identify horizontal governance within Japanese companies. Learmount (2002), for example, characterizes the governance of Japanese companies as “socially endogenous corporate governance” that “draws on the voluntary reciprocal obligations and responsibilities enacted in everyday individual-level and organizational-level socio-economic interactions, rather than the exercise of hierarchical controls of individual behaviour” (Learmount 2002, p. 150). This concept is consistent with horizontal governance.

2.3 Traditional Japanese Corporate Governance: The Prevalence of Horizontal Governance

Until the mid-1990s, there has been a strong likelihood that horizontal governance has been a dominant feature of Japanese companies. Although it is difficult to present direct evidence of horizontal governance, I present indirect logical evidence by demonstrating the favorable conditions that have influenced the horizontal governance function of Japanese management. Before proceeding to the discussion on Japanese pro-horizontal governance conditions, I summarize certain characteristics of ownership structure and board composition of Japanese companies.

Table 2.1 Proportion of Stable Shareholders (1990)

Stable shareholders (%)	With this number (%)
10	0.8
20	0.8
30	2.0
40	4.9
50	17.3
60	32.7
70	30.8
+	10.6

Source: Shoji Homu Kenkyu Kai (1990); cited in Learmount (2002), p. 21

Table 2.2 International comparison of common stock ownership (%)

	Japan (1994)	US (1994)	UK (1993)	Germany (1993)
Financial sector	44	45	62	29
Banks	26	3	1	14
Insurance	16	4	17	7
Funds	0	34	41	8
Others	2	4	3	0
Non-financial sector	56	55	39	72
Corporate	24	0	2	39
Individuals	24	48	18	17
Foreign	7	6	16	12
Other	1	1	3	4

Source: OECD (1996)

The ownership structure of Japanese companies has been characterized by stable shareholding or cross-shareholding.¹ Table 2.1 presents the proportion of stable shareholders in public corporations in 1990. On aggregate, approximately three quarters (74.1 %) of Japanese public corporations had a quite stable shareholding structure, with stable shareholders commanding 60 % or more of the outstanding shares. Table 2.2 shows that the majority of stable shareholders are Japanese financial institutions and other corporations with which the company conducts long-term business or financial transactions.

These stable shareholders build a long-term and closed relationship, becoming silent partners and agreeing to waive control rights and the option of selling to third parties—a system that has been criticized for engendering collusion among cross shareholding companies. Because such ownership structures significantly reduce the threat of hostile takeover bids, stock markets have not functioned as corporate governance mechanisms.

¹ I use these terms interchangeably although there is a slight difference in their meaning.

With respect to corporate board of director composition, the most notable characteristic is the virtual non-existence of outside, non-executive directors, and the subsequent domination by insiders (executive directors). The executive directors are subordinates to the CEO and, therefore, no external monitoring can be expected from them, which emasculates the board as a mechanism for checking CEO behavior.

The main banks have (allegedly) filled the void of standard corporate governance mechanisms in Japanese companies rather than shareholders, stock markets, and boards of directors. The banks are considered the effective governing subject of the Japanese corporate system based on the contingent governance mechanism (Aoki 1994). A main bank entrusts its management rights to the current executive teams of its client companies; however, it directly intervenes when performance deteriorates. Because it is credible that the corporate managers will be deprived of their management rights by a main bank if they perform poorly, discipline is maintained even when business is flourishing.

The main banks have been considered the only governing subject that exerts power over a client company in the Japanese corporate governance system. However, some empirical studies suggest that this is not the case partly because fierce competition among banks prevents them from exercising power over clients (e.g., Scher 1997; Tanaka 2002). Moreover, Learmount (2002) notes that “the relationship between a company and its main bank is not based on the power of one party over the other; on the contrary, both parties seem to be concerned with acting in ways which avoid being perceived as taking advantage of a powerful position” (Learmount 2002, p. 89).

A bank’s (potential) power is compromised once companies gain their financial independence. Since the early 1980s, deregulation and internationalization of corporate finance has provided Japanese companies with increasing independence from bank loans. This has deprived main banks of any power to control and discipline Japanese companies. A main bank intervenes in the management of its client if the company is on the brink of bankruptcy. This does not mean, however, that the exercising of power by the main bank is anticipated at normal times, much less when the company enjoys financial independence. All these factors imply that main banks are not necessarily governing subjects that wield significant power over companies.

Therefore, I conclude that vertical governance mechanisms have been weak within the Japanese corporate system. Instead of vertical governance, I suggest, horizontal governance played a significant role. Horizontal governance refers to voluntary discipline through CEO sympathetic consideration; however, the CEO’s recognition of attentive consideration from certain stakeholders, or catalysts, is almost indispensable to enact and enhance CEO’s sympathetic consideration. From this perspective, I posit that is highly likely that horizontal governance has continuously prevailed in Japan.

The focus of my theory is the relationship between a CEO and the core employees and cross-shareholders in Japanese companies. This relationship has powerful characteristics that activate CEO sympathetic consideration for both

employees and cross-shareholders who, in turn, act as catalysts for CEO consideration. Core employees refer to managers and workers who have made a long-term commitment to work for a firm. Cross-shareholders include the main banks although they are not necessarily a governing subject.

In the context of vertical governance, employees and cross-shareholders of Japanese companies have been regarded as functionally impotent because of their lack of power over the CEO. However, ironically, horizontal governance necessitates this very lack of power on the part of the stakeholders. Additionally, both core employees and cross-shareholders possess positive, pro-horizontal governance features that encourage a CEO to sense that he is receiving attentive consideration; thus, leading the CEO towards voluntary self-discipline. Core employees and cross-shareholders are satisfactory catalysts for horizontal governance. Hence, an interesting paradox emerges from this proposition; while inside directors, who are significant core employee constituents, and cross-shareholders have been considered negative factors in vertical governance, with respect to horizontal governance they are positive, or rather decisive factors in making a CEO faithful to his duties and responsibilities.

There are favorable conditions for horizontal governance in the Japanese corporate system. Whereas vertical governance depends on the strength of disciplinary power that governing subjects have over a governed object, horizontal governance depends on the strength of mutual consideration between a CEO and the catalysts of governance, and particularly on the strength of CEO's sympathetic consideration. This consideration relies on the particular characteristics of the catalysts who direct their attention to the CEO. It is these characteristics that are the focal points. They include (1) the seriousness and ability of catalysts as observers, (2) the significance and unselfishness of catalysts as resource providers, and (3) the depth of the relationship of catalysts to the company (and its CEO) as stakeholders. In these three respects, core employees and cross-shareholders of Japanese firms are considered satisfying catalysts by being attentive to, and receiving sympathy (consideration) from, the CEO.

2.3.1 The Seriousness and Ability of Catalysts as Observers

The more seriously catalysts observe a CEO and the greater catalyst capability is to evaluate the CEO, the more effective their attention will be in provoking CEO sympathetic consideration. Employees and cross-shareholders in Japanese companies have been serious observers, highly capable of CEO evaluation even without associated powers of control.

Employees are committed and identify with their companies under the lifetime employment system. Employee concern with the present and future situation of their companies renders them attentive to CEO policy and behavior. Although workers and mid- and lower-level managers seldom observe the CEO directly,

they are able to know the capacity and behavior of CEO by other means. At least, formal CEO decisions are communicated to all employees.

However, informal matters such as informal CEO decisions, CEO behavior as a company leader, or personal propensity, all of which are critical factors in CEO evaluation, are not communicated formally; these information cannot be acquired unless it is gathered first hand. The majority of employees are not in a position to do so; however, a relatively large group of senior managers is. They enjoy ample opportunity to gather such information because most of them are members of the board of directors, who can observe the CEO's behavior directly, as well as operational heads of the firm's main division; although as CEO subordinates they cannot affect the CEO, it is likely that they can observe the CEO; and the evaluations made by senior managers based on such observations are easily communicated within the company through each division which they represent at board meetings. Employees are capable of evaluating the CEO also because a bottom-up decision-making procedure is a main feature of Japanese management; this procedure provides employees, particularly middle managers, with sufficient information and discernment to evaluate CEO decisions.

The essential features of cross-shareholders is that they are not only company shareholders but also business and/or financial partners. This implies that poor management on the part of the company may compound the detriment to cross-shareholders in their capacity both as shareholders and as trading partners. If shareholders only, they could sell off company shares to avoid further damage; however, this is difficult when they are also trading partners. This dual role forces them to be attentive observers of the company (and the CEO) with which they have business relationships.

In addition, cross-shareholders are superior evaluators of the company and the CEO compared to other shareholders. Daily transactions provide cross-shareholders with detailed information concerning the company. They are business specialists with business experience of their own or with business monitoring experience as a creditor. Other shareholders, such as institutional investors, are specialists in market investment but not in business management.

2.3.2 The Significance and Unselfishness of Catalyst as Resource Providers

Serious and able observers can even be more effective catalysts if they contribute resources to the company. This is particularly so when they contribute important resources in an unselfish way. The CEO is likely to feel indebted to such contributors, which will arouse his sympathetic consideration for them.

No manager would deny (at least officially) that employee contribution is essential to the firm; but in Japan, more than any other country, the idea is widely perceived, explicitly and convincingly. The active involvement of employees in

firm operation and decision-making has been a salient feature of Japanese management. The dynamic has been a source of competitive advantage for Japanese companies along with firm-specific employee investment derived from such involvement and a long-term commitment to the company.

Moreover, it is the cross-shareholders that have protected this firm-specific investment from being exploited by foreign or domestic predators.² Moreover, cross-shareholders are major suppliers, purchasers, and/or capital providers with whom the company maintains long-term network relationships, another key factor in the success of Japanese companies.

The resources contributed by employees and cross-shareholders are significant, and CEOs acknowledged these contributors to the extent that they feel a sense of indebtedness.

The feeling of indebtedness might be attenuated, however, if resources are provided with the sole intention of treating the company (and the CEO) as a means to maximizing resource providers' self-interest. However, this has not been the case for employees and cross-shareholders of Japanese companies. It is true and justifiable that the core employees and cross-shareholders pursued their own interests to some extent; but, in general, individuals worked or transacted for the benefit of the company that employed them and/or with which they did business, based on reciprocal responsibilities, obligations, and trust (Learmount 2002).

2.3.3 The Depth of the Relationship of Catalysts as Stakeholders

Sympathetic consideration is more evident the stronger the relationship between the parties involved. More direct, frequent, and multi-dimensional interactions concerning higher-stakes matters in the longer-term will result in deeper relationship, and deeper relationship develops mutual responsibilities to further stimulate sympathetic consideration.

Japanese management has long been noted for its long-term, relationship-oriented approach to stakeholders. A CEO aims to actively communicate with middle managers and even junior employees (for example, by holding small group meetings with middle managers and paying frequent visits to factories and other job sites). A CEO aims to communicate much more so with senior managers including the executive directors, the majority of whom have shared their working experience with the CEO as a member of the same company community.

Cross-shareholders are long-term business partners as well as long-term stable shareholders. In most cases, cross-shareholders, as business partners, interact with the company more directly, frequently, and multi-dimensionally in the longer term

²Managers have been aware of the importance of firm-specific investment long before the term was coined and disseminated by academics.

than other shareholders. Therefore, the company's relationship (and top management's relationship) with cross-shareholders is stronger than the company relationship with other shareholders including institutional investors.

These various characteristics of Japanese employees and cross-shareholders have been critically regarded as preventing CEO discipline by an outside body. Hence, these characteristics impede vertical governance through control. Alternatively, these characteristics facilitate horizontal governance through mutual consideration.

2.4 The Current Japanese Corporate Governance System: Strengthening Vertical Governance

Amidst worldwide concern with corporate governance since the mid-1990s, when successive corporate scandals plagued the country, the lack of corporate governance became a popular issue in Japan. Ailing corporate performance in the post bubble economy was also ascribed partly to governance deficiencies. Japanese corporate governance has evolved in a new direction, a direction towards the establishment of effective governance. It was construed as “[to] realize a form of corporate governance that meets global standards” (Keidanren 1997), which in effect were Anglo-American standards, utilizing a board of directors, shareholders, and the stock market to sufficiently play their roles as corporate governing subjects that discipline the CEO. Emphasized were the control by shareholders and the market (empowerment of shareholder rights and the promotion of market discipline) and the greater role of board monitoring.

First, the control by shareholders and the market has been strengthened. Substantial change in ownership structure has occurred, and an increase in foreign institutional ownership and an unwinding of cross-shareholding have developed concurrently.

Figure 2.3 shows the long-term trend of all Japanese listed firm ownership structures. The ratio of foreign ownership, the majority of whom are foreign institutional investors, soared from 4 % in 1990 to 26 % in 2007, replacing domestic financial institutions as the largest category. Ownership by financial institutions, and banks in particular, dropped significantly. Banks sold their corporate shares partly because of the need to satisfy the BIS (Bank for International Settlements) rule and the introduction of current value accounting in Japan. The unloading of corporate shares by financial institutions caused a decline in the stable shareholder ratio from 45 % in the early 1990s to 27.1 % in 2002 (NLI Research Institute 2004; Miyajima and Kuroki 2007).

These changes brought two pressures that intensified vertical governance. First, there is intensified pressure from shareholders. Large institutional shareholders, particularly foreign shareholders, demand higher returns on their investments (dividend increases and share buy-backs, for example) and enhanced corporate

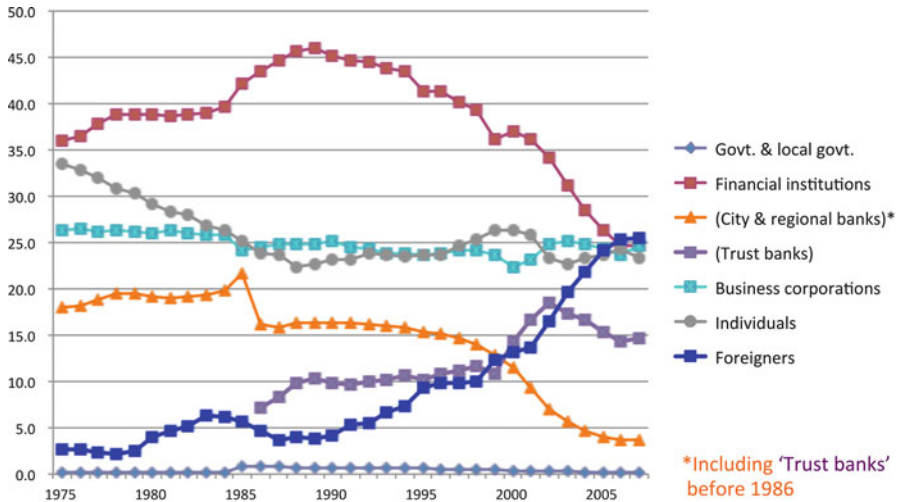


Fig. 2.3 Long-term trends in ownership structure of Japanese listed firms (%). Source: All Domestic Stock Exchanges in Japan (2007)

governance within the firms with which they invest. This behavior is in contrast to stable shareholders who would not make such demands. These shareholder demands are conducted at IR meetings or other informal meetings as well as at the annual general meeting. Such demands—or even the possibility of these demands—by shareholders, alongside continued CEO monitoring, can function as the voice mechanism (Hirschman 1970) to enforce management discipline.

Another pressure that surfaced from ownership structure changes was intensified pressure from the market. Foreign institutional investors, unlike conventional cross shareholders, will not hesitate to sell their shares to a takeover bidder who offers a premium price. The rise in foreign ownership, therefore, posed the extensive threat of hostile takeover bids in Japan for the first time since the early 1970s (when the liberalization of the Japanese capital markets began). This led to executive sensitivity with respect to company share prices. To some extent, the exit mechanism of the stock market became effective. Because the threat of hostile takeovers has yet to be imminent for the majority of Japanese companies, the market pressure seems to have remained in a potential state. However, Japanese corporate executives are sensitive to their own company’s share price as a result of recent, sporadic occurrence of hostile takeover bids, coupled with intensified shareholder pressure, which was not the case 10 or 20 years ago.

Second, with respect to the boards of directors, corporate governance reform, or board reform, has steadily increased among Japanese companies since 1997 when Sony first initiated its own reforms. Full reform consists of (a) introducing an executive officer system, (b) reducing the size of boards, and (c) increasing outside directors, as was the case in Sony’s reforms. Many companies that followed suit put both the introduction of the executive officer system and the reduction in the size of boards into practice, aiming, allegedly, at speeding up decision-making and

enhancing the integrity of each business unit. The majority, however, stopped short of the full scale introduction of external directors, which would have tightened external supervision of top management.

However, the full reform of boards of directors has been introduced in the law as an option. An amendment to the Commercial Code in 2002 introduced a new governance structure called the “company with committees” system. Under this new American-style structure, it is required that (1) a board possess three committees (for audit, appointments, and compensation), all of which are made up of a majority of outside directors and that (2) executive officers, as well as a board of directors, be established. This structure, however, is a second option alongside the conventional option allowed by law. Companies are permitted to opt for this new model in place of the traditional “company with the auditors” system. However, the ratio of the Tokyo Stock Exchange firms that have adopted this new structure is confined to only 2 %. Notwithstanding, the fact should not be underestimated that the governance-enhancing board was well-institutionalized in the Japanese Companies Act and an increasing number of companies that have retained the traditional board structure are now choosing to introduce outside, non-executive directors (the ratio of Tokyo Stock Exchange First Section firms that have one or more external directors rose from 30 % in 2003 to 45 % in 2007). External supervision is becoming more widespread and tolerated in Japan (Buchanan and Deakin 2007).

In sum, the standard corporate governance mechanisms have arisen in recent years whereby shareholders, stock markets, and boards of directors play certain roles (potentially at least) in enforcing CEO discipline.

2.5 Horizontal Governance in Decline?: The Outcomes of the Recent Emphasis on Vertical Governance

The significant change in Japanese corporate governance towards enhanced vertical governance that began in the late 1990s has the (logical but fair) potential to undermine the foundation of Japanese firm horizontal governance. Foreign or domestic institutional investors and external directors engage in CEO discipline using power that is based on the presuppositions of a pessimistic view of human nature (1A), and dominance of the governing subject over a governed object (1B). This leaves little room for mutual consideration. The CEO is expected to deliver good business results that are objective and easily perceived. Unperceived and subjective benefits, such as sympathetic consideration, are not expected from a CEO by institutional investors and external directors. Foreign or domestic institutional investors who seek corporate control within the marketplace are not interested in mutual consideration at all. Consequently, CEOs are concerned more with exhibiting positive business results and less with consideration and voluntary discipline, which can lead to unfaithfulness to their duties without the external control of others. An excess of emphasis on vertical governance may cause (or may

have begun to cause) fundamental damage to horizontal governance that has so far functioned well in Japan.

The complementary balance between the vertical and horizontal governance modes is delicate. They have coexisted for years in Japanese corporate governance, with horizontal governance presiding over vertical governance, and vertical governance being mobilized only in exceptional cases. However, horizontal governance is intrinsically vulnerable to vertical governance. Although it is unlikely that corporate practices will undergo such extreme change that would cause vertical governance to dominate horizontal governance, it is possible that people's perceptions about CEO discipline could shift radically in favor of vertical governance. A demand for intensified vertical governance that dismisses horizontal governance as either irrelevant or naïve, could cause horizontal governance to steadily give way to vertical governance.

There exists a kind of asymmetry between these two modes of governance in that they can easily coexist as long as horizontal governance prevails, but not necessarily when vertical governance dominates. One reason for the asymmetry is that vertical governance is supported by the coercive powers of legal oversight and its institutional foundations, whereas horizontal governance relies solely on, and is supported by, informal interactions among the parties involved.

The second reason for the asymmetry is that vertical governance can produce demonstrable evidence, for example, the findings of introduced outside directors, regardless of their effectiveness in monitoring the CEO. However, with respect to horizontal governance, it would be impossible to produce direct evidence. The CEO inculcates self-discipline through horizontal governance using introspective reflection from mutual consideration with catalysts.

The third reason is as follows: if the overall consensus in society is in favor of horizontal governance, this consensus will become socially binding, holding CEO executives responsible for the faithful execution of their duties; however, if the overall social consensus is in favor of vertical governance, it may release CEOs from the faithful execution of duty because the presumptions of vertical governance provide a convenient excuse for misconduct. Therefore, it is likely that they will behave exactly as the presumptions predict (Ghoshal and Moran (2006) call this a self-fulfilling prophecy). Individuals will demand intensified vertical governance, relegating more socially acceptable horizontal governance as irrelevant or naïve. Should this occur, caution is required in suggesting that the ownership and board structure changes of Japanese corporations over the past decade are changes that have improved overall Japanese corporate governance.

While the quality of vertical governance can be improved by change in ownership and board structure, the quality of horizontal governance in Japan can and will deteriorate as a result of change in ownership and board structure. An overdependence on vertical governance is not productive, as the global and particularly US experience has shown, partly because it results in a vicious circle of corporate scandal and tightened regulation. Therefore, caution and skepticism is required concerning the unintended consequences of allowing vertical governance to supersede horizontal governance within Japan corporations.

With respect to the Japanese corporate system, I suggest the harmonious coexistence of horizontal and vertical governance, where horizontal governance is proactively emphasized. To create such a coexistence, more emphasis must be given to horizontal rather than vertical governance. Considerable care and maintenance is required to prevent horizontal governance from being overwhelmed by the current, twenty-first century tide of vertical governance. The reinforcement of mutual consideration is significant. The conceptual framework for horizontal governance (see Fig. 2.1) implies that both parties involved in mutual consideration are pertinent; however, I suggest that consideration by the CEO is much more essential.

The critical issue is the moral edification of incumbent and future corporate executives. Since the end of World War II, Japanese society has ignored the notion of moral edification. However, I believe this is exactly what Japanese business education should reemphasize and commit to. Moral edification is the key to realizing a harmonious coexistence between horizontal and vertical governance. This commitment would lead to a more desirable and humane form of Japanese corporate governance, which will promote sound and vigorous corporate activity and economic and social prosperity.

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Chapter 3

Empirical Analysis of the Influence of Outside Directors on Japanese Firm Performance

Shinya Miwa

Abstract This chapter has two purposes. The first is to consider why the managers of Japanese companies are reticent about appointing outside directors, despite strong pressure from foreign investors to make such appointments. The second is to empirically examine the relationship between the appointment of outside directors and the performance of Japanese companies that are listed on the First Section of the Tokyo Stock Exchange (TSE). My investigation reveals that the managers of TSE listed companies do not feel the need to appoint outside directors as they are satisfied with the current corporate governance system. This includes a board comprising at least three statutory auditors, of whom more than half are outside auditors, as well as the checks and balances provided by the board of directors. In addition, outside directors are expected to supervise management, but they are not necessarily required to become involved in managerial decision making. Some empirical studies, which analyze U.S. and Japanese companies, show no apparent enhancement of corporate performance by the appointment of outside directors. The results presented in this chapter confirm the findings of these studies and show that there is little likelihood that the appointment of outside directors has any significantly positive effect on corporate performance. This is likely to be a reflection of the above noted fact that managers in TSE listed companies do not necessarily expect outside directors to become involved in managerial decision making.

Keywords Board composition • Corporate governance • Firm performance • Inside director • Outside director

S. Miwa (✉)

Professor, Corporate Governance, Department of Economics, Kokushikan University,
Setagaya-ku, Tokyo, Japan

e-mail: miwas@kokushikan.ac.jp

3.1 Introduction

A committee style of corporate governance, modeled on a U.S. management structure model, has been adopted by some Japanese firms since the revision of the Commercial Code was brought into effect in 2003.¹ Companies adopting the code's systems are required to establish committees of nomination, compensation, and audit, and the revision requires that more than a half of each committee be outside directors. On the other hand, the appointment of an outside director is not mandatory in those traditional Japanese companies that have a board of statutory auditors and existed before the introduction of committee style governance. Since Japanese management is reluctant to appoint outside directors, these account for the majority of Japanese companies.

Despite such reluctance among managers, the pressure to introduce outside directors into Japanese firms has become stronger in recent years. For example, the Organization for Economic Co-operation and Development (OECD) states "that a sufficient number of board members will need to be independent of management" (OECD 2004, p. 63), and the Pension Fund Association in Japan asks that at least one third of directors in a company should be independent outside directors in "Principles of Corporate Governance" (Pension Fund Association 2010). The Asian Corporate Governance Association (ACGA) also recommends that independent external directors comprise one half of the board over the longer term (Asian Corporate Governance Association 2008, p. 5). Furthermore, from 2009² the TSE has required TSE listed companies to appoint at least one independent outside director or statutory outside auditor to represent the interests of general stockholders.

This chapter has two purposes. The first is to consider why the managers of Japanese companies are reticent about appointing outside directors, despite strong pressure from foreign investors to make such appointments. The second is to empirically examine the relationship between the appointment of outside directors and the performance of Japanese companies that are listed on the First Section of the TSE.

The chapter is organized as follows. Section 3.2 explains the role of outside directors and refers to previous research to examine the influence their appointment has on corporate performance. In Sect. 3.3, I use the results of a survey undertaken by the TSE to look at the current situation of outside director appointments in

¹ This revision of the Commercial Code enabled large stock companies to select either companies with committees or those with boards of statutory auditors. Subsequently, in 2006, the Companies Act was introduced, which prescribed the stock companies system and replaced the Commercial Code.

² The TSE released "Principles of Corporate Governance for Listed Companies" in December 2009. There is no description of the number of outside directors that should be appointed in listed companies in this document. However, there is the comment that "each listed company is required to sufficiently disclose the details of its corporate governance structure and the reasons for its selection of a particular structure" (Tokyo Stock Exchange 2009, p. 12).

Japanese TSE listed companies. I then consider why managers of TSE listed companies are unwilling to appoint outside directors. In Sect. 3.4, I empirically examine the relationship between the appointment of outside directors and the performance of TSE listed companies. Section 3.5 presents a summary and conclusions.

3.2 Relationship Between Board Composition and Corporate Performance

In this section, I will first explain the role of outside directors, and will then refer to previous research to consider the relationship between the appointment of outside directors and corporate performance.

Under Japanese Companies Act, stock companies are obliged to have at least one director. A director is elected by a general meeting of shareholders to perform a decision making management role, and to supervise other directors. There are two types of directors in companies, inside directors and outside directors, and generally, there are differences that apply to their respective roles.

Inside directors are well versed in the internal operations of a business, and are assumed to have the firm-specific knowledge needed to make managerial decisions. Such knowledge is important when management strategy is being decided upon, and inside directors are believed to play a large part in improving firm performance. However, there are problems associated with the position. For example, in Japan, company presidents usually appoint inside directors from the ranks of the business's employees. These directors will have difficulty in adequately monitoring their more senior presidents, and they are very unlikely to be able to object to the business ideas of these presidents. Moreover, inside directors often serve as the heads of operating divisions, and instincts of strong attachment or self-preservation can influence their decisions. For example, a director in such a position may oppose the closure of a division even when its performance necessitates just such a board decision. As a result, the performance of the entire company is likely to suffer because of the poor performance of such divisions.

Outside directors, on the other hand, may bring professional expertise that can be applied to the general management of a company, even though they may not be familiar with the internal operations of a particular business. Such knowledge is useful when they advise managers. They are also expected to look after the interests of stakeholders when making decisions, and monitor top management. The fact that outside directors do not have close relationships with top management should ideally result in effective monitoring.

However, there are some situations where they may be unable to meet such expectations. For example, Japanese Companies Act allows managers to appoint acquaintances or individuals with good connections as outside directors. In Japanese firms, therefore, such outside directors may not be sufficiently independent of

management, and business performance may decline when they hesitate to express frank opinions to managers, or do not fulfill their monitoring duties adequately.

In short, both inside and outside directors *may* contribute to an improvement in firm performance, but there is also the possibility that they *may not*. What, then, of the results of previous empirical studies that analyzed the relationship between the appointment of outside directors and firm performance in the U.S. and Japan?

Many empirical studies analyze the relationship between the percentage of outside directors in the total number of directors and the performance of U.S. companies. For example, both Hermalin and Weisbach (1991) and Mehran (1995) demonstrate that there is no significant correlation between them. Yermack (1996) also shows that a significantly negative correlation exists between the percentage of outside directors in all directors and Tobin's q , using the ordinary least squares (OLS) method. However, it has been shown that such a correlation disappears when a fixed effects model is used. Furthermore, it has also been shown that the composition of a board of directors has an insignificant correlation with other measures of corporate performances, such as return on assets (ROA) and return on sales (ROS).

On the other hand, Bhagat and Black (1999) conducted an empirical analysis of the relationship between the composition of boards of directors and the performance of U.S. companies. This shows that the proxy variable for the independence of boards of directors has a negative correlation with firm performance.

As described above, some previous works show that corporate performance is not necessarily high in companies that appoint outside directors. There is a similarly ambiguous relationship between the appointment of outside directors and corporate performance in empirical research dealing with Japanese companies. For example, Miyajima (2008) shows that the performance of Japanese companies, which is measured by Tobin's q and ROA, is partly positively sensitive to the corporate governance score variable, CGS_{br} , but not to a statistically significant degree.³ This variable measures board reforms, such as adopting the executive officer system and introducing outsiders onto a board. Miwa and Ramseyer (2005) also show, by conducting a regression analysis,⁴ that there is a uniformly insignificant relationship between *Total Outside Directors* (the variable that stands for the number of outside directors on a board) and firm performance.⁵

³ Miyajima (2008) also conduct the following estimation, where CGS_{br} is replaced by a dummy variable, which takes a value of 1 when the company has outside directors, and 0 otherwise. The empirical results show that there is no significant relationship between the dummy variable and corporate performance.

⁴ Miwa and Ramseyer (2005) define outside directors as follows: directors with previous career experience in a bank, another firm (other than a bank), or the government; and directors holding a concurrent position at a bank or another firm (other than a bank).

⁵ Miwa and Ramseyer (2005) also conduct the following regression analysis, where a *Majority Outside Directors* dummy for the presence of a majority of outside directors is incorporated into regression models. The empirical results show that there is an insignificant relationship between corporate performance and the *Majority Outside Directors* dummy.

To examine whether empirical results similar to the findings of Miyajima (2008) and Miwa and Ramseyer (2005) can be obtained, I conducted a regression analysis of the relationship between the percentage of outside directors on a board of directors and the performance of TSE listed companies in Sect. 3.4.

3.3 Explanation of the Number of Outside Directors That Are Appointed in TSE Listed Companies

The TSE conducted an investigation of TSE listed companies (referred to hereafter as Tokyo Stock Exchange (2011)), using data from the “Report on corporate governance” of September 10, 2010.⁶ In this section I will show, using the results of the TSE investigation, that outside directors are very seldom appointed in these companies. I will then consider why managers in these companies are reluctant to appoint outside directors.

According to Tokyo Stock Exchange (2011), among TSE listed companies the percentage with a board of statutory auditors is 97.8 %, while the percentage with committees is 2.2 %. The average number of outside directors per company is 0.91 across all TSE listed companies, and 0.83 in companies with a board of statutory auditors. In comparison, the average is 4.43 in companies with committees. From these results, it can be confirmed that almost all TSE listed companies have a board of statutory auditors, and that managers of such companies are more reticent about appointing outside directors than those of companies with committees.

According to Tokyo Stock Exchange (2011), 52.4 % of companies with a board of statutory auditors do not appoint outside directors. The figures for companies with a board of statutory auditors, which have outside directors are: companies appointing one outside director, 25.5 %; companies appointing two outside directors, 13.4 %; and companies appointing three outside directors, 5.6 %. These numbers show that companies making few appointments represent a majority on the TSE, and this is reflective of the fact that, under Japanese Companies Act, companies with a board of statutory auditors are not required to appoint outside directors. Many managers in such companies seem to see no great advantage in making these appointments.

On the other hand, the results of this investigation show that there are no companies with committees that employ one or fewer outside directors. The figures for companies with committees are: companies appointing three outside directors, 33.3 %; companies appointing four outside directors, 19.6 %; and companies appointing five outside directors, 25.5 %. The reason for these very different results is that companies with committees are required to set up an audit committee, a

⁶The number of analyzed companies is 2,294. The breakdown is as follows: the number of companies listed on the TSE First Section is 1,669; the number of companies listed on the TSE Second Section is 443; the number of companies listed on the TSE Mothers is 182.

nominating committee, and a compensation committee, and, by law, each committee must have a majority of outside directors.

So why are the managers of companies with a board of statutory auditors reluctant to appoint outside directors? According to the Tokyo Stock Exchange (2011, p. 29), the reasons are “the cross-checking between (board of) Statutory Auditors comprised mainly of outside statutory auditors and directors, the segregation of supervision and execution through the introduction of an executive officer system, the proper functioning of advisory functions of an advisory board, etc.” In addition, Japanese managers state that “advice from and issues raised by Statutory Auditors on a 4-year term are effective based on the broader picture and less influenced by short-term views” (Tokyo Stock Exchange 2011, p. 29). The above reasons suggest that Japanese managers believe that, since the current management system is fully functional, it is unnecessary to appoint outside directors.

In addition to Tokyo Stock Exchange (2011), the TSE distributed a survey to 2,261 TSE listed companies (listed as at March 31, 2005), eliciting a response rate of 61.0 %. The TSE then published a summary of the survey results (Tokyo Stock Exchange (2005)).

In the survey, the TSE asked companies with outside directors (560 companies) what roles were expected of these directors. According to Tokyo Stock Exchange (2005), the TSE received the following answers: (1) To enhance the supervision of directors (78.6 %, 440 companies); (2) To establish compliance management processes (70.4 %, 394 companies); (3) To ensure that directors fulfill their fiduciary duty of loyalty and their duty of care as good managers (61.8 %, 346 companies). “Other” was a response received from 42 companies (7.5 %), and this was broken down as follows: (1) To provide managerial advice; (2) To reflect a variety of management perspectives; (3) To use managerial knowledge and expertise that inside directors do not have; (4) To let their opinions, common sense, and thinking percolate into companies; and (5) To strengthen the supervision of managers, from a position of independence, to protect the interests of shareholders.

The results of the survey suggest that the managers of most companies that have outside directors may not expect these directors to participate in making managerial decisions, but they may expect them to monitor the illegal actions of managers.

3.4 Empirical Analysis

The previous section shows that managers of TSE listed companies expect outside directors to keep out of management decision making, while expecting them to monitor management for illegal activities. When outside directors act to fulfill such expectations, they may be unable to raise corporate performance, but they may be able to enhance compliance management.

By conducting regressions using panel data from TSE listed companies, I will examine, in this section, whether or not Japanese outside directors play an active role in improving firm performance. After explaining the methods of the empirical analysis, the results will be shown and their implications discussed.

3.4.1 *Methods of the Empirical Analysis*

This paper uses panel data from companies listed on the TSE First Section. The data covers 5 years and was collected as of July 2004, July 2005, August 2006, July 2007, and August 2008. It was sourced from the Nikkei Economic Electronic Databank System (NEEDS) and the Corporate Governance Evaluation System (NEEDS-Cges).

I analyzed companies that were continuously listed on TSE First Section during the period from 2004 to 2008. Companies that were newly listed or were delisted during this period were, therefore, excluded from the sample. I also excluded observations that had missing values. The resulting sample comprised 1,124 companies.

I conducted the following empirical analysis to study the relationship between the appointment of outside directors and firm performance. I analyzed how the percentage of outside directors (or independent outside directors) on a board in 2004 influenced the average of the market-to-book ratio or ROA during the 5 year period 2004–2008 (or the 3 year period 2004–2006). If outside directors do improve corporate performance, then the estimated coefficient of the percentage of outside directors (or the percentage of independent outside directors) will be significantly positive.

I will now explain the method of conducting the empirical analysis. I estimated the impact of the percentage of outside directors on a board of directors (OD) in 2004 on the average value of firm performance for the period 2004–2008.⁷ I estimated the following regression model, where the dependent variable is the market-to-book ratio (Q) used as a measure of corporate performance, by using the OLS method. Q is calculated by dividing the market value of total outstanding shares plus book value of all financial liabilities by the book value of total assets.

$$Q_{0408} = f(OD_{2004}, FO_{2004}, CROSS_{2004}, MO_{2004}, SO_{2004}, DR_{2004}, LASS_{2004}) \quad (3.1)$$

The “0408” that is attached to the dependent variable indicates that Q is the average value for the 5 year period 2004–2008. On the other hand, the “2004” that is attached to the explanatory variables indicates that these represent data for the year 2004. In Eq. (3.1) all independent variables, other than OD, are control variables.⁸ Next, I will explain how Q is related to these.

During the period from the collapse of the Japanese “bubble economy” of the late 1980s to the start of the global financial crisis in 2008, foreign investors were

⁷ The definition of “outside directors” in my empirical analyses is based on that prescribed by Japanese Commercial Code. Directors from a parent company or a main bank, and directors who are friends or relatives of the president can be regarded as outside directors because the definition of “outside directors” in Japanese Commercial Code does not necessarily require independence.

⁸ See Mehran (1995) and Yermack (1996) for the selection of control variables.

actively buying shares in Japanese companies. They were also actively exercising their voting rights at the shareholders' general meetings of Japanese companies because they were trusted by mutual funds and pension funds, and had fiduciary responsibilities. Such behaviors by foreign shareholders may have contributed to Japanese companies improving the efficiency of their management. I, therefore, hypothesize that the percentage of shares held by foreign investors (FO) will have a positive influence on Q.

Mutual shareholding is expected to help companies in a business group to form long term and stable relationships with other group companies, and to improve profitability through trading with them. As a result, mutual shareholding may increase corporate value. On the other hand, mutual shareholding may reduce the probability of hostile takeovers because it reduces the number of shares of the companies in a business group that are traded on the stock market. Companies in a business group do not tend to exercise voting rights against managers of other group companies, even if the performance of the latter companies is bad, and individual investors do not have enough shares in the latter companies to influence their management. Thus, corporate value may decrease since the discipline to let managers improve firm performance is not given to the managers of companies in a business group by the general shareholders.⁹ In this paper, therefore, I refrain from predicting whether the percentage of total shares, held by listed companies that can have cross-shareholding ties (CROSS), will improve Q or not.¹⁰

According to Jensen and Meckling (1976), as the level of managerial ownership increases, their interests will coincide with those of the shareholders as they will reduce their consumption of perks. Jensen and Meckling (1976) argue that, as the shareholdings of managers increase, corporate value will also increase because the agency cost of equity, which results from the conflicting interests of shareholders and managers, will be mitigated. From their theoretical analysis, I hypothesize that the percentage of shares held by all directors and statutory auditors (MO) will have a positive influence on Q.¹¹

Stock options are a form of incentive compensation that gives directors or employees the right to buy shares in their company at an exercise price in the future. Since compensation is linked to rises in the stock price, they become more

⁹ Lichtenberg and Pushner (1994) show empirically that ownership by business companies influences corporate performance negatively, although their empirical analysis does not directly focus on the relationship between the ratio of cross-shareholding and corporate performance. This result suggests that, even if a business company holds a lot of the shares of another company, the former does not necessarily give the manager of the latter discipline to enhance managerial efficiency. One of the reasons for this is that, in cases of cross-shareholding, the former is not likely to exercise voting rights at shareholders' meetings against the managers of the latter, regardless of their level of performance. In addition, Hiraki et al. (2003) show empirically that mutual shareholding has a negative relationship with corporate value.

¹⁰ CROSS data was collected and calculated by Nippon Life Insurance (NLI) Research Institute.

¹¹ Morck et al. (1988) and McConnell and Servaes (1990) show that management shareholding has a positive correlation with corporate value if the percentage of shares held by managers is within certain ranges.

conscious of this and more motivated to improve performance. Stock options are expected to bring the interests of management and shareholders into line, and to solve the problem of the agency cost of equity. In this paper, I hypothesize that the dummy variable (SO), which takes a value of one if stock options are adopted, will have a positive effect on Q .¹²

The impact of debt on corporate performance has not yet been determined theoretically. Debt has a tax saving effect because the interest paid is recognized as an expense when calculating corporate income tax. Therefore, the use of debt will increase corporate value. On the other hand, debt has the effect of increasing bankruptcy costs and corporate value will decrease if debt is used excessively.¹³ Myers (1977) also shows that debt is likely to cause a problem of underinvestment that results in abandoning positive net present value (NPV) projects. Because this problem of underinvestment causes the agency cost of debt, corporate value will decrease due to the use of debt. I have used DR (book value of total financial liabilities divided by book value of total assets) as a control variable. Since DR is likely to affect Q both positively and negatively, I have refrained from predicting the relationship between them in advance.

Finally, I will consider the effect of firm size on corporate performance. The expansion of a company has the potential to achieve “economies of scale” and enhance corporate performance, but it also has the potential to expand bureaucracy and harm corporate performance. I have, therefore, refrained from making a forecast concerning the relationship between the logarithm of total assets (LASS) (a proxy variable for firm size) and Q .

I will also show how the results of the empirical analysis change if I substitute the proportion of independent outside directors on the board of directors (IOD) for OD in Eq. (3.1), or if I substitute ROA for Q .¹⁴

3.4.2 Results of the Empirical Analysis

First, I considered the estimated results of Eq. (3.1), shown in the previous section. Panel A of Table 3.2 shows that the coefficients of OD2004 and IOD2004 are positive in columns (A) and (C), which do not include industry dummy variables, and they are statistically significant at the 10 % significance level. On the other hand, the coefficients of OD2004 and IOD2004 are positive in columns (B) and (D),

¹² Kato et al. (2005) conducted an empirical analysis of Japanese companies and show that the adoption of stock options in Japanese companies is likely to improve corporate performance.

¹³ For example, see Bradley et al. (1984) for the optimal capital structure model, in which several determinants of capital structure, such as bankruptcy costs, the tax system and so on, are taken into account.

¹⁴ The definition of IOD is as follows. $IOD = (\text{the number of outside directors that have not had any work experience at banks, controlling companies, or affiliated companies}) / (\text{the total number of members of a board of directors})$.

which include industry dummy variables, but they are not statistically significant at the 10 % significance level.¹⁵ These results indicate that there may be a positive correlation between the percentage of outside directors on a board of directors and future corporate performance, but the relationship is weak.¹⁶

I also estimated equations where Q0408 in Eq. (3.1) is replaced with Q0406. The reason for this estimation is to confirm whether the percentage of outside directors on a board of directors significantly influences future corporate performance when the analyzed period of corporate performance is shortened from 5 years (the period 2004–2008) to 3 years (2004–2006). The empirical results are almost the same as those in Panel A of Table 3.2, but I have omitted a demonstration of the results of the additional analysis due to space constraints in the paper.

Panel B of Table 3.2 shows the estimated results where Q0408 in Eq. (3.1) is replaced with ROA0408. Unlike the estimated results of Panel A of Table 3.2, the coefficients of OD2004 and IOD2004 are not statistically significant at the 10 % significance level.

I also estimated equations where ROA0408 is replaced with ROA0406 to shorten the period of the analysis. The estimated results are almost identical to those in Panel B of Table 3.2, but I have omitted a demonstration of the results of the additional analysis due to space constraints in the paper.

Overall, there seems to be only a weak statistical correlation between the percentage of outside directors on a board of directors and the future market-to-book ratio, although the former is likely to have a positive relationship with the latter. Moreover, the percentage of outside directors on a board of directors is not very likely to have a significant relationship with ROA in the future.¹⁷

Next, I examined the effect of the control variables on firm performance. The coefficients of FO2004 are positive and are statistically significant at the 1 % significance level in all estimated equations. The coefficients of SO2004 are also positive in all estimated equations and are statistically significant at the 1 %

¹⁵ There seems to be no multicollinearity in all the estimated equations in Table 3.2 because the variance inflation factors (VIF) of all estimated equations are low.

¹⁶ OLS estimation is likely to produce a spurious correlation between Q0408 and OD2004 (or IOD2004) because columns (A) and (C) do not contain industry dummy variables. This may be one of the reasons why every coefficient of OD2004 and IOD2004 in columns (A) and (C) is significantly positive.

¹⁷ I conducted a *t* test and Wilcoxon rank-sum test as additional analyses, to examine whether or not there were differences in corporate performance (Q0406, Q0408, ROA0406, ROA0408) between companies with a board of statutory auditors and companies with committees of nomination, compensation and audit. I selected the data from July 2004 to distinguish between companies with a board of statutory auditors and companies with the three committees. The empirical results showed, in all variables, that companies with the three committees had better corporate performance than companies with a board of statutory auditors. However, they were not statistically significant at a significance level of 10 %, except for the case where the Wilcoxon rank-sum test was performed for Q0408. These results were also consistent with the results of the regression analysis that indicate that outside directors may not contribute to an improvement in firm performance.

significance level, except in columns (F) and (H). These results suggest that the adoption of stock options, and ownership by foreign shareholders is likely to enhance corporate performance in the future. This is consistent with the hypotheses explained above.

Although the coefficients of MO2004 are positive in all estimated equations, they are statistically significant at the 1 % significance level only in those regression equations where ROA is the dependent variable. However, the coefficients of CROSS2004 are negative in all estimated equations and are statistically significant at the 1 % significance level. These results show that increasing managerial ownership of equity is likely to increase ROA in the future, and it is also likely that mutual shareholding will harm corporate performance in the future.

In addition, LASS2004 is likely to have a negative effect on corporate performance in the future. DR2004 may have a positive impact on the market-to-book ratio of assets in the future, but it may negatively influence ROA in the future.

Table 3.1 shows that the means of both OD2004 and IOD2004 are low. Moreover, the percentage of observations in the sample where OD2004 has a value of 0 is 70.82 % (796 observations), while the percentage of observations where IOD2004 has a value of 0 is 77.49 % (871 observations). There are many companies that do not have any outside directors, and the percentage of outside directors is extremely low even when companies have them. The empirical results shown above may come about from such situations.

Finally, using other methods, I again examined the relationship between the appointment of outside directors and firm performance. I created a dummy variable (OD_DUM2004) that takes a value of 0 if OD2004 is 0, and 1 otherwise. Similarly, I created a dummy variable (IOD_DUM2004) that takes a value of 0 if IOD2004 is 0, and 1 otherwise. I then examined how the estimated results will change if, instead of OD2004, each dummy variable is incorporated into Eq. (3.1).

Although I omitted to show the tables due to space constraints in the paper, the estimated results are as follows. The coefficients of OD_DUM2004 and IOD_DUM2004 are positive and statistically significant at the 10 % significance level in the regression equations that do not have industry dummy variables, and use Q0408 as the dependent variable. However, the coefficients of both variables are positive but are not significant at the 10 % significance level if the regression equations contain industry dummy variables. These empirical results are virtually the same as Panel A of Table 3.2. However, all coefficients of OD_DUM2004 and IOD_DUM2004 are not statistically significant at the 10 % significance level in the regression equations when using ROA0408 as the dependent variable. These empirical results are almost the same as Panel B of Table 3.2.

As described above, Miyajima (2008) empirically analyzes the association between corporate performance and the corporate governance score (CGS_{br}) for one fiscal year and shows an insignificant relationship between them. These empirical results are consistent with those of this paper, although he uses CGS_{br} —the index that reflects various board reforms, including the introduction of outside directors to a board—for his empirical analysis.

Table 3.1 Summary Statistics

Variable	Mean	Standard deviation	Minimum	Maximum
(1) Corporate performance				
Q0408	1.2551	0.8409	0.6642	25.1561
ROA0408	0.0601	0.0515	-0.1783	0.6366
(2) Outside directors				
OD2004	0.0514	0.0997	0.0000	0.6250
IOD2004	0.0369	0.0833	0.0000	0.5556
(3) Stock ownership				
FO2004	0.0995	0.1051	0.0000	0.7670
CROSS2004	0.1007	0.0866	0.0000	0.4842
MO2004	0.0406	0.0843	0.0000	0.6001
(4) Other variables				
SO2004	0.3194	0.4664	0.0000	1.0000
DR2004	0.5435	0.2100	0.0546	0.9827
LASS2004	25.4319	1.3749	21.3116	30.6344

Notes: The sample consists of observations of 1,124 Japanese companies listed on the TSE First Section. The definitions of variables are as follows.

$Q = \{(\text{market value of total outstanding shares}) + (\text{book value of all liabilities})\} / (\text{book value of total assets})$

$ROA = (\text{ordinary profit}) / (\text{book value of total assets})$

$OD = (\text{the number of outside directors}) / (\text{the number of all members belonging to the board of directors})$

$IOD = (\text{the number of independent outside directors}) / (\text{the number of all members belonging to the board of directors})$

$FO = (\text{the percentage of shares held by foreign investors})$

$CROSS = (\text{the percentage of total shareholding held by listed companies that can keep cross-shareholding ties})$

$MO = (\text{the percentage of shares held by all directors and statutory auditors})$

$SO = (\text{the dummy variable that takes a value of one if stock options are adopted, and zero otherwise})$

$DR = (\text{book value of all liabilities}) / (\text{book value of total assets})$

$LASS = (\text{logarithm of book value of total assets})$

“0408”, which is attached to the variable, indicates that it is the average value for the 5 year period from 2004 to 2008.

“2004”, which is attached to the variable, refers to data for the year 2004.

On the other hand, Miwa and Ramseyer (2005) use *Total Outside Directors* (a variable that represents the total number of outside directors) for their empirical analysis while I use the percentage of outside directors on a board of directors in this chapter. The empirical results of Miwa and Ramseyer (2005), which relate to the impact of outside directors on firm performance, are almost the same as those of this chapter, since the variables that we adopted are similar.

As shown in Sect. 3.3, managers of TSE listed companies do not necessarily require outside directors to be involved in managerial decision making. If they base appointments on this idea, then the contribution of outside directors to an

Table 3.2 OLS regression of firm performance on the percentage of outside directors

Dependent variable	Panel A: Empirical results of regression models where the dependent variable is Q0408				Panel B: Empirical results of regression models where the dependent variable is ROA0408			
	Q0408	Q0408	Q0408	Q0408	ROA0408	ROA0408	ROA0408	ROA0408
Estimated equations	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
OD2004	0.4156 (1.88)*	0.2836 (1.42)		0.4878 (1.50)	0.0006 (0.04)			
IOD2004			0.6672 (1.93)*					
FO2004	2.4990 (3.21)***	2.6465 (3.02)***	2.4273 (3.26)***	2.5819 (3.08)***	0.1542 (5.83)***	0.1534 (5.10)***	0.1546 (6.03)***	0.1546 (5.31)***
CROSS2004	-0.8036 (-4.47)***	-0.5999 (-4.45)***	-0.8271 (-4.51)***	-0.6184 (-4.55)***	-0.0546 (-3.98)***	-0.0503 (-3.69)***	-0.0547 (-4.03)***	-0.0499 (-3.70)***
MO2004	0.4633 (1.11)	0.0896 (0.15)	0.4408 (1.05)	0.0771 (0.12)	0.0944 (3.71)***	0.0793 (2.85)***	0.0942 (3.72)***	0.0796 (2.88)***
SO2004	0.1316 (3.00)***	0.0873 (2.76)***	0.1257 (3.02)***	0.0820 (2.69)***	0.0084 (3.06)***	0.0062 (2.33)**	0.0085 (3.09)***	0.0063 (2.36)**
DR2004	0.1399 (1.78)*	0.2113 (2.65)***	0.1269 (1.63)	0.1974 (2.49)**	-0.0578 (-7.65)***	-0.0569 (-7.17)***	-0.0577 (-7.71)***	-0.0566 (-7.24)***
LASS2004	-0.1193 (-2.54)**	-0.1258 (-2.50)**	-0.1176 (-2.55)**	-0.1237 (-2.52)**	-0.0039 (-2.10)**	-0.0040 (-1.95)*	-0.0039 (-2.12)**	-0.0041 (-2.00)**
Industry dummy variables	No	Yes	No	Yes	No	Yes	No	Yes
Number of observations	1,124	1,124	1,124	1,124	1,124	1,124	1,124	1,124
Adjusted R ²	0.114	0.123	0.122	0.124	0.283	0.310	0.283	0.310
F-statistics	13.07***	8.30***	13.09***	9.92***	40.95***	17.77***	41.24***	17.83***

Notes: The definitions of variables used in OLS regression are as follow.

Q = (market value of total outstanding shares) + (book value of all liabilities) / (book value of total assets)

ROA = (ordinary profit) / (book value of total assets)

OD = (the number of outside directors) / (the number of all members belonging to the board of directors)

IOD = (the number of independent outside directors) / (the number of all members belonging to the board of directors)

FO = (the percentage of shares held by foreign investors)

CROSS = (the percentage of total shareholding held by listed companies that can keep cross-shareholding ties)

Table 3.2 (continued)

MO = (the percentage of shares held by all directors and statutory auditors)

SO = (the dummy variable that takes a value of one if stocks options are adopted, and zero otherwise)

DR = (book value of all liabilities) / (book value of total assets)

LASS = (logarithm of book value of total assets)

“0408”, which is attached to the variable, indicates that it is the average value of the 5 year period from 2004 to 2008.

“2004”, which is attached to the variable, refers to data for the year 2004.

Coefficient estimates appear with White (1980) robust standard errors.

t-statistics are in parentheses.

***, **, *, significant at the 1 %, 5 % and 10 % level respectively.

improvement in corporate performance may be very small. The empirical results of this paper are likely to reflect such situations.

3.5 Summary and Conclusions

In this chapter, I used the TSE survey to confirm that managers of TSE listed companies are reluctant to appoint outside directors. I also considered why the managers of Japanese companies are hesitant to make these appointments when there is strong external pressure to do so. My findings revealed that managers of TSE listed companies do not feel the need to appoint outside directors because they are satisfied with the current corporate governance system, such as a board of statutory auditors, of which a majority are outside auditors. It also has the checks and balances provided by a board of directors. I also ascertained that managers expect outside directors to function as supervisors of management, but do not necessarily require them to be involved in managerial decision making.

Some empirical studies that analyzed U.S. companies do not conclude that the appointment of outside directors enhances corporate performance. The empirical results of this paper also show that there is little likelihood that the appointment of outside directors has a significant effect on corporate performance. This is consistent with the results of Miyajima (2008) and Miwa and Ramseyer (2005), and is likely to be a reflection of the above noted fact that the managers of TSE listed companies do not necessarily expect outside directors to become involved in managerial decision making.

So, do outside directors fully perform the supervisory role that the managers of TSE listed companies expect of them? Are they able to prevent illegal acts by managers, such as accounting fraud? An empirical study of the supervisory role of outside directors would be my chosen future research topic.

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Chapter 4

The Social Roles of Japanese Companies Under the “New Public” Policy: How They Collaborated with Nonprofit Organizations to Rescue the Areas Affected by the Great East Japan Earthquake of 2011

Yasunari Takaura

Abstract The analysis of this chapter indicates that a company can be a player in creating the “new public” by showing the collaboration between Japanese companies and the nonprofit sectors, including nonprofit organizations in support activities. Although traditional Japanese companies are community organizations that are closed and scarcely related to the external society, their existing value structure began to sway with the bubble burst and globalization, resulting in the new moves of Japanese companies.

Keywords Nonprofit organizations • The Great East Japan Earthquake • The New Public • Types of collaboration

4.1 Introduction

The social-economic system led mainly by the government has been faced with an impasse along with the slowdown of the growth of the domestic economy, and the pressure of the market competition has increased because of deregulation. The market-oriented attitude to heighten the competitive power of Japanese companies has been sharpened while the so-called U.S. type “Market Centrism” expanded and some corporations appeared to lack the virtue of social equity (Tanimoto 2002, p. 135). On the other hand, while a lot of scandalous companies have been criticized by the Japanese citizens and the mass media, it seemed that not only legal compliance but also social contribution tended to be required for each company.

In recent years, therefore, the concept of “New Public,” through which they insist that public services should be provided by not only the government agencies

Y. Takaura (✉)

Associate Professor, Business Administration, Graduate School of Economics and Management, Tohoku University, Sendai, Miyagi, Japan
e-mail: takaura.yasunari2014@gmail.com

but also by multi-stakeholders (which consist of other actors such as nonprofit organizations, companies and citizens), has been politically proposed. Due to this policy and eager to contribute to society, a number of companies worked cooperatively with nonprofit organizations. Since the Great East Japan Earthquake of March 2011, the contribution of domestic enterprises to the reconstruction process has been particularly remarkable. In other words, the power of multiple-sector collaboration has been useful in various scenes.

Social capital plays an important role in the mutual cooperation and unity of the people in the areas affected by the earthquake. According to Putnam (1993), the network of trust and norms revitalize the concerted action of people, enhance the efficiency of society and highlight the importance of social characteristics. Nishide (2004) stated that nonprofit organizations are responsible for creating social capital in the community; weakening legacy and individualistic lifestyle; and deepening the solidarity, bond, and trust among people.

By building relationships between organizations and fixing the support system around nonprofit organizations, companies can take the public responsibility of deepening the solidarity and ties within the region. In the disaster of the unprecedented Great East Japan Earthquake that had severe impacts on the continuity of businesses, this relationship assumed the lead role in solidifying the basic business environment. In cooperation with nonprofit organizations, many companies were involved in the rebuilding of community life and social infrastructure.

In this chapter,¹ I would look at the background of collaboration between nonprofit organizations and companies in Japan and the US, respectively. After reviewing the basic type of collaboration from a theoretical perspective, I would investigate how Japanese companies could participate in the “New Public,” which was mainly dominated by nonprofit organizations; then, based on survey data related to the collaboration between nonprofit organizations and companies in disaster relief, I would also look at how these companies might play a unique role.

4.2 The Emerging of Cooperation with Nonprofit Organizations in the Corporate World of Japan and the United States

Unlike private companies that pursue profit and government agencies that provide public services, nonprofit organizations are voluntary organizations formed by the volunteerism of people in the community. To be categorized as a nonprofit, an organization should not be profit-oriented, should operate autonomously, and should work actively for the public’s interests (Salamon 1997).

¹ Section 4.2 was cited from Takaura (2006) (with some additions and alterations) and Sect. 4.3 was from and with Takaura (2007).

Since Drucker published his book, ‘Managing the Nonprofit Organization,’ in 1990, the nonprofit as a civil sector has been drawing attention in the field of business administration. According to Drucker (1990), mission is important in the management of a nonprofit. To this end, he said that marketing strategy, human resource development, and performance measurement are required (Drucker 1990).

In the US, nonprofit organizations face a crisis as government subsidies are reduced significantly due to changes in welfare policy. In addition to charitable donations, nonprofit organizations began to focus on business development to survive. They began to partner with companies to solve problems in their communities.

In Japan, long after WWII, employment relationships, personnel evaluation systems, and strong commitment to corporate organization were formed. Due to these developments, enterprise systems performed very well economically and became lean organizations involved in society (Tanimoto 2002). Being incorporated into the socio-economic system spared companies from reduction or decline. The Japanese society is based on family, neighbor, and community relationships; thus, it is traditionally indifferent to the challenges of the public. Citizenship was not emphasized in the Japanese society.

However, interest in volunteer activities increased following the Great Hanshin-Awaji Earthquake in 1995, which exacerbated employment problems brought about by the collapse of the economic bubble in the early 1990s. People reconsidered the meaning of work and their relationships with companies. A movement of citizens spread, which was committed to solving diverse individual and community issues brought about by financial challenges. The values, norms, and structure of the enterprise system changed. Specifically, the validity of the closed structure of the enterprise system began to be questioned (Tanimoto 2002).

A company could not disregard the rise of the voluntary and the citizen sectors within Japanese society and therefore it was required for each company to reconstruct their relationship with the stakeholders surrounding them beyond economic interests.

Since the 2000s, Japanese companies have been asked to take CSR (Corporate Social Responsibility) as the global standard from Western markets and others. As a result, collaboration between companies and nonprofit organizations developed for the purpose of contributing to the community. A number of projects have been carried out to solve problems in local and international communities such as the development of rescue tents for refugees by Teijin and Peace Winds Japan, charity cards created by Mitsui Sumitomo Insurance and the KIDS EARTH FUND, and the “nonprofit Entrepreneurship School” by NEC and the ETIC support for youth ventures (Partnership Support Center 2003).

As a result, the number of collaborations accumulated. In such collaboration projects, companies, often beyond charity as mere monetary contribution to nonprofit organizations, offer core management resources such as technological tie-up, supply of talented-people and know-how, or practical use of organizational network. Several projects have been deployed to exploit the uniqueness of each company.

4.3 The Types of Collaboration Between Companies and Nonprofit Organizations

ISO26000 series, the standard guidelines on social responsibility of organizations that were issued in November 2010, encourage organizations to create mechanisms of stakeholder engagement to explore and solve business issues through cooperation and dialogue with stakeholders involved in the organization. From the point of view of social responsibility and the impact of enterprises on civil society, it is an important business ethic to build good partnerships with various civil society organizations like NGOs, charities, community groups, religious organizations, and trade unions (Crane and Matten 2004).

Being allies with civil society organizations, i.e., nonprofit organizations in the broad sense that are highly able to solve problems at the local or global society, will improve the quality and quantity of CSR more than ever. While every company is expected to develop relationships with stakeholders in order to build sustainable societies, nonprofit organizations (as gatekeepers of civil society that mediates information) may be the most effective partners.

According to the pyramid model of CSR (Carroll 1991; Saito 2000), which was constructed from the normative point of view about the relationship of society and business, a company can evolve from the first stage, that is, economic responsibility by providing expected economic services to the next level, that is, legal responsibility to comply with laws and regulations, to ethical responsibility by doing business that meets the social norms, and then to philanthropic responsibility by being actively involved in the solving of social problems as good corporate citizens. In the final social responsibility level, companies and nonprofit organizations are oriented in the pursuit of common profits as both have the same set of values. This cooperation is meant to strategically realize Win–Win relationships.

Now, how can this Win–Win relationship be developed? According to Austin (2000), the collaboration of nonprofit organizations and companies often has the following three-stage pattern (Partnership Support Center 2003). As the collaboration reaches the later stage, the relationship becomes close and deep and thus the stage of partnership based on equality (Table 4.1).

(1) Philanthropic type; (2) Transaction type; (3) Integration type.

However, Austin did not say that all collaboration patterns should lead to the integration type. It is important to develop various collaborative projects taking advantage of each type as outlined below.

4.3.1 Collaboration with Nonprofits: Philanthropic

It is often noted that the philanthropic type is a one-way relationship from companies to nonprofit organizations, such as monetary and material contribution to nonprofits, sending employee volunteers, and lending business offices at low rates.

Table 4.1 Types of collaboration of companies and nonprofits

	Philanthropic	Transactional	Integrative
Collaboration mindset	<ul style="list-style-type: none"> • Gratefulness and charity syndromes 	<ul style="list-style-type: none"> • Partnering mindset • Increased understanding and trust 	<ul style="list-style-type: none"> • “We” mentality replaces “versus them”
Strategic alignment	<ul style="list-style-type: none"> • Minimal fit required, beyond a shared interest in a particular issue/area 	<ul style="list-style-type: none"> • Overlap in mission and values 	<ul style="list-style-type: none"> • Relationship as strategic tool • High “mission mesh” • Shared values
Collaboration value	<ul style="list-style-type: none"> • Generic resource transfer • Typically unequal exchange of resources 	<ul style="list-style-type: none"> • Core competency transfer • More equal exchange of resources 	<ul style="list-style-type: none"> • Joint value creation • Need for value renewal
Relationship management	<ul style="list-style-type: none"> • Corporate contact usually in community affairs or foundations; nonprofit contact usually in development • Minimal personal connection to a cause • Project progress typically communicated via a paper status report 	<ul style="list-style-type: none"> • Expanded personal relationships throughout the organization • Strong personal connection at leadership level • Emerging infrastructure, including relationship managers, communication channels/vehicles 	<ul style="list-style-type: none"> • Expanded opportunities for direct employee involvement in relationships • Deep personal relationship across organization • Culture of each organization influenced by the other • Partner Relationship Managers • Explicit internal and external communication strategies and processes
Collaboration definition and performance	<ul style="list-style-type: none"> • Minimal collaboration in defining activities • Foundation guidelines often determine types of projects or corporations respond to specific requests from nonprofit organizations • Minimal performance expectations 	<ul style="list-style-type: none"> • Shared visioning at top of organization • Projects of limited scope and risk that demonstrate success • Explicit performance expectations • Informal learning 	<ul style="list-style-type: none"> • Projects identified and developed at all levels within the organization, with leadership support • Broad scope of activities of strategic significance • Organizational integration in execution, including shared resources • Incentive systems encourage partnerships • Active learning process • High mutual expectations and accountability

Source: J. Austin (2000, 2001)

Companies intend to make good relations with the community through local contributions specifically by supporting nonprofit organizations. The Boston Community College, which provides consulting services to local companies on how to contribute to the community, explains the meaning of creating relationships, as they rely on the social contract concept of LTO (license to operate) wherein contributions are assigned to the company by the community.

An example of a company engaged in charity collaboration is Marbins, a leading department store which has 260 stores in 14 states in the U.S. The company carried out the “Community Closet” program which supports homeless women’s social rehabilitation since 1998 (Saito 2000). With trailers visiting everywhere, this program provides free clothing for the homeless or for women who rely on social welfare but are actively seeking for jobs.

While local supporting groups are in charge of coordination, Marbins also provide great contribution as employee volunteers or professional advisers support the selection of dresses and fashion makeup, among others.

4.3.2 Collaboration with Nonprofit Organizations: Transactional

Under the transactional type, companies and nonprofit organizations mutually exchange management resources and seek a more direct Win–Win relationship. Companies and nonprofit organizations act on their specific missions, and cooperate on common interest.

This sort of collaboration is typically shown in cases such as joint product development. For example, since 2004, TOSTEM, the housing materials manufacturer, developed universal design goods jointly with a nonprofit organization, the Universal Design Citizen Network. In the case of the development of automatic front doors for homes, the nonprofit organization joined in product development from the trial production stage where they recruited mothers who held infants, wheel chaired users, or cerebral infarction patients to cooperate as participants with their individual check lists. The high capability of the nonprofit organization for marketing research had been utilized. As members of the development department of TOSTEM could hear their customers’ voices directly, they were able to create a concrete index that consequently improved their product development (Partnership Support Center 2006).

4.3.3 Collaboration with Nonprofit: Integrative

In the integrative type, nonprofit organizations and companies would collaboratively provide management resources and be integrated in a social business; at this

stage, their level of sharing values is already deep. For the companies, it is possible to contribute deeply to solve social problems, and for the nonprofit organizations, they can achieve the mission at higher levels.

The project on which the overseas transportation network of the Nippon Yusen Kaisha (NYK) Line played an important role can be categorized as an integrative type because the company aimed at solving global and local social problems by collaborating with a nonprofit organization. NYK has since 2000 contributed to the medical support project by the reproduced bicycle in developing countries with no fee. This is a grand plan to help local medical workers in the developing countries of Asia and Africa by shipping abandoned bicycles you see in front of the local train station. They worked on the project with government agencies that had problems with abandoned bicycles near stations and JOICEF, which had expert knowledge on medical support in developing countries, and shipped used bicycles overseas free of charge to support the medical visits of nurses and midwives to the local communities. They were able to donate 13,000 units in 55 countries in 6 years to 2006 (Partnership Support Center 2006).

4.4 Development of Nonprofit Activities and Collaboration After the Earthquake Disaster

We wish to know whether the cooperation between nonprofit organizations and companies contributed to disaster relief after the Great East Japan Earthquake. For example, the book wagon project of Toppan Printing, which was characterized as a unique collaboration case for disaster relief, was created by a variety of inter-sectional cooperation.

This project aimed to provide a “place where people can interact through books,” as a mobile library was placed in temporary residential areas of Sendai city from July 2011 to March 2012, and from June to December 2012. The company has collected a library of about 4,000 books, including donations from employees and business publishers, before they started. They consigned the organizing of books to welfare organizations; at the same time, they requested for the cooperation of a local company that had dealt with the consultations with social entrepreneurs. They also cooperated with a nonprofit organization that is experienced in managing children’s houses to manage child care support in the city as employee volunteers of Toppan participated weekly. In the salon of the cyclic activity destination, Starbucks also cooperated by providing coffee. Company officials are seeking long-term disaster relief while they continue to create partnerships, especially with nonprofit organizations. This project could be identified as the successful ‘New Public’ one with various stakeholders and employees, business partners, social venture, nonprofit and welfare organizations involved.

In the following section, we strive to grasp macro trends from the perspective of specific community support activities of nonprofit organizations and social

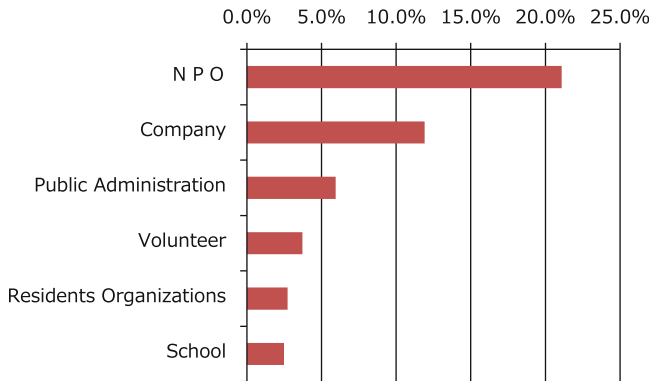


Fig. 4.1 Collaboration partners of nonprofit organizations (n = 403)

contribution activities of large companies, how often and in which field, and to what extent nonprofit organizations and companies had been eager to cooperate and team up as partners.

First of all, we look at the perspective of the non-profit sector, which has been assisting in the community. Our study² on nonprofit organizations working on disaster relief a year after the earthquake from the article database of the biggest local newspaper in Sendai, Kahoku-Shinpo, showed various cross sectional collaborations between nonprofit organizations with other non-profit organizations, companies, government, schools, or residents' organizations.

You can most often see the collaboration between nonprofit organizations (Fig. 4.1). The ratio was a little more than 20 % (21.1 %). Nonprofit organizations cooperated within and without the disaster area and constructed a network so that they employed each other's special skills such as offering goods in a disaster area, or offering psychological help, establishing and managing a child care institution, and corporate planning of an event. Subsequently, the collaboration with companies was about 10 % (11.9 %) and exceeded the number of collaboration with administration (6.0 %).

In these cooperation projects, companies typically provided nonprofit organizations with their specific resources and know-how. For example, a medical equipment sales company donated a doctor's car, an industrial rubber company provided a tennis court for the makeshift housing complexes, an educational materials

²This research was conducted by Yasunari Takaura with whom Yasuyuki Yokota and Katsunori Sato cooperated. On the electronic articles database "KD," which was constructed by the most influential local newspaper Kahoku-Shinpo, we chose related articles through the search terms, "earthquake disaster" and "nonprofit" within the period of March 12, 2011 to March 11, 2012. From this search, we identified all the 348 cases. Then, we scrutinized the items from the point of the view of what happened and when, where, by who, to where, for whom, with whom it was done, while we as much as possible complemented lacking information with the contents from the Web page of each organization. Please refer to Takaura (2012) for details.

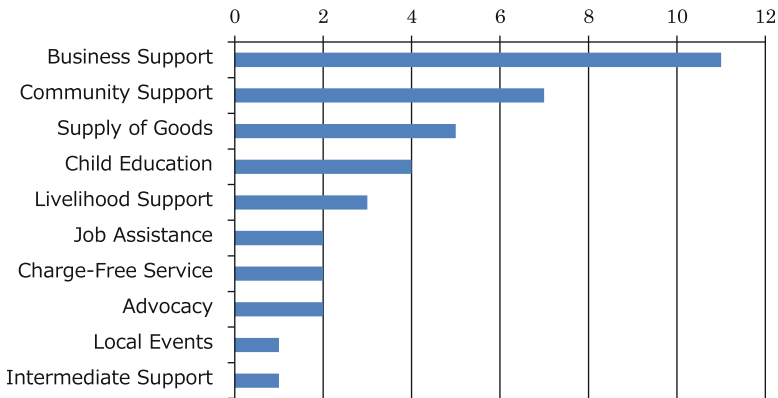


Fig. 4.2 Activity fields of nonprofit organizations in terms of their collaboration with companies ($n=38$). Definitions of each category are as follows. Supply of Goods: serving food, offering medical supplies, and others; Charge-Free Service: volunteer service such as telephone consultation for psychological support of the affected, or washing muddy photographs damaged by the tsunami; Child Education: activities which can support the stability and development of children’s sentiments, mind, or body through field experience, art workshops, and others; Aid for Childcare: activities which can socially support child-rearing, such as giving aid-for-childcare information for refugees and issuing the handbook on disaster prevention for parents and children; Community Support: activities which can build the community and deepen the bonds between residents in shelters or makeshift houses such as holding an athletic festival for residents and a revival market in the community; Livelihood Support: measures which improve and reconstruct the living environments of disaster victims such as home visits for those who live in makeshift houses or distribution of mobile devices for the hearing-impaired; Job Assistance: measures which aid in the employment of those who suffered and lost their jobs such as offering lectures for qualification acquisition or using the emergency-employment subsidies to employ them; Business Support: activities that support business resumption of entrepreneurs such as installation of temporary shopping centers or cooperation in terms of product sales; Advocacy: appealing for the protection of rights of women in shelters or proposing revival policies; Intermediate Support: indirect support such as financing other supporting groups or providing helpful information

company offered free study support to affected children, and others. Alternatively, a company built a disaster relief house and entrusted the management to a local nonprofit organization for lasting support service. Moreover, some local Shinkin banks (credit unions) used the money raised by an NGO through donations to start a tie-up project with the goal of reviving the local economy.

When analyzing the activities of nonprofit organizations such as collaboration with companies, most of these activities are related to business support, community support, supply of goods, or child education (Fig. 4.2). Most cooperation with companies were in the field of business support such as raising support funds for the disaster areas, execution of projects to revitalize farmlands that were damaged by salt water, and support for the sales of goods as local job assistance for the disabled.

While the tendency of nonprofit organizations towards business support is by no means higher compared to their tendency towards community support, it resulted to

an increase in business support cases when you selected nonprofit organizations that collaborated with companies. This suggests that creating partnerships with companies is more effective than a nonprofit sector solely doing economic support that intends to revitalize business activities in the disaster area. A company may be expected to put in management resources in order to provide long-term support for the revival of a disaster area.

4.5 Disaster Relief Activities of Companies in Collaboration with Nonprofit Organizations

Hence, did the disaster relief activities of companies focus on support to and collaboration with nonprofit organizations? In this section, we will discuss from the point of view of the corporate sector.

First, 225 companies from the Nikkei average were chosen as a representative sample of large companies. From the results of the database study³ based on related press releases and CSR reports of each company, we will investigate to what extent they supported activities after the Great East Japan Earthquake.

Among the variety of organizations that received contributions or goods were local governments such as disaster prefectures, cities, towns and villages, schools, hospitals, and the Red Cross (Fig. 4.3). Japanese company funds flowed intensively to the Red Cross and the Central Community Chest of Japan, so that they received up to 50 % of all these funds (Fig. 4.4). On the other hand, the donation and supply of goods to grass-roots nonprofit organizations that practically support disaster areas were also found prominent. If you combine these direct support to nonprofits and indirect support through intermediated agencies, such as the Japan Platform or the Japan Nonprofit Center (the percentage of company contribution to these intermediated agencies are now more than the percentage of company contribution to individual nonprofit organizations), nonprofit organizations comprised 1/5 of all

³ This research was done with the cooperation of Katsunori Sato, Masakazu Horikoshi, Yasuyuki Yokota, and Du Yi Jing in my laboratory. The research procedure is as follows. From the 225 national corporations which constituted the Nikkei stock average index, we extracted information about their philanthropic activities related to the Great East Japan Earthquake disaster on their CSR reports, which were mostly issued for the fiscal year of 2011, or related press releases that were published in their websites until April 2012. Here, general business support activities for business continuity management (BCM), like dispatch of aid staff to branch offices in the disaster area, establishment of task force, enhanced correspondence with customers, power saving or paid work for the revival of affected businesses were removed from philanthropic activities. However, we included the startup of very socially-relevant innovations, such as the foundation of a revival fund, in the analysis. We removed overlaps from the same project held in another place or done in another time. We then classified the data based on the contents of the activity and then coded the data from the viewpoint of support form, support field, purpose, supported sector, collaboration pattern, and others. Then, we created the database which consists of all 880 examples.

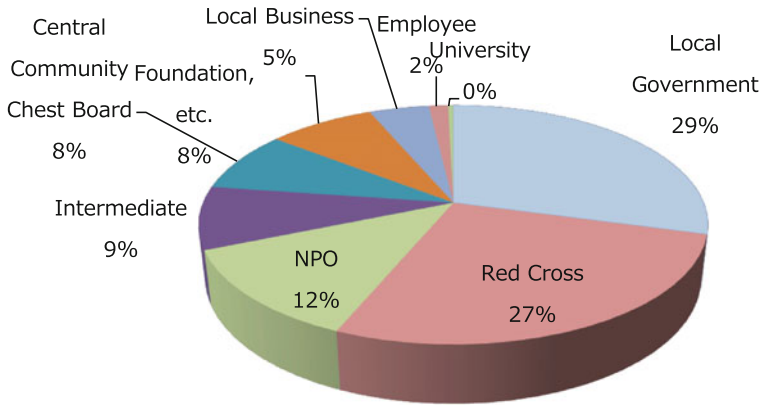


Fig. 4.3 Sectors Japanese companies supported (n = 483)

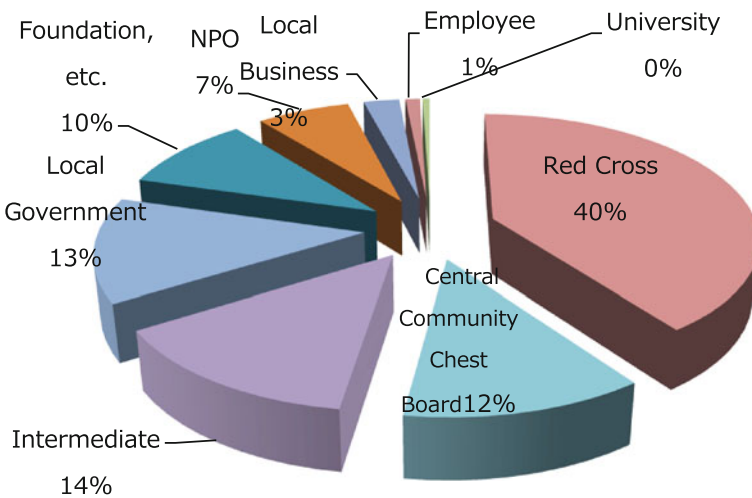


Fig. 4.4 Recipients of donations by Japanese companies (n = 195)

supported organizations and showed more presence than the local governments or the Red Cross.

Although nonprofit organizations were often chosen as the supported organization, to what extent were Japanese companies involved in collaboration in a narrow sense with nonprofit organizations? Although only a few cases of collaboration (with the exception of one-way contributions) were found, the collaboration with nonprofit organizations was presumed to spread as much as the cooperation of companies with local governments or other companies (Fig. 4.5).

The following were the most common form of support services that companies provided: supply of goods, employee volunteers, charity cooperation, and others (Fig. 4.6). Some companies formed an alliance with nonprofit organizations by

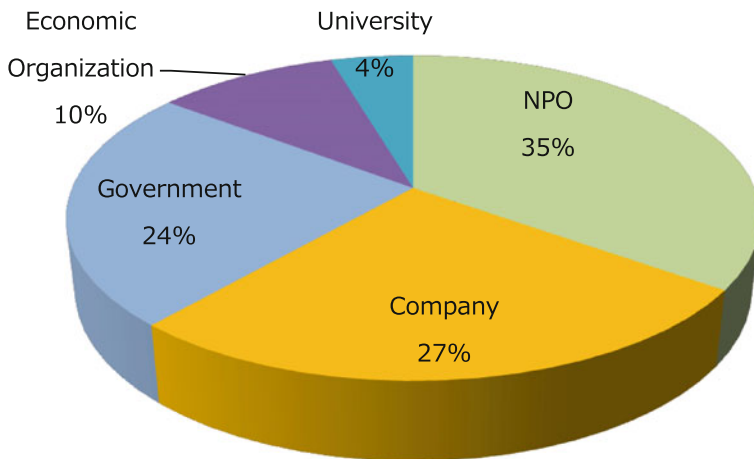


Fig. 4.5 Collaboration partners of companies (n = 109)

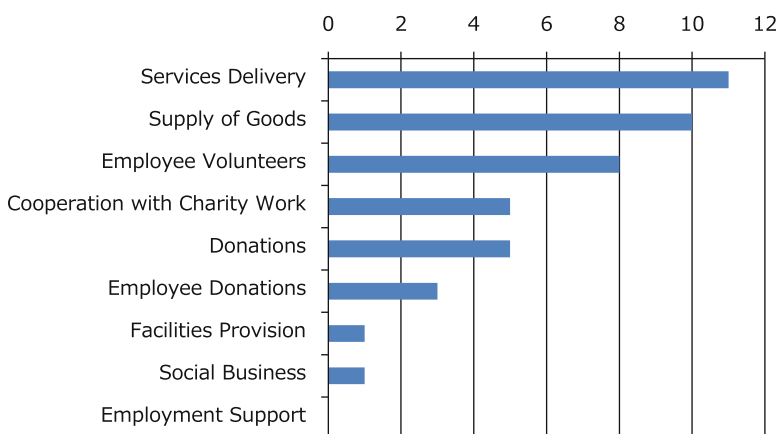


Fig. 4.6 Support provided by companies when collaboration partners are nonprofit organizations (n = 44). Further explanation of each category is as follows. Services Delivery: corporate measures of providing human, facilities, and information resources like dispatch of relief, talented people, cargo shipment, installation of communication facility in the shelter, sales service for makeshift houses, exemption from interests and special insurance agreements for disaster victims, instructions on the use of a certain washing technology for photograph restoration, holding an in-company product exhibition, and others; Supply of Goods: donation of life articles such as drinking water and food or industrial equipment, and others; Employee Volunteers: recruiting volunteers from employees and officers, foundation of a volunteer leave system, and others; Cooperation with Charity Work: contribution support measures involving customers and suppliers such as the installation of charity boxes in front of company shops and the donation of a small part of the sales along with campaigns to assist in the reconstruction of the affected area; Donations: offering relief money directly to the disaster victims and the provision of support money for reconstruction assistance, among others; Employee Donations: soliciting contribution from officers or current/retired employees, and the company matching the total contribution; Facilities Provision: opening a recreation institution or a company office for the affected and offering free rent by transforming a landed property into an area for makeshift houses; Social Business: commercialization of support services such as the provision of revival funds, creating a plan for volunteer bus tours, and routine selling of recycled household appliances in the disaster area; and Employment Support: employment of disaster victims and training them

providing copiers and maintenance services for the printing needs of individuals from the temporary housing areas, delivery mediation of emergency relief supplies, employee volunteer dispatch as local nonprofit organizations mediated, or construction of donation sites for the nonprofit organizations. In turn, some nonprofit organizations were also involved in the financial support activities of companies such that these nonprofit organizations became fund advisors to the companies in the latter’s quest to aid other nonprofit and community organizations.

Overall, a lot of nonprofit organizations familiar with local needs may be expected to provide the network and use their coordination capabilities and business management know-how. This tendency towards a cooperative relationship may lead to the movement from a mere philanthropic type to a transactional type where management resources can be exchanged between organizations. It remains to be seen how much cooperative relationships for disaster relief will evolve in the future.

4.6 Conclusion

In this chapter, we recognized that Japanese companies can create a “New Public” by cooperating with nonprofit organizations and by contributing to the non-profit sector with reference to their support activities after the Great East Japan Earthquake. Currently, Japanese companies are asked to contribute to restoring and reconstructing disaster areas. There is a need for companies to play an active role in sharing the knowledge and human resources that they have developed in their core business to keep providing the affected community with their wisdom and solutions, in cooperation with nonprofit organizations who share their vision of humanity and social change.

Regarding the social role of corporations, Drucker in the 1970’s pointed out the need for social responsibility management when big businesses in the US became prosperous. He insisted that companies should not only minimize the negative societal impact of their business activities but also to “turn solving the problems of society to business opportunities” (Drucker 1973). By reaching out actively to its business environment, companies can create business opportunities and at the same time enhance the societal value of their activities.

Recently, Porter et al. called corporate activities that aim for the coexistence of economic merit and social value as activities with CSV (Creating Shared Value). Examples of such activities include the maintenance of society’s infrastructure, construction support for the supply chain, and the creation of social businesses by multinational companies. They defined CSV as a new social responsibility domain (Porter and Kramer 2011).

While a US-type market principle progresses, companies are expected to perform CSV activities in proportion to their power and influence, and to contribute to the solution of a social problem. Hence, companies should move towards regarding nonprofit organizations as integration partners in creating a common value that profits both the local/global society and the company.

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Chapter 5

Formation of the New Japanese Style Management Strategy

Yoshinobu Sato and Mark E. Parry

Abstract The authors discuss the linkages between characteristics of the Japanese management style and the poor performance of many Japanese companies since the mid-1990s. The authors argue that some characteristics of the Japanese management style are ill-suited to the demands of the global and information economy. To support this argument, the authors analyze key Japanese management practices from four perspectives, the high-context culture, explorative versus exploitative product development, the experiential learning model, and the market sensing component of strategic flexibility. The authors close with suggestions for possible ways for the Japanese company to draft a new Japanese-style management strategy.

Keywords “Boiled-Frog” syndrome • Experiential learning • Exploration and exploitation • High/low-context culture • Japanese style management • Strategic flexibility

5.1 The Lost 20 Years in Japanese Style Management

The global success of many Japanese companies in the 1970s and 1980s prompted worldwide praise of Japanese-style management. Many articles and books were written identifying important characteristics of this style and discussing the implications of these characteristics for management in western countries. However, the world’s interest in Japanese management faded rapidly with the fall of the Japanese economy in the 1990s. In Japan, the two decades since this fall are often referred to as the “Lost 20 Years.” Japanese studies of this period have attributed the recent

Y. Sato (✉)

Professor, Marketing, Institute of Business and Accounting, Kwansai Gakuin University,
Nishinomiya, Hyogo, Japan
e-mail: cit02137@kwansai.ac.jp

M.E. Parry

Ewing Marion Kauffman/Missouri Endowed Chair, Entrepreneurial Leadership,
Kansas City, Missouri, USA

Professor, Marketing, Henry W. Bloch School of Management,
University of Missouri-Kansas City, Kansas City, Missouri, USA
e-mail: ParryM@UMKC.edu

struggles of many Japanese firms to various characteristics of the Japanese management system. One argument that has received particular attention in the last few years is the contention that Japanese companies have an obsession with quality that is not valued by global customers, resulting in a “surplus quality” problem that is only attractive to Japanese consumers. This phenomenon is sometimes referred to as the “Galapagos-ization” of Japanese products.¹

In this chapter, we discuss several theoretical perspectives that provide insight into the ways in which the problems currently faced by many Japanese companies can be linked to the thought processes and learning characteristics of the Japanese business people. In the following sections we discuss relevant insights from analyses of national cultures, models of individual learning styles, and strategic frameworks involving exploration, exploitation, and strategic flexibility. We illustrate the relevance of these models and frameworks to Japanese firms by presenting the experiences and insights of Japanese business experts who have observed the struggles of Japanese companies in foreign markets. We close with a series of recommendations for Japanese companies as they work to create a new style of Japanese management.

5.2 The High-Context Culture

One stream of research that provides insight into the challenges faced by Japanese firms examines aspects of Japanese culture. One relevant framework arises from Edward. H. Hall’s discussion of high-context and low-context cultures. This distinction has been widely used by academics in the study of communications in eastern and western cultures. As explained by Hall:

A high-context (HC) communication or message is one in which most of the information is either in the physical context or internalized in the person, while very little is in the coded, explicit, transmitted part of the message. A low-context (LC) communication is just the opposite; i.e., the mass of the information is vested in the explicit code (1976, p. 79).

According to Hall, shared context lessens the need for verbal communication. In a high context culture people obtain a lot of information from the environmental and situation environments surrounding a conversation (the so-called “air in the situation”), and this non-verbal information lessens the amount of information that must be communicated verbally.

Cardon identified a number of additional distinctions between high-context and low-context cultures:

In HC cultures, information is widely shared and thus requires extensive cultural programming whereas in LC cultures, information is less widely shared and thus requires less cultural programming. HC cultures emphasize stability whereas LC cultures emphasize

¹ With regard to recent articles about Japanese-style management, see for example Fukui (2013) and Markus (2009).

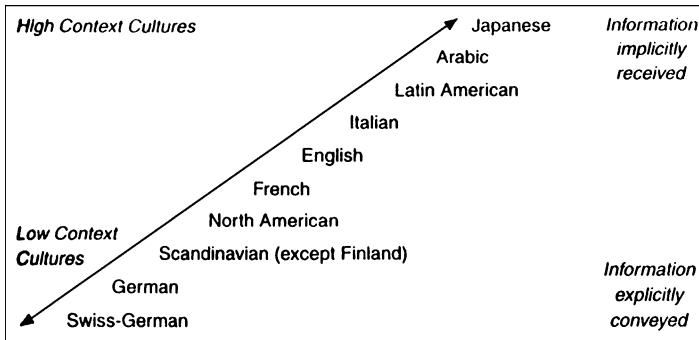


Fig. 5.1 Depiction of Cultures along a Continuum from Low-Context to High-Context. Source: Katan 1999

change and mobility. In HC cultures, providing too much information is considered talking down to others, whereas in LC cultures, doing so is considered being thorough. In HC cultures, communication is an art form that is unifying and cohesive and thus displays sophistication, nuance, and cultural identity. In LC cultures, communication is primarily task oriented. HC cultures appreciate slow, indirect messages whereas LC cultures insist on fast, direct messages. HC cultures extensively use informal information networks whereas LC cultures prefer formal information networks. HC cultures interpret laws with personal involvement and thus bend rules to accommodate relationships whereas LC cultures interpret laws impersonally and thus maintain strict adherence to rules. Fundamentally, HC cultures tend to employ more holistic thinking whereas LC cultures tend to employ more linear thinking (Cardon 2008, p. 401).

Building on Hall's research, Katan (1999) used Hall's insights to array countries along a continuum from low-context to high-context cultures. As depicted in Fig. 5.1, Japan was identified as the purest example of a high-context culture.

As one might expect, the characteristics of the planning and implementation systems traditionally associated with Japanese style management reflect in part the very cultural characteristics that lead scholars to classify Japan as a high-context culture. These characteristics include long-term planning horizons, participative management, trust and interdependence, and an emphasis on teamwork and cooperation (Keys and Miller 1984). At the same time, recent commentators have suggested that some of these high-context culture characteristics also have negative aspects that can be tied directly to the difficulties many Japanese companies have experienced in turbulent global environments. These negative aspects manifest themselves in planning and implementation systems that are not designed for rapid responses to significant, unexpected environmental changes.

For example, in low-context cultures, providing a lot of information is "considered being thorough" (Cardon 2008). Thus an effective manager presenting the business case for a new idea to senior managers will assemble facts and build a logical argument to support his or her recommendations. In contrast, people from high-context cultures believe that "providing too much information is considered talking down to others." What information is likely to be omitted? According to

Hall's theory, the information that is omitted will be information that is widely-shared (or perceived to be widely-shared). The potential danger of such omissions is that planning and implementation decisions may focus on evaluations based on shared information that has not been articulated as part of the decision process.

The omission of shared information may well be efficient when the business environment is stable, but it can be dysfunctional when environmental conditions changes in ways that make some shared information out-of-date and no longer relevant to the current decision context. In particular, managers may reject options because those options are "not the Japanese way" or are "not the way our company does business." The problem with such statements is that they are often based on shared information about the way in which Japanese companies in general, or a manager's companies in particular, do business. A key part of this shared information involves perceptions of environmental conditions. When those environmental conditions change, the appropriateness of strategies designed for the earlier environment may lose effectiveness. For this reason, it becomes necessary to articulate the facts and analyses that will permit executives to determine whether the traditional ways of doing business are still relevant or whether it is necessary to develop new strategies appropriate for the changed environmental conditions.

According to Kouichirou Yoshikoshi, many Japanese companies have responded poorly to changing environmental conditions because Japanese managers often make decisions about strategy options without first reviewing the relevant data and using that data to build logical arguments to support strategic and tactical decisions. Mr. Yoshikoshi is the executive responsible for the dramatic improvement in the performance of Triumph International Japan. In 2005 Yoshikoshi observed that "If the Japanese develop the habit of thinking logically about everything, they will be able to do more things well." He continued:

Japanese people tend to react to new things by expressing a judgment. When I ask a person who says "I dislike this" why he or she dislikes it, then he and/or she is going to think logically. It is better to think logically from the start and then evaluate. This is a different kind of thought process. For example, when Japanese people consider a problem involving the appropriate size of a product, they usually say something like "The existing size is good because it is small and pretty." Rather than responding in this way, we have to begin the conversation logically and objectively. For example, we might say: "This size is good because we can easily operate it with one hand" (Yoshikoshi 2005, pp. 116–118).

Yoshikoshi traces these problems to the Japanese education system:

To change the custom of evaluating things based on feelings to evaluating things based on logic, we need training to be logical. Because this training requires repetition, students should learn to think logically in schools. But Japanese schools don't provide this kind of education (Yoshikoshi 2005, pp. 116–118).

In part, the failure of Japanese schools to provide critical thinking skills may reflect the importance of seniority and deference to authority in Japanese culture (Chie Nakane 1967; Hofstede and Hofstede 1996). In education, students are trained to look to the teacher for answers. Kozo Tajima, vice-chairperson of Japan Football Association, has argued that this training impairs the ability of students to analyze situations, evaluate options, and communicate their analysis

to others. Tajima used his experience as a soccer coach to illustrate the importance of logical analysis.

Soccer is a sport without a single correct answer; instead, you can choose from among several options. When you receive the ball, you may dribble it or pass it. You determine by yourself where to kick the ball and how to kick it. And this does not happen only when you have the ball. You don't have the ball for more than two or three minutes during a 90 minute game. You spend more time without the ball and you have to decide what to do several thousand times, or tens of thousands times, in a single game.

It is important to see the situation, think about it, evaluate, and play. Eventually I understood the importance of this approach. Simply put, it is the ability to “logically evaluate and play.” I thought the secret to develop this ability might be the development of communication skills (Tajima 2012, p. 43).

Communication skills are only useful when those skills are used to convey situation-relevant content. In an entrepreneurship context, Robert Baron (2006, p. 106) has talked about the importance of recognizing the patterns or *gestalts* associated with entrepreneurial opportunities:

Pattern recognition is the process through which specific persons perceive complex and seemingly unrelated events as constituting identifiable patterns. In essence, it involves recognition of links between apparently unrelated trends, changes, and events—links suggestive of patterns connecting them together. The patterns suggested by these links or connections then become figures instead of undifferentiated (and often overlooked) ground. In essence, then, pattern recognition, as applied to opportunity recognition, involves instances in which specific individuals “connect the dots”—perceive links between seemingly unrelated events and changes. The patterns they perceive then become the basis for identifying new business opportunities.

In a similar way, Tajima talks about the importance of pattern recognition in assessing opportunities on the soccer field:

. . . with enough training in the logical analysis of situations, you may reach a point where you can understand situations instantly and assess them properly even when playing soccer. In addition, even when you fail, as a player who reflects on his actions, you can think about a different approach next time. However, the player who does not reflect and only does what he is told cannot make any improvement on his own (Tajima 2012, p. 43).

Tajima tested this philosophy in Germany and Japan. As he explained:

I went to Germany in 1983 and studied for 2 and a half years to become a coach. Coaches often interrupt a practice game to discuss a play. For example, they might ask “why did you pass the ball there?” German children immediately responded with statements like “Peter runs fast, so I passed the ball to that part of the field because I thought Peter could reach it.” However, when I stopped a game in Japan and asked Japanese children why they did something, they didn't say anything. They only watched my face, because they were waiting for me to tell them the answer (Tajima 2012, p. 43).

Tajima had a similar experience after he was invited to work with J League, the professional soccer league formed in Japan in 1993:

J League began with ten teams, and there were eight Japanese managers. Two years later the number of teams had expanded to 14, but the number of Japanese managers had fallen to four. The managers who resigned gave various reasons for their resignations, but their

explanations all had one thing in common. In those days there were a lot of foreign celebrity players such as Zico and Lineker who asked many questions such as “Why did you replace that player at that point in the game?” and “What is your goal for this exercise?” The Japanese managers who left J League did not know how to respond to these questions. They were just like the Japanese children who couldn’t answer me when I asked them “Why did you kick the ball there?”

J League was preceded by a league consisting of company soccer teams. Because the manager, coach, and players were like a boss, supervisor, and subordinates, there were no players who asked these kinds of questions. As a result, no manager had to answer a player who asked “Why did you replace that player?” The foreign players in J League thought that the Japanese managers and coaches were poor, because they could not answer the players’ questions. Though the players never said this, but the manager and coach understood how the players felt. Feeling uncomfortable, the managers resigned (Tajima 2012, p. 43).

From these experiences, Tajima concluded that the ability to communicate the rationale for one’s actions was critical. However, this is difficult in a culture where the importance of understanding without verbal communication is highly valued. As Tajima explained:

...when I call my house and my child answers the phone, I ask my child “Where is your mama?” Without any further conversation, the child’s mother comes to the phone. This behavior is a reflection of the Japanese cultural expectation regarding the importance of “reading somebody’s thoughts.” However, given the nature of communication in Europe and America, it isn’t possible to communicate well if you ask “Where is your mama?” instead of saying “I’d like to speak with your mama.”

When you go abroad, you rarely see conversation that requires the ability to read somebody’s thoughts. I think the importance of clear communication is important, not only for soccer, but also to work in the world (Tajima 2012, p. 45).

The analyses of Yoshikoshi and Tajima both attribute the current problems of many Japanese companies to cultural characteristics that influence the amount of information that is verbally communicated during the decision-making process. However, their comments also highlight potential problems arising from the ways in which people learn. We will explore this topic in the next Section.

5.3 Exploration, Exploitation, and the Experiential Learning Model

In a seminal paper on organizational learning, March (1991) distinguished between exploration and exploitation. According to March (1991, p. 71), exploration “includes things captured by terms such as search, variation, risk taking, experimentation, play, flexibility, discovery, innovation,” while exploitation “includes such things as refinement, choice, production, efficiency, selection, implementation, execution.” The distinction is important, because each type of learning requires different skills and abilities. March illustrates his argument by contrasting radical and incremental innovation (i.e., the “refinement of an existing technology

and invention of a new one”). As March explains, “It is clear that exploration of new alternatives reduces the speed with which skills at existing ones are improved. It is also clear that improvements in competence at existing procedures make experimentation with others less attractive” (March 1991, p. 72).

During the Japanese economic boom, Japanese firms were praised for their skills in incremental product and process innovation. For example, in a widely-cited study of Japanese new product development, Takeuchi and Nonaka (1986) studied six Japanese new product teams in six corporations. The authors attributed the success of these product teams to a new product development process that featured, self-organizing project teams, overlapping development phases, learning by doing, and the organizational transfer of learning. Importantly, each of the new products examined in this study were incremental innovations: two copiers, two cameras, a car, and a personal computer.

The Japanese approach to quality improvement was also widely influential. As popularized by Edward W. Deming, the PDCA process (Plan—Do—Check—Act/Adjust) involves the following steps: develop a plan for improvement, implement the plan, observe and analyze the results, and then develop a new plan for further improvement. Importantly, however, these steps all focused on incremental improvements in existing product processes.

Exploration in general and the development of radical innovations in particular, require a different type of learning process. While exploitation involves refining an existing business model, exploration involves the development of a new business model, one that changes the basis of competition among firms. Marketing consultant Hiroki Suzuki traces the current problems of Japanese companies to their inability to develop game-changing products and processes:

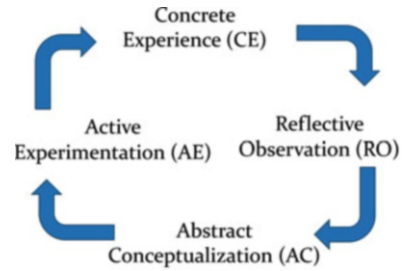
One important characteristic of the Japanese people is a belief in the importance of thorough training through constant repetition. During World War Two the Japanese military developed incredible skills in aerial dogfights and naval and aerial bombardment through difficult, specialized training that required superhuman effort. It is said that watchman acquired the ability to quickly find at night hostile craft located as far away as 8,000 meters. The mental discipline necessary for such training was based on the Bushido and samurai mindsets from earlier centuries. This approach was very effective in the early stages of the war.

In contrast, the U.S. forces adopted a new system that dispensed with superhuman training. Even a pilot with limited operational skills could survive based on the attributes of his plane and the tactics designed for that plane. For example, the U.S. military developed a missile that could shoot down enemy planes even when the missile’s accuracy was less than optimal. They developed radar that could find enemy craft even when night vision was poor. They developed many such devices, along with the tactics to use them. In other words they changed the rules of the game.

When the game changed, the key factors for victory also changed, and the skills which the Japanese had developed became obsolete. The Japanese belief in mastery through constant practice was undermined by this changing of the rules.

Samuel J. Palmisano, chairperson of IBM, preaches that “only the person who changes the rule of the game wins.” However, many Japanese companies have adopted the same rule of the game as the past Japanese military. One remarkable example are the Japanese products

Fig. 5.2 Kolb's
Experiential Learning
Model. *Source:* Kolb 1976



that now feature sophisticated functions developed through continuous improvement, but have lost market share because the de facto standard is monopolized by overseas companies. As a result, the Japanese companies have fallen victim to the Galapagos syndrome, which means an isolated state.

Considering this situation, I had a keen realization about a weakness in building business strategy of Japanese companies. What is their strategy? I define strategy as choosing an index or a weighted set of key success factors to pursue. For example, suppose that I randomly choose people walking around town to make them compete at sumo wrestling. If I then study the winners, I should be able to find certain common denominators. Here, I might conclude that “much weight” is an important key success factor. In other words, in the game called the sumo, the strategy to gain weight is a key factor for success.

Every game has key success factors which play an important role in strategy. An effective key success factor is one that benefits those who pursue it. Importantly, a specific set of key success factors does not maintain its effectiveness forever. For example, for a while TV manufacturers effectively pursued increases in the visual clarity of their screens. More recently, however, this tactic has been less successful in loosening the purse strings of consumers.

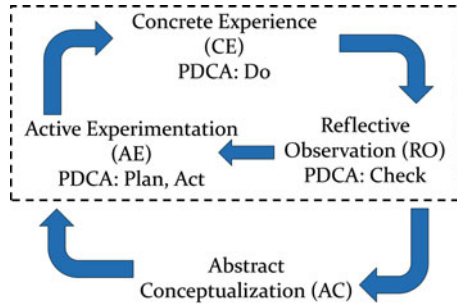
It is extremely important that a strategy produces an effect. The kind of strategy chosen should reflect the key success factors that the player intends to pursue. In order for Japan to break out of its present condition, companies must abandon the pursuit of key success factors that have lost their effectiveness. Insight that can see through to the essence of the situation is the most important requirement to define the precise key success factors needed for victory (Suzuki 2012b, pp. 30–31; See also Suzuki 2012a).

One way to conceptualize the process needed to develop explorative products and processes is through Kolb's experiential learning model, which postulates that learning involves a cycle of repeated activities. As shown in Fig. 5.2, the key steps in this cycle involve concrete experience (CE), reflective observation (RO), abstract conceptualization (AC), and active experimentation (AE). According to Kolb (1976, p. 22), the learner:

... must be able to involve himself fully, openly, and without bias in new experiences (CE); he must be able to reflect on and observe these experiences from many perspectives (RO); he must be able to create concepts that integrate his observations into logically sound theories (AC); and he must be able to use these theories to make decisions and solve problems (AE).

To clarify the differences between this model and the PCDA model, it is helpful to recast the PDCA model into three of the four steps in experiential learning model.

Fig. 5.3 The Relationship Between the Experiential Learning Model and PDCA.
Note: The elements of the PDCA model are contained within the dotted rectangle



As shown in Fig. 5.3, these steps are Active Experimentation (Plan), Concrete Experience (Do), Reflective Observation (Check), and Active Experimentation (Act/Adjust). Thus the important difference between Kolb’s experiential learning model and the PDCA cycle model is the process of abstract conceptualization. This is not to say that checking in the PDCA does not involve an analysis of cause and effect. The real question raised by this comparison of learning processes involves the level of abstraction reached in applications of the PDCA model.

Abstract conceptualization goes beyond the process of observing that an action produced an undesirable result, speculating on the reasons why the action produced the unfavorable result, and identifying possible corrective actions. Abstract conceptualization involves generalizing beyond the immediate situation. By abstracting from one’s concrete experience and developing generalizations about what might or might not work in other contexts, one develops his or her own theory about the process, and this theory can be applied (Active Experimentation) when a similar problem arises in a different situation.

From the perspective of organizational learning, the PDCA process was designed to address one type of exploitation challenge: quality improvement. However, the sphere within which this process was applied was narrowly defined (manufacturing quality), and Japanese companies were not able to apply the process of abstract conceptualization in order to generalize the quality improvement process to other contexts. This point was made forcibly by turnaround specialist Tadashi Saegusa, who is chairperson of Misumi:

For me, the examples that best illustrate the importance of abstraction and theorization arise from the ways in which Toyota’s Kanban System was systemized and applied to many industries by the American in the 1980s as a new management concept. Why were the Japanese been able to do this elaboration themselves instead of letting the American do it? I think this failure illustrates the problem of the intellectual and logical ability of the Japanese management.

At that time, the Toyota Kanban System was adopted in Japan only by the machine assembling industry. However, according to the American consultants who helped transfer the Japanese management system to America, the essence of the Japanese system was the Toyota Kanban System.

These consultants introduced this system into various industries in America as part of their consulting business. As a result, the Kanban System was introduced into firms from a

variety of fields, including electric equipment, PC, film, airplane, medical equipment, toy, resin molding, distribution, mail, construction, and hospitals. These firms were in non-manufacturing industries that people in Japan thought were unrelated to the Toyota production system. As a result, the number of industries in the United States trying to adopt the Kanban System was far greater than the number of firms trying to do so in Japan.

Bruce Henderson, the founder and president of the BCG, was unable to understand the reason for the effectiveness of the Toyota production system as a management method. He wondered how reducing stock could become the strength of the Japanese management system. So he sent two of BCG's American consultants, Thomas M. Hout and George Stalk, Jr., to Japan to analyze the Toyota system and theorize about it. In 1990 they published their findings in the book *Competing Against Time*.

Hout and Stalk argued that the Toyota Kanban System was a new corporate strategy that focused on the factor of "time." This was a wonderful abstraction. As soon as this concept of "time" was shown to the Americans, they noticed that this concept was applicable, not only to a shop floor, but to all of a company's activities, including sales, development and so on.

In the United States the Toyota production method was connected to computing systems and internet technology. Through trial and error, the Americans became skilled at this way of thinking, which was soon elaborated as the concept of BPR (business process re-engineering). This is a great example of the American ability to "abstract, theorize, and elaborate."

Was it not possible for the Japanese who were the biological parents of the Toyota production method to "abstract, theorize, and "like the American did? . . .the Japanese people have literally sweated to improve ("kaizen") shop floor procedures by various techniques such as working overtime together, devising a work process, or putting a lot of suggestions in a suggestion box. The Americans could not match this process. However, we Japanese business people were not able to come up with the idea of changing a company by taking the analysis of business methods one step further, viewing them in a more abstract sense, theorizing, and elaborating a new theory to for improvement within their organizations. I think this inability has caused the weakness of today's Japanese company.

Tom Hout did not have even one year of business experience acquired by working for a company. In other words, this is an example of the evolution of management practice arising, not from field experience, but only by power of conceptual reasoning. If Japanese top managers are now to create a new 'Japanese management', they should not focus on imported concepts from the United States. Instead, it is necessary that they creatively produce a new style of creative management through 'abstracting, theorizing, and elaborating' while moving back and forth between theory and the field (Saegusa and Itami 2008, pp. 111-116).

According to Kolb, the experiential learning model captures two primary dimensions in the learning process. One dimension highlights the tension between concrete experience and abstract conceptualization, while the other dimension focuses on the tension between active experimentation and reflective observation. As a result, "in the process of learning one moves in varying degrees from actor to observer, from specific involvement to general analytic detachment" (Kolb 1976, p. 22). According to Kolb, it can be difficult to shift between actor and observer: "The modes of active experimentation and reflection, like abstractness/concreteness, stand in opposition to one another. Reflection tends to inhibit action, and vice versa" (Kolb 1976, p. 22).

The latter observation is confirmed by the observations of Hiroyuki Mitani, who is the President-director of Novartis Pharma in Japan. Mitani has stated that “‘sensitivity × experience’ determines the success or failure of the business.” Mitani uses the word “sensitivity” to refer to the ability to thoughtfully reflect on experience. In essence, Mitani is making the same distinction articulated by Kolb between reflection and action:

Generally speaking, the human resources of a company fall into two categories. One category involves consultant-like people who are very good at analysis. Many departmental staff members fall into this category. A second category involves people who can quickly implement strategy and tactics. Many sales representatives and field staff employees fall into this category. An interesting thing is that the people in each category are often weak in the areas where people from the other category excel.

For example, though some people are able to implement plans quickly, they do so without thinking about the process and results. Therefore they repeat the same mistakes again and again, which is not acceptable. How can management overcome this weakness? Theoretical justification and practical experience are both necessary to overcome this kind of problem.

For example, a consultant type may be very capable at explaining the theory behind a persuasive technique, but the same person may not be able to actually use that technique to persuade someone to do something.

On the other hand, people in charge of sales are not going to spend much time analyzing things. They are good at finding a ways to somehow persuade a partner to sign a contract. In many cases this focus makes a lot of sense (Mitani 2012, pp. 78–79).

After distinguishing between observation and action, Mitani goes on to argue that the employees of Japanese companies are often oriented toward action:

Judging by my experience, I think there are more people focusing on implementation than observation in Japanese companies. I see them acting completely on the basis of “reflex nerves.” But this kind of behavior is only relevant in the environment that used to confront Japanese companies: a stable environment that emphasized the importance of rules of thumb and pre-established harmony.

It is often said that “there are answers in the field.” While this is true, it is also true that there are several hundred possible answers and hints in the field. Therefore one needs the ability to identify the few right answers from these many answers and hints. To find answers that have future applicability, it is necessary to raise one’s antenna and evaluate answers theoretically. To this end, “sensitivity” is important. On the other hand, the judgment based on experience is also naturally necessary.

I think that “sensitivity × experience” determines the success of a business. If one relies only on experience, one cannot cope with a change in the world. On the other hand, if one relies only on “sensitivity,” one cannot make use of the accumulation of the know-how that one learned. One repeats it continuously and learns continuously. However, there is no end to the companies that attempt to ride out difficult situations through the accumulation of employee experience over long periods of time. This process condemns these companies to remain in same cycle, unable to advance to a new way of thinking.

I think that this problem is the reason why Japan has become weak. At one time Japan was able to maintain soaring growth simply by doing the same things more efficiently. However, the present state of accelerated change indicates that the conditions necessary for success have changed. One cannot foresee a future change unless one adopts a daringly new

viewpoint. To do this, the Japanese must now escape from their current comfortable place (comfort zone) (Mitani 2012, pp. 79–81).

In this section we have argued that many Japanese companies have excellent skills in developing exploitative products and processes. However, changes in the global business environment require explorative activities, and this transition has been difficult for many Japanese companies. The Japanese management experts cited in this section argue that more Japanese executives need to develop the ability to conceptually abstract from their experiences in order to develop new, explorative solutions for a new global business environment. The development of this ability is hindered, however, by a preference for action over reflection. The preference for action has another potential danger, which is the ability to quickly sense and respond to important changes in the environment. We address this problem in the next Section.

5.4 Barriers to Strategic Flexibility and the Boiled-Frog Syndrome

Recent discussions in the strategy literature have identified strategic flexibility as one factor that influences a firm's ability to respond to changing environmental conditions. According to Shimizu and Hitt (2004, p. 44), strategic flexibility is the "capability to identify major changes in the external environment, quickly commit resources to new courses of action in response to those changes, and recognize and act promptly when it is time to halt or reverse existing resource commitments" (Shimizu and Hitt 2004, p. 44). Here we focus on the first element of this definition: identifying changes in the external environment.

According to Shimizu and Hitt (2004), problems in identifying changes arise from two factors. First, managers who are promoted preserve the mindsets and processes that led to their promotion. As a result, "successful experience often prevents managers from being sensitive to important new information" (Shimizu and Hitt 2004, p. 46). The second problem arises from the dispersion of these mindsets and processes throughout the organization. As Shimizu and Hitt (2004, p. 46) explain:

...the mind-set and decision rules of top management are often shared, routinized, and taken for granted within the organization. This process ensures that the same type of information will be collected using the same methods and that the information collected will be analyzed using taken-for-granted assumptions with routinized approaches. Ideas and actions that deviate from the current routines will not be considered legitimate. Such outcomes produce organizational inertia and make it less likely that an organization will consider (pay attention to) new information (e.g., negative feedback from the market). Instead, this type of information will be either ignored or assumed to be an exception and not analyzed further.

When mindsets and decision rules make the firm less sensitive to environmental information, the firm is a potential candidate for what some have called the “boiled-frog” syndrome.² According to popular accounts of this syndrome, a frog that is thrown into hot water will immediately jump out. However, because frogs cannot sense very gradual changes in temperature, a frog that is thrown into cooler water will not jump out as the temperature gradually rises. Thus to successfully boil a frog, one must start by placing the frog in cooler water and then heating the water slowly enough that the frog will not sense the increase in temperature.

While the biological accuracy of the boiled-frog syndrome is disputed by scientists, the story is widely used as a metaphor for a failure to respond to radical change that occurs at a very slow rate. While most managers quickly notice sudden and dramatic changes in the environment, they are less able to sense the small, gradual changes occurring in the global environment until their companies are in crisis. Many observers of the Japanese economy believe that Japanese companies fell into a kind of “boiled-frog” syndrome during the “lost 20 years”.

There are four hurdles that must be overcome to avoid the “the boiled-frog” syndrome. To prevent this syndrome from arising, all four hurdles must be addressed. The first hurdle is a lack of urgency, arising from the failure to perceive any kind of impending crisis. The inability to a looming crisis often arises from either a failure to pay attention to information in general (i.e., being in a mindless state) or carelessness (i.e., a failure to pay attention to specific information that signals a potential crisis). The negative effects of both types of information insensitivity are intensified by the the high-context culture tendency to groupism and “group think,” which refers to the tendency to behave in the same orderly manner for the sake of uniformity.³

The second hurdle that must be addressed is the need for new solutions to firm challenges (i.e., a new style of Japanese management) that are based on new theory. We have already addressed this point in our discussion of the need for abstract conceptualization combined with active experimentation.

The third hurdle is a lack of the courage necessary to pursue innovative change. Often a lack of courage arises because managers are uncertain whether proposed changes will really succeed. In part, the fear of failure arises from a lack of abstract theorizing that provides confidence to act in the absence of concrete experience. This problem is compounded in high-context cultures like Japan, because Hofstede and Hofstede (1996) have observed that an important characteristic of high context cultures

²For further discussions of the “boiled-frog” syndrome, see Villiers (1989), Richardson et al. (1994), and Sato and Parry (2010).

³Janis (1972), who analyzed failures of the policymaking process in the United States, observed that the policymaking groups responsible for these failures were characterized by high group cohesiveness in their decision-making process. She termed this characteristic “Groupthink”, and argued that “Independent Critical Thinking” was needed to counter the effects of groupthink.

It has been argued that that groupthink is more likely to arise in high context cultures that, relative to low-context cultures, attach more importance to consensus. Sato (2006) applied this perspective to his analysis of the response of Yoshinoya Co., LTD. to the BSE incident.

is uncertainty avoidance. The desire to avoid uncertainty makes it very difficult to draft and carry out new, untested strategies with uncertain prospects for success.

Even if one can draft a new innovative strategy, one must have the courage to advocate for the strategy's implementation despite the opposition that arises from the strong sense of Japanese groupism mentioned earlier. Moreover, even when a middle manager finds the courage to advocate for a new strategy, the recommendation is likely to be ignored or by senior management. As Chie Nakane (1967) observed, the seniority-based organization of the Japanese company often results in an environment that discourages logical analysis.

The fourth hurdle arises from the challenges associated with implementing new corporate strategies. One challenge consists of finding a leader who can draft a plan for implementing the new strategy. A second challenge is the creation of a timetable for implementing the new plan, including the specification of key milestones and the dates when those milestones must be achieved. A third challenge is the creation of a monitoring and "course correction" system to ensure that the new plan is actually implemented by the employees in operations, sales, customer service, and other departments. If implementation problems arise, the company must be able to quickly identify, analyze and address them. Historically Japanese companies have demonstrated great skill in addressing these three implementation challenges.

In summary, the strategic management literature has emphasized the importance of sensing and responding to environmental changes. Importantly, the failure to sense environmental change can lead to the boiled frog syndrome. To prevent this from happening, many Japanese companies need to strengthen their skill in the abstract conceptualization stage of experiential learning in order to develop new theories. In addition, Japanese companies need the courage to test the implications of their theories through active experimentation.⁴

5.5 Positioning to Global Markets

In addition to creating new innovative corporate strategies, Japanese companies must also enhance their ability to communicate the superiority of their products and services outside of Japan. In recent years the inability to communicate effectively with global customers has been a serious problem for many Japanese firms. In part, this problem reflects the past innovative successes of these companies. From the 1960s to the early 1990s, Japanese companies used their skills in exploitation to successfully introduce products such as automobiles and electrical appliances that featured innovative improvements. In most cases, communicating the superior

⁴The "boiled-frog" syndrome is related to the concept of "Organizational Mindfulness" (e.g., Langer (1997), Langer (2000), and Weick and Sutcliffe (2006)), but the authors think find the former concept more helpful in analyzing Japan's "lost 20 years."

quality of these products was simplified by the fact that consumers could easily recognize that quality.

Recently, however, global consumers have found it more difficult to assess claims of product superiority. As the physical attributes of competing products have become more similar, claims of superiority have begun to focus on attribute differences that are harder for consumers to evaluate. When consumers have difficulty evaluating quality claims, a company's communication skills assume greater importance in the process of building and maintaining perceptions of product differentiation.

Unfortunately, many Japanese companies have a disadvantage relative to foreign companies in communicating the superiority of their products. This disadvantage has played an important part in Japan's "lost 20 years." In part, this communication problem arises from the fact that the companies have historically focused on the development of high-quality products, believing that "the high-quality product will sell itself." This belief, along with the emphasis in Japanese markets on relationship selling, has resulted in a failure to appreciate the importance of positioning in effective global communication strategies. Another contributing factor may be a mistaken belief, arising from Japan's high-context culture, that some things do not need to be verbally-communicated.

There are, however, some Japanese entrepreneurs who have achieved great success in overseas markets. These people have successfully decoded the paradigm shift (Kuhn 1962) toward global competition, constructed their own theories, used those theories to develop superior products, and communicated the appeal of their products to overseas customers. In this Section we focus on two of these entrepreneurs: artist Takashi Murakami and patissier Susumu Koyama.

Over the last decade the works of Takashi Murakami have attracted considerable interest at art auctions. The three-dimensional girl statue "HIROPON" sold at auction for \$380,000 in 2002, while the picture "NIRVANA" sold for \$1,140,000 in 2006. In 2008 the three-dimensional work "PANDA" sold for 2,720,000 dollars and the statue "MY LONESOME COWBOY" sold for over \$15 million (including a 1.6 million auction fee). The latter work, purchased at a Sotheby's auction held in New York, was produced in 1998 and features a naked man standing 254 cm in height. Before the auction, the statue was projected to sell for three to four million dollars.

Murakami was born in Tokyo in 1962. In 1982 he entered the Japanese Painting Department of the Faculty of Fine Arts, Tokyo National University of Fine Arts and Music. After graduating with his undergraduate degree, he entered the masters program in the Japanese Painting Department at the same University, and then acquired the first doctoral degree offered by that department in 1993.

After completing his graduate program, Murakami began using traditional Japanese painting techniques to create art featuring characters from comics and animated cartoons. However, he fell into a deep depression after one of his paintings, "DOB Kun," which was inspired by a study of the Doraemon and Sega's game character Sonic was heavily criticized by an art gallery in 1994. He decided to spend a year in New York after receiving a scholarship of Rockefeller

Foundation in 1994. While there, he reflected on the possibilities of targeting both art critics and the international market in order to attain critical acclaim and commercial success. After returning to Japan, Murakami opened an art studio, which he called “HIROPON FACTORY”. In 2002 Murakami changed the studio to the name “Kaikai Kiki”. According to Murakami, the new name was derived from two Japanese characters (kiki and kaikai) meaning mysterious. The name was intended to convey the idea of a splendid style. At the same time, Murakami did not want to follow the conventional definition of style in Japan. As Murakami explained: “The high point of Japanese art occurred in the Muromachi era, when painting was characterized by the spirit of “Basara” (literally, acting without restraint). I would like to create a world in which I can freely express myself, as opposed to not noble art inspired by reflecting on the time when Japanese art was at its high point.”

Murakami (2006) insists that “Japanese artists should learn the rules of the European and American art world so that they can actively participate in the world actively.” As Murakami explained:

In the first place, the concept of “art” is a European and American thing. Both “the arts” and “the fine arts” are phrases that Japan did not have before the Meiji Restoration. In Japan, fine art referred to “decoration” and items used for “interior design.” “Pure art” is a concept borrowed from Europe and America. So if your goal is “pure art,” you should acquire a European and American style and know the European and American rules.

In 2012 Murakami spoke about the reasons for his success⁵:

I think the reason [for my success] is that I analyze Japanese beauty and create my art using plain words so that people around the world can understand Japanese beauty. I have been making my work strategically and carefully by thinking about the animated cartoons and the geek Otaku culture that rose after World War II in Japan and by combining these ideas with traditional pictures of Edo. I am trying to connect them so that I can rebuild them and align my work with the context of the Western history of art. This is my originality.

Murakami (2006) also offered the following explanation of the difference between the Japanese artist and the European and American artist as follows.

The reason why the art in Japan lacks vitality is that more value is placed on sharing the same thought than on ‘ringing a bell’ with something new. This value placed in Japan on sharing the same thought is different from the values of Westerners, who have been educated to respond with pleasant feelings to the ringing a bell.

As used by Murakami, the phrase “ringing a bell” refers to the kind of reflection that follows concrete experience in the experiential learning model. Murakami (2006) believes that art lovers in Europe and America art markets do not want art that produces “vague, Japanese-style impressions like ‘the colors are beautiful’” What these connoisseurs want, according to Murakami, is the enjoyment of arising from thinking about art as an intellectual conversation between the artist and the viewer. He calls this “a basic attitude toward art” in Europe and America.

⁵ “Sekai-de-Top-wo-Toru, Gendai-Bijutsuka, Murakami-Takashi-san, Interview,” Asahi Shinbun, January 17, 2012, p. 17.

To illustrate his ideas, Murakami (2006) cited the experience of Akira Kurosawa, whose focus has shifted in the later stages of his career to “superficial artistic techniques.” However, these movies “do not have the impact of the early samurai movies that caused a revolution in film-making. In art, you should concentrate your power on thought not a technique.”

Murakami’s argument can be restated using March’s distinction between exploitative and explorative product development. Rather than focusing on “technique,” which can be thought of as a kind of exploitation, the artist should pour his energy into exploration. In terms of the experiential learning model, the focus of technique can be thought of as a movement directly from reflective observation to active experimentation. Murakami is advocating that artists, before moving to active experimentation, spend time in abstract conceptualization in order to develop a new theory that specifies the kind of conversation they wish to have with the viewer. It is this theory that should guide the artist’s active experimentation.

Susumu Koyama is a second example of a Japanese entrepreneur who has achieved international success. Koyama was born in Kyoto City in 1964. His father was a cake craftsman in charge of the cake section at a Japanese traditional sweet shop. After graduating from a high school, Koyama studied to become a cake craftsman at the “Tsuji Professional Culinary Training College.” After graduating, Koyama began working for “Swiss Cake Heidi,” and held a variety of positions beyond cake preparation, including cake design, department store sales, and accounting.

Koyama left “Swiss Cake Heidi” at the end of 1999 and founded a consulting company providing planning and management services to cake companies. During this time he helped create Tokyo’s “cream puff boom” in the early 2000s. In 2003 he opened his own store, “PATISSIER eS KOYAMA,” in Sanda City, Hyogo Prefecture. His new store launched several innovative and commercially successful pastry products, including unique Koyama roll cakes and layer cakes (Baumkuchen).

In October 2011, at the annual “Salon du Chocolat” festival held Paris, Koyama won the “Foreigner Section Highest Award,” which is given each year to the festival’s outstanding non-French chocolatier. In addition, in the guidebook entitled “Michelin for Chocolate,” Koyama’s chocolate received the highest possible rating, a feat never before accomplished by a first-time participant in the Michelin rankings.

At the festival itself, Koyama presented chocolates made with unique Japanese ingredients including black seven-flavored spices and Daitokuji natto (natto made in Daitokuji Temple). In addition, to reinforce the Kyoto-inspired character of his chocolate, he served “Kyo-bancha,” a course green tea from Kyoto that Koyama had drunk with cake from early childhood. In addition to choosing the ingredients and creating the design of his chocolates, Koyama thought carefully about the best way to communicate the appeal of his chocolates to the judges and guest participants in order to win the contest. He later recalled that:

Because I am a worrier by nature, I didn’t think it was appropriate for a newbie like me to communicate the wonderfulness of my chocolate simply by saying to the judges, “Please eat my chocolates!” So I decided to prepare a careful written explanation to accompany my chocolates.

I wrote my product explanation in French. I believed a long statement would not be read by the judges, so I took a lot of time creating an explanation that communicated my heartfelt feelings about my chocolate without being too wordy.

[My statement addressed the following questions.] What kind of materials did I use? What kind of flavor and aroma does the chocolate have? What was the vision that guided my creation of these chocolates? In addition to words, I used illustrations and photographs of my chocolate so that the judges and guest participants could clearly understand my vision. I suspect I was there only competitor who prepared this kind of communication for the judges (Koyama 2012, p. 28).

In addition, I believed that focusing on the taste of the chocolate was not enough. I thought it was also necessary to communicate my view of ‘Japanese-made chocolate’ through product displays, the interior decoration of the store, product packaging, product brochures, and so on. I designed the product packaging to feature Japanese black paper cut to resemble a scene in Kyoto, where I was born and raised. I then decided to also design my booth with black and white colors (Koyama 2012, p. 33).

[As a result of such careful preparations] Judges and audience members told me that “I could feel the Japanese tradition in your chocolate.” It seems I was somehow able to communicate my thoughts. This experience convinced me that, if I develop the vision that I want to convey and communicate it with all might [literally, “with 120 % of my power”], I can connect with people across national borders. The chocolate of eS KOYAMA was chosen for the cover of the official guidebook of Salon du Chocolat Paris of 2012. When I heard this, it confirmed to me the effectiveness of my communication, which brought me great joy (Koyama 2012, p. 38).

One of the things that attracted attention at the Salon du Chocolat was my complete lack of experience in foreign countries.” All the other prize winners had a shop in France. I have heard that my receipt of this award marked the first time in the festival’s history that a patissier had received the top award despite having no foreign study experience and no commercial presence in France (Koyama 2012, p. 39).

These comments reveal that Koyama, like Murakami, developed (1) an “original theory” based on conceptual abstraction to guide their product development and (2) a way to effectively communicate the appeal of their products. Consistent with marketing theory, these two examples suggest that, for Japanese companies that seek to penetrate foreign markets, the development of a new theory to guide product development is not enough. These companies must also think carefully about positioning their products and services in ways that appeal to customers foreign markets and develop marketing tools that effectively communicate this appeal.

5.6 Discussion

To succeed in the new, rapidly changing global business environment, Japanese companies must create a “New Japanese Style of Corporate Management Strategy” by understanding the constraints arising from a high context culture, increasing their emphasis on explorative product development, developing their sensing capabilities, and applying the experiential learning cycle.

Successful application of the cycle of experiential learning requires that team members build and maintain mutual trust in order to support the transition from reflective observation to active experimentation. We have argued that there are two possible paths between these stages. One path, which flows directly from reflective observation to active experimentation, is appropriate for exploitative product and process development. Many Japanese companies have already developed successful routines and processes for managing this direct path. However, we have argued for the existence of a second path, which is an indirect path that flows through abstract conceptualization. It is this indirect step that is crucial to the ability to develop new theories that can become the basis of explorative product development.

Japanese companies must also be sensitive to the possibility that their strengths in reflective observation have weakened since the 1990s. In particular, the adoption of American management approaches such as a results-oriented focus, re-structuring, and the flattening of the organization may have undermined traditional learning capabilities. In summary, Japanese companies need to reconstruct their learning models by incorporating the logical and critical thinking skills of abstract conceptualization to develop (1) new theories to guide both explorative product development and (2) new communication skills to communicate with internal and external stakeholders.

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Chapter 6

Strategy and Interorganizational Relations of Japanese Companies: The Organization-Set Strategy

Isao Akaoka

Abstract This chapter describes the history of the intensifying function of the market principle and growing interest in corporate profit instead of sociality (employee-orientation) when managing Japanese companies during globalization. It states that today's Japanese companies began to place importance on interorganizational strategy (organization-set strategy) that deals with the relations with subsidiaries, affiliated companies, and customers in addition to the strategy of each company, including product and market strategy and diversification.

Keywords Ω -style management • Interorganizational relations • Japanese Management • The six corporate groups

6.1 Introduction: Ω -Style Management

The Japanese management system has been advocating market fundamentalism in the labor market since the bursting of the bubble economy in the 1990s, as if the “Japanese-style Management of the New Age” proposed by the Japan Federation of Employers’ Association created the turning point of this transformation. However, the transformation led to the emergence of several problems, prompting the review that has been underway lately of the shift in the status of personnel from regular employee to non-regular employee.

In response to the country’s prolonged economic stagnation, rapidly spreading economic globalization, and the trend of deregulation, sophisticated companies have been addressing the growing demand for stockholder sovereignty by resolutely developing management systems that Japanese companies have rarely used

I. Akaoka (✉)

President of Seijoh University and Professor, Business Administration,
Seijoh University, Tokai, Aichi, Japan

Emeritus Professor, Kyoto University, Kyoto, Kyoto, Japan

Emeritus Professor, Prefectural University of Hiroshima, Hiroshima, Hiroshima, Japan
e-mail: akaoka@seijoh-u.ac.jp

in the past—such as complete subsidiary acquisition, company split, and delisting—in order to realize management that is focused on profitability.

The emerging management model is neither the American style nor the traditional Japanese style. Using “Theory Z” created by Dr. William Ouchi as a reference (Ouchi 1981), we picked the Greek letter Ω (Omega) that corresponds to Z in the alphabet and called the emerging management model “ Ω -style management.” Funded by the grants-in-aid for scientific research (challenging exploratory research) for 2011, we embarked on research into “ Ω -style management.” Subsequently, our application for “Basic Research B” to develop this research toward 2012 was accepted in April this year, and we have begun work on this study. We have asked researchers from diverse fields in management science to participate in this new project independently, in order to gain a correct understanding of the transformation of Japanese management, without asking for their opinions as to whether or not Ω -style management has emerged. (Researchers who have first-hand experience of Japanese corporate management are among the participants.)

Figure 6.1 shows the process of the shift to Ω -style diagrammatically. Japanese management has traditionally placed relatively little importance on market fundamentalism in both the capital market and labor market, and placed great importance on relations with employees in the labor market (Japan Federation of Employers’ Association 1995). If C stands for the capital market, E represents the labor market (recruitment, reassignment, dismissal, and retirement of employees), and a capital letter and small letter are used to show the level of importance, the traditional Japanese-style is cE (E is made up of factors such as lifetime employment, seniority criterion, and company union.) Since 1995, Japanese management has been seeking to transform E to e and advocate market fundamentalism in the labor aspect. That means transforming c to C in the capital market. In the transformation process, companies that reorganize, shrink, and expand their relations with subsidiaries and affiliates from the viewpoint of the core company’s profitability have started to attract attention.

Interorganizational strategy contains an intercompany alliance strategy, but organization-set strategy has presumably become important from the perspective of the organization set model proposed by Evan (1966).

However, negative effects and problems caused by strengthened market fundamentalism were often pointed out after some 10 years had elapsed since 1995. Responding to these concerns, a new move to transform e to new E was observed.

What can be said about C? Some top executives and auditors have expressed their concerns about an excessive emphasis on market fundamentalism in the composition of subsidiaries and affiliates. We wish to conduct research on how the concerns about excessive emphasis on market fundamentalism have developed.

It is hard to realize the shift from c to C in the traditional E domain. Therefore, the shift from c to C has presumably been realized while the transformation to e and transformation to C were realized simultaneously, or while the shift to c was preceded by the shift to e to open up the road to C. This process increased the possibility of organization-set strategy.

Then, we discuss the traditional characteristics of Japanese-style management and their transformation.

important for such a resource-poor country as Japan, and that the development and utilization of human resources characterizes the so-called “Japanese-style management” made up of three components of lifetime employment, seniority criterion, and company union. Sixth is the Japanese decision-making system that takes the three components of Japanese-style management into consideration. Seventh is the unique Japanese characteristic of a board of directors that is the supreme decision-making organization, and eighth is the general shareholders’ meeting that has lost substance.

What the above eight characteristics have in common is supposedly the concept to seek profit and stability as a whole by controlling the realization of market fundamentalism, which emphasizes short-term profit and adjusting the profit of people concerned from a long-term perspective. There was a strong tendency to seek human resources that were helpful to increasing team strength instead of elites and prominent heroes. This is different from the western system that has market fundamentalism seeking short-term profit at its heart.

The characteristics of Japanese-style management mentioned above have managed to increase management efficiency by realizing market fundamentalism. However, the economy is globalized and the function of market fundamentalism has intensified in various fields. Especially, the short-term and rapid international transfer of a large amount of capital has intensified interest in corporate profit, and in response to this, the characteristics of Japanese-style management have transformed, making it easier to trade and acquire companies. In other words, an emphasis on profit (return on investment) has encouraged the promotion of trade and acquisition of companies. As a result, Japanese corporate strategy now attaches weight to interorganizational relations that deal with subsidiaries, affiliates, and business accounts, besides product and market strategy and diversification strategy.

6.3 Transformation of Japanese Management

(1) Direct finance and stockholder sovereignty

The funding of Japanese companies has been characterized by indirect finance and the main banking system. However, as Fig. 6.2 shows, the share of direct finance has been increasing quite rapidly since the late 1990s. Companies have to be sensitive to the moves of stockholders, and they are being asked to provide stockholders with convincing explanations on how to develop unprofitable subsidiaries over the long term. In addition, it is no longer possible to leave stockholders’ voices to control the outflow of dividends of highly profitable subsidiaries to companies outside the group. This is evidenced by the rapid increase in newspaper articles that contain the term “stockholder sovereignty” (Table 6.1).

(2) Decreasing cross holding

A high level of cross holding is liable to cause serious problems such as weakening the monitoring function of a general shareholders meeting and a

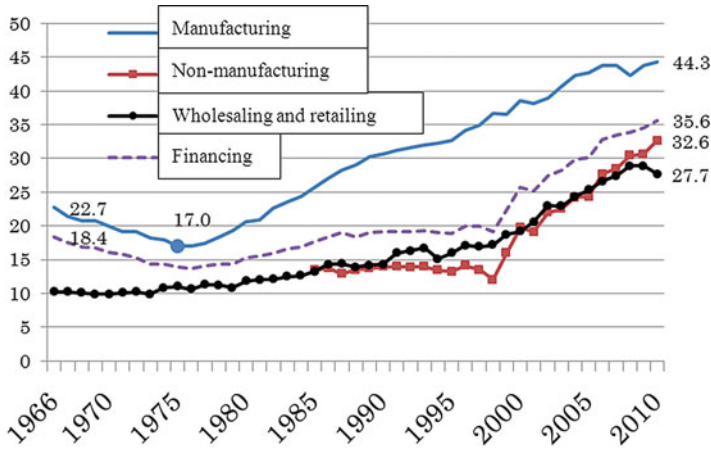


Fig. 6.2 Trend of direct finance ratio. Sources: “Annual Report of Corporate Statistics” and “Survey Results of Corporate Statistics (2010)” published by the Ministry of Finance (they did not cover the finance business and insurance business.)

Table 6.1 The number of newspaper articles that contain the term “stockholder sovereignty”

	Stockholder sovereignty
1980–1989	3
1990–1994	7
1995–1999	29
2000–2004	42
2005–2010	73

consequent distortion of management¹ in addition to the problem of maintaining capital. In Japan, however, cross holding developed to (1) secure stable capital for growth, (2) maintain long-term and continuous business relations between companies, and (3) increase the export business and develop the foreign business by maintaining close relations with general trading companies. In addition, the Japanese securities business suffered a depression in 1964 when its capital markets were liberalized in conjunction with Japan’s membership in the Organization for Economic Co-operation and Development (OECD). Under these circumstances, cross holdings developed to (4) form a corporate group centered on the zaibatsu (company syndicate) and major banks for fear of takeover by foreign funds.

However, because the accounting standard was changed from an acquisition cost basis to market price basis after the bursting of the bubble economy, it

¹ A major incident occurred when a huge valuation gain due to the price increase of cross-held shares was used to turn a profit in a period of worsened results without returning it to stockholders. At the same time, the loss of the oppressive feeling in management of the cross holdings was also indicated.

became hard to retain holdings in poorly performing companies, and the move to cancel cross holdings came to the fore. A survey conducted by Ito (2011) indicates that the proportion of companies maintaining cross holdings with banks decreased from 88.3 % in 1995 to 43.1 % in 2009, and those maintaining cross holdings with industrial companies decreased from a share of 75.9 % in 1995 to 47.8 % in 2009. This further indicates that the number of banks per company maintaining cross holdings decreased from 9.2 to 1.9 banks, and the number of industrial companies per company maintaining cross holdings decreased from 9.2 to 4.8 companies between 1995 and 2009.

The above survey results indicate that the cancellation of cross holdings is happening between companies and banks, and between companies and industrial companies (Ito 2011).

The possibility of restructuring an organization with an emphasis on market fundamentalism has strengthened.

(3) Transformation of the six corporate groups

Traditionally, the six corporate groups that originated from zaibatsus such as Mitsui, Mitsubishi, and Sumitomo, and the financial groups centered around main banks, have been key to understanding the intercompany relations in Japan. Each corporate group has a presidents' meeting to develop the cross holdings for the stability of stockholders and joint investment.

However, the restructuring of the financial industry created three financial groups: Mitsubishi UFJ, Sumitomo Mitsui, and Mizuho. Accordingly, companies that participated in the six presidents' meeting are now required to attend a number of presidents' meetings and the level of cross holding continues to decrease. The corporate groups of this type are still in the process of transformation, and the moves of these corporate groups presumably affect the organization-set strategy of each core company of the corporate groups. The realities of the six corporate groups mentioned above are still being studied, and it is necessary to analyze the organization-set strategy of the core companies by taking into consideration the research results.

(4) Management of affiliates of the focal companies

Chandler (1962) indicates that a corporate strategy like diversification specifies a task environment, and an organization compatible with the task environment is formed (contingency theory). Specifically, it is the virtually agreed conclusion that a decentralized organization is adopted in the task environment of a high level of uncertainty, and a centralized organization is adopted in the task environment of a low level of uncertainty.

Companies need to increase their short-term profit at least to a level above which the capital market accepts when equity capital ratios increase, procurement of capital in the market becomes widespread, and stockholder sovereignty is emphasized. However, there is more to consider. Ansoff (1965) showed that a return on investment should be maximized only after the constraining conditions, including social responsibility, are satisfied.

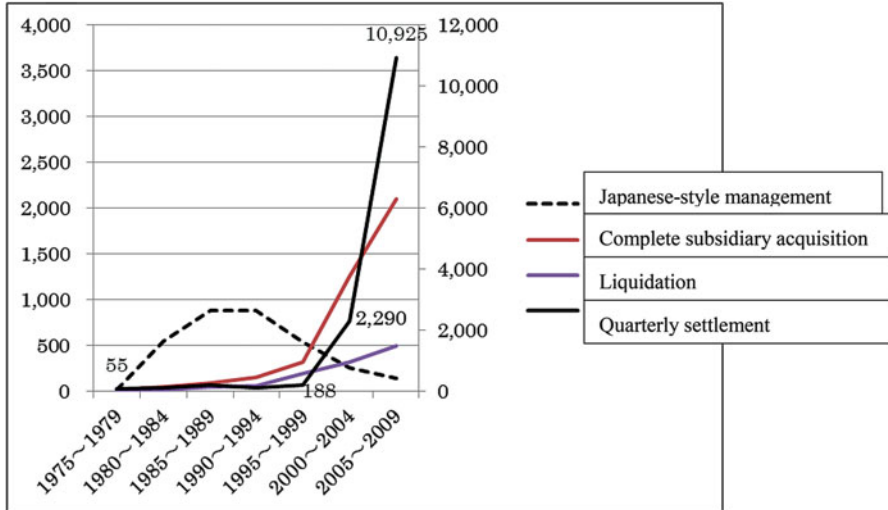


Fig. 6.3 The number of articles in Nihon Keizai Shimbum and Nikkei Sangyo Shimbum containing certain phrases

That is because, in order to avoid losing in a competitive situation, a company has to realize faster growth and raise more capital than its competitors if it does not have a unique business that blocks the competition.

It goes without saying that management based on the long-term perspective still remains important, but short-term management results have become unprecedentedly important today.

Figure 6.3 shows the result of an article search of the Nihon Keizai Shimbum and Nikkei Sangyo Shimbum newspapers. The graph shows the number of articles that contain the term “quarterly settlement.” Only five articles containing this term appeared in these two newspapers in the 5 years after 1975, but 11,000 articles containing this term appeared in the 5 years after 2005, that is, on average there were six articles everyday containing the term “quarterly settlement,” and 40 articles every week. Listed companies close their accounts and present their business plan every 3 months. The focal company has had to develop solid business activities in response to pressure that the organization set should be restructured and arranged from the viewpoint of profit maximization with constraint conditions.

When Company A, which is a subsidiary of the focal organization Company X, contributes to the results of Company X in an organization set, Company X has to make Company A a wholly-owned subsidiary in the long run by increasing the ownership ratio, unless it can explain to stockholders that Company A can develop independently instead of being restructured as a wholly-owned subsidiary. Otherwise, the business manager of Company X cannot be said to have effectively managed Company X. Adversely, if

Company A suffers from a considerably lower profit rate than Company X, it is necessary to improve the management of Company A or liquidate it. In either case, the change process will be challenging for the business manager and employees at Company A, but unless these measures are taken, the manager of Company X is managing the company inefficiently without fully utilizing the capital.

However, the above analysis can only be true when there is perfect information on the capital market, the business manager, and employees, and when the three have complete freedom to move. In reality, business managers and employees do not have as much freedom to move as capital.

The above situation is often critical to the welfare of people. The “perfect subsidiary acquisition” in the former case and “liquidation unless management can be improved” in the latter case deliver the optimal resource allocation. Therefore, these types of adjustment are advancing, though Japan’s typically strict business practices need to be eased further. As Fig. 6.3 shows, sensitivity to profits and interest in stockholder sovereignty are increasing at the same time as liquidations and complete subsidiary acquisitions (which are hard to realize in traditional Japanese society) are becoming easier to achieve. That is, we can say that the conditions are improving for a management strategy of the focal organization that takes the whole of the organization set into consideration, and businesses are becoming more well-organized.

However, unlike capital, each business manager and employee has a character and feelings, and it is vital to take these into consideration. Our society allows companies to pursue profit in free competition, and thereby contribute to optimal resource allocation, because people’s welfare is maximized through the optimal allocation of resources that are scarce in comparison with people’s desires. Accordingly, it is necessary to give consideration to the happiness of business managers and employees. We expand on this theme below in the discussion on the transformation and review of Japanese management.

(5) Transformation and review of Japanese management

Corporate management in Japan is changing significantly. Traditionally, Japanese-style management has been characterized by (1)a lifetime employment, (2)a seniority criterion, and (3)a company union (Abegglen 1958).

During the prolonged economic stagnation that started in the 1990s, business managers and many researchers insisted that two kinds of transformations were necessary and suitable to the desire of workers. These were (1)b departure from lifetime employment and a mixture of the three models of lifetime employment, short-term employment, and high-level specialist employment, and (2)b the adoption of performance-based pay. (1)a, (2)a, and (3)a control the short-term direct influence on a company’s external labor market and take advantage of the long-term perspective of people involved, but (1)b and (2)b strengthen the realization of the external market.

(3)a company labor union has the power to exercise control when the labor market functions as the internal labor market of a company. However, it cannot

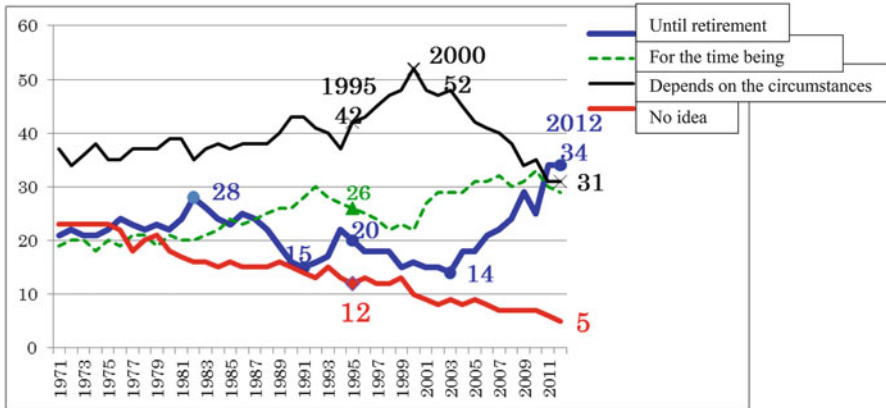


Fig. 6.4 Survey results on the attitude of new recruits about continuous service

control the market easily when the labor market becomes external, unless the externalized labor market covers the external labor market.

In terms of increasing the short-term efficiency of management, the above reform seems to have achieved its goal. However, there have been big side effects from (1)b and (2)b that have affected Japanese management adversely, besides creating big problems in Japanese society. Regarding (3)a, because it did not transform itself into a labor union that covers the external labor market, it failed to strengthen its power to address the problem.

The side effect mentioned above is that it has become hard for all company members jointly to promote management on a long-term perspective. There has been a decline in the motivation and environment to promote management that is developed over the long term in cooperation with frontline workers, and it has become difficult to retain skills that need considerable time to hand on to the next generation. As a result, it has become difficult to maintain the profound management that characterizes Japanese business.

Moreover, social problems have arisen. Fulltime workers in long-term employment are asked to work in very demanding working conditions because they have been given a favorable position, while those who decided against becoming fulltime workers in search of the joys of freedom also find themselves in stringent working conditions and even struggle to manage their lives.

The Japan Productivity Center conducted a survey on the attitude of new recruits towards their continuous service. Figure 6.4 shows the survey results. New recruits wishing to “work for the present company until retirement” decreased between 1995—when the Japan Federation of Employers’ Association published a book titled “Japanese-style Management of the New Age” and recommended utilization of short-term employment—and 2003. After 2003, the rate of such new recruits increased, and new recruits seeking lifetime employment accounted for 34 % both in 2011 and 2012. Efforts are being made to meet this demand.

6.4 Organization Relation Strategy of the Focal Company

Various strategies such as diversification, product, and competition strategy are usually mentioned in discussions on strategies involved in corporate management. They are mostly used to analyze a company independently. However, because business and product have a life cycle and competitors, companies have to develop business activities in several business domains (business mix) and supply multiple kinds of products and services (hereafter they are collectively called product mix, and service is included in product) in order to maintain a certain level of profitability. Some companies manage all these different elements independently, but subsidiaries and affiliates usually manage some of them. In the former case, PPM (product portfolio management) is used to decide what product mix and business mix should be selected as an independent company (Kikutani & Saito 2006). However, what is used for decision making in the latter case?

In this case, the organization set model proposed by William Evan is helpful for the discussion. If the core company in a group is designated as the company to discuss (focal organization: FO), then we need to work out a strategy to form and strengthen the organization set that maximizes the output of the FO. An organization set is not simply composed of the capital owning relationship; it also includes companies with which a company has business relations beyond the boundary of subsidiaries.

Traditionally, the results of a company as an independent entity are subject to discussion, but achieving results by constructing the best relationship between an input organization and output organization for business activities seems to be attracting more attention.

In this connection, Japanese-style management discussed above is being reviewed as part of the move toward strict market fundamentalism, and it is being abandoned and restructured, depending on the situation. It will be reviewed again given the necessity to adjust the profits of people involved from a long-term perspective once any adverse effect is found inside the company and society.

We look into the restructuring of the organization set of actual companies. As Table 6.2 shows, 244 companies canceled the listing of parent/subsidiary pairs, of which 149 (61 %) were manufacturers. Of the 149 manufacturers, 43 were electric appliance manufacturers. That is, electric appliance manufacturers accounted for 18 % of the 244 companies that canceled the listing of parent/subsidiary pairs.

The electric appliance manufacturers have faced fierce competition from newly industrialized countries and have lots of input companies and output companies as

Table 6.2 The number of companies that canceled publicly listed parent/subsidiary pairs between 1999 and 2010

The number of cancellations of publicly listed parent/subsidiary pairs (1999–2010)	244	100.0 %
Business category of the parent company: Manufacturing	149	61.1
Electric manufacturing (of manufacturing)	43	17.6

affiliates. Moreover, electric appliance manufacturers including Matsushita Electric Industrial were the model of Japanese-style management. This is the shift toward Ce in the Figure of Ω -type management (see Fig. 6.1).

For this reason, we first look into the moves of the restructuring of the organization set with a focus on the electric appliance industry. However, the research has just started, and not enough knowledge has been obtained yet. We present some materials and wish to get opinions and comments from researchers.

6.5 Transformation of the Organization Set in Panasonic

Yousin Park and Yunju Chen have been conducting a network analysis of the research on the corporate restructuring of the electric appliance industry and Canon. They reported the research results in the Korean–Japanese Economics & Management Association in 2011. Their research results indicate that companies that suffered from seriously worsened results embarked on a restructuring of the organization set (Fig. 6.5).

Panasonic recorded radically worsened results in 2002, so it acquired its affiliates in succession and turned them into subsidiaries (see Table 6.3) (Business relations were also reorganized, but we do not mention them here). Excellent companies must have received support from Panasonic's head office, which is the focal organization, and business managers and employees worked together to grow their companies. However, the companies in which they took pride were integrated into Panasonic. This strengthened its market fundamentalism and increased profitability. Besides, the head office increased its capital investment and strengthened its control over the companies inside the organization set.

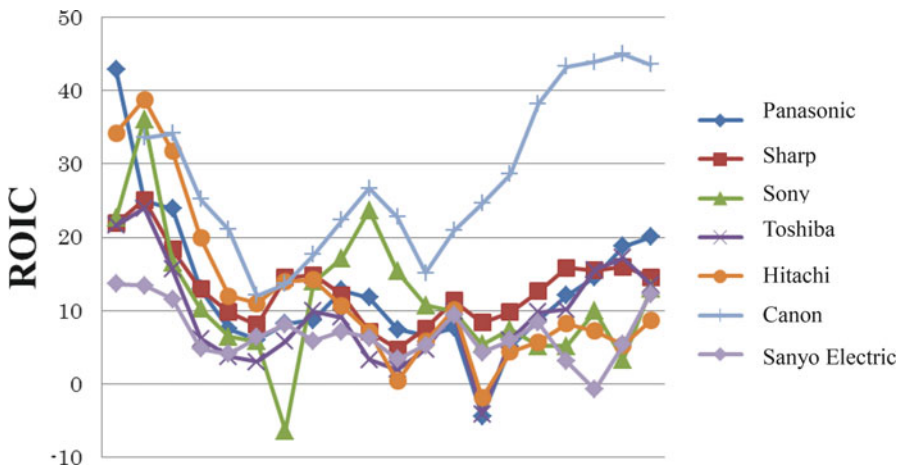


Fig. 6.5 Profit rate of invested capital of Panasonic and others (1989–2008, recovered from seriously worsened results)

Table 6.3 Panasonic's restructuring of the organization set

January 2003: Shift to management control by business domain due to business restructuring	
October 2002	Matsushita Communication Industrial, Kyushu Matsushita Electric, Matsushita Seiko, Matsushita-Kotobuki Electronics Industries, and Matsushita Transmission System became wholly-owned subsidiaries through stock swaps
April 2003	<ul style="list-style-type: none"> • Matsushita Electronics Components, Matsushita Battery Industrial became wholly-owned subsidiaries through stock swaps • Panasonic became a uniform global brand
April 2004	Matsushita Denko (Currently Panasonic Denko) and Pana Home and its subsidiaries were restructured as consolidated subsidiaries through the acquisition of additional shares of Matsushita Denko
April 2005	Merged Matsushita Information Instruments
March 2007	Matsushita Toshiba Picture Display became a wholly-owned subsidiary
August 2007	Changed Victor Company of Japan and its subsidiaries from consolidated subsidiaries to equity method affiliated companies due to a capital increase through third-party allocation implemented by Victor Company of Japan
April 2008	Merged Matsushita Refrigeration
October 2008	<ul style="list-style-type: none"> • Listed company name was changed from Matsushita Electric Industrial to Panasonic • Merged Matsushita Battery Industrial
December 2009	Sanyo Electric and its subsidiaries became consolidated subsidiaries due to Panasonic's acquisition of a majority of Sanyo's voting right

Note: Important subsidiaries became consolidated subsidiaries, and the level of importance was decided on the basis of four items: asset, sales, profit, and retained earnings

Equity method affiliated company: In principle this means a non-consolidated subsidiary and affiliate where a parent company has a voting right between 20 and 50 %, but a company cannot be made an equity method affiliated company if it is low in importance

6.6 Conclusion

We briefly discussed Panasonic's pressure to restore its business performance in Sect. 4.5. The management regeneration is supposedly represented by the shift from (1)cE to Ce. However, Panasonic recorded a huge loss, as did another two home electric appliance manufacturers, and its aggregate market value went down below one trillion yen for the first time since 1986 when the oldest data are available. Actually, the aggregate market value of one trillion yen is one seventh of the aggregate market value in 2006 when it peaked (Nihon Keizai Shimibun: November 1, 2012).

We plan to examine as soon as possible whether the drastic decrease in the aggregate market value was due to problems that arose after 2011, and whether it is necessary to shift to (3)CE. Patent Result (Tokyo) organizes the patents registered with Japan Patent Office and released the "Patent Asset Scale Ranking" that shows the value of patents owned by companies. This ranking indicates that Panasonic has maintained the top position since 2009 when the survey started (Nihon Keizai Shimibun: November 7, 2012.)

We do not mention other indexes here, but we think we can look to Panasonic's management ability to engineer a big recovery.

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Chapter 7

Financial Market Globalization and Its Influence on Japanese Firms

Toshimi Okazaki

Abstract This chapter argues the globalization trend influence of the financial market over Japanese companies. It explains specifically that ad hoc measures were repeated in Japan during the time when the American style market was positioned as the “success model” after the bubble burst and that Japanese companies gradually aspired for management that attaches importance to share prices.

Keywords Bad Loans • Globalization of Financial Market • Reform of Japan’s Financial System • The bubble burst

7.1 Introduction

In November 1996, then-Prime Minister Ryutaro Hashimoto proposed the concept of a Japanese version of ‘Big Bang’. Subsequently, by 2001, Japan’s financial market had initiated radical reforms of the financial system with the objective of restructuring itself as an international financial market, specifically along the lines of New York and London. ‘Global’ was one of the three main rules of these reforms, the others being ‘free’ and ‘fair’, and it refers to an international market in the forefront of the times. At the time, it was believed that the globalized financial market would attract capital from around the world and generate enormous wealth. However, in reality, the reforms were unsuccessful and did not generate wealth; they merely led to ‘changes’. The greatest change was that governments throughout the world became unable to control the international flow of capital that could simultaneously enhance as well as destroy a nation’s economy. Countries with globalized financial markets are now at the mercy of the markets and can only react to events.

In this chapter, we examine Japan’s financial markets, how they internationalized, and the internationalization process since the beginning of globalization. Furthermore, we consider the influence of this new market on Japanese firms.

T. Okazaki (✉)

Associate Professor, Financial Management, Faculty of Management,
Otemon Gakuin University, Ibaraki, Osaka, Japan
e-mail: okazaki@office.otemon.ac.jp

7.2 Beginning of Financial Market Internationalization

Globalization of financial markets refers to a situation in which capital moves freely across borders, resulting in linkages between financial markets of different countries and growing homogenization.¹ Globalization has been strongly influenced by the US government and financial industry, and as markets deregulate, they become Americanized.

The US financial market plays a major role in asset management and speculation, even beyond its role in capital procurement. Within the larger economy, it generates large profits rather than playing a complementary role in the financial aspects of the real economy.

Institutional investors, investment banks and investment banking divisions of commercial banks play a central role in mature asset management and speculation. The degree of tolerance of typical institutional investors in the United States varies with investment goals, though these sophisticated investors are not averse to taking risks in order to obtain high returns, as long as the risk falls within their range of tolerance. Some institutional investors become greedy in pursuit of profit and employ complex schemes to generate extraordinarily high returns. Investment banks, who often invest their own capital, respond to the needs of institutional investors with advanced financial technologies that enable the investors to propose innovative financial products and investment methods.

There was a high level of wariness in the United States regarding the growing power of traditional commercial banks, with many regulations enacted. For example, ban business across state lines. Because of this regulatory environment, the stock market in the United States developed more quickly than that in other countries, though many regulations limited free dealing until the 1970s.

The period from the end of the 1970s through the 1980s witnessed great changes in the financial market environment. One was in the international flow of capital, with large amounts circulating through developed countries seeking investment targets. Beginning in the 1970s, the economic growth of many developed countries began to slow, and decreased demand for capital caused surplus funds, which were loaned to countries in Central and South America. However, the 1980s saw a succession of bond defaults in these borrower nations, and external debt problem became apparent. Capital flow into Central and South America quickly dried up, and capital began seeking investments in developed countries.

The second change was in newly implemented economic policies. The Reagan administration advocated a 'small government' and moved towards deregulation in several areas in order to create economic efficiencies. Deregulation and

¹ A financial market includes securities markets (stock markets, bond markets and financial derivatives markets), short-term financial markets and foreign exchange markets, though globalization focuses on stock markets.

liberalization occurred in financial markets, with no impediments to experimentation with new product development and novel investment methods.²

The third change was the beginning of the financial revolution, with the rapid development of derivatives and other innovative financial products. Derivatives were developed as a means of hedging the currency and interest rate risk inherent in the dramatic price fluctuations caused by liberalization. However, they quickly enticed investors as financial products for generating unprecedented high rates of return.

As a result of these changes, the US financial market became a centre for abundant capital, attractive financial products and the generation of large profits. The US financial industry became an important industry that was highly competitive internationally. Furthermore, to support its financial institutions and the growth of institutional investors overseas, the US government opened the financial market to foreign capital forced to other countries, including Japan, and scrapped regulations and practices that blocked free dealing. This policy change was a trigger for the internationalization of various countries' financial markets.

Meanwhile, Japan confronted US market liberalization and deregulation and could not avoid market reforms even without US pressure.

In post-war Japan, it was illegal for one institution to have both a banking business and a securities business. Banks handled the former, whereas securities firms engaged in the latter, and the resultant financial system overwhelmingly favoured banks. This system adapted well to the chronic post-war capital shortage, with banks preferentially supplying limited capital to firms in specific industries, serving the financial role of promoting economic growth. During this period, capital procurement and management in the securities market was kept to a minimum, with deposits accumulating in banks, which skilfully circulated capital by loaning it to companies at low interest.

However, the 1973 oil crisis ended high economic growth, with declines in plant and equipment investment. Companies reduced their demand for external capital, surviving on internal financing for much of their capital needs. This resulted in a surplus of capital in Japan, and the government replaced industries as the greatest domestic consumer of capital. It was then searching for opportunity that the financial market would support the smooth issuance of government bonds and provide a place for asset management.

Characteristic of financial market reforms during this period is the phrase *futatsu no kokusaika*, or 'two kokusaika', referring to government bonds and internationalization (both pronounced the same in Japanese), which enabled the emergence of an effective government bond market. Financial institutions could neither increase government bond holdings nor hold all their bonds to maturity because of liquidity concerns. This situation required the speedy creation of secondary markets and resulted in the rapid expansion of the government bond market. At the time, Article 65 of the Securities and Exchange Law forbade banks from having a securities business, but an exception was provided for banks with a securities business dealing

² All through financial system of the United States, refer to Takagi (2006), about a small government of US, refer to Reich (2007)

with public bonds in order to ensure the smooth consumption of government bonds.³ Thus began the entry of banks into the securities business.

The liberalization and internationalization of Japan's financial market were discussed in 1983s Japan–US Yen–Dollar Committee. On the basis of these talks, the implemented reforms included regulations governing the conversion of foreign currency into yen, the liberalization of Euroyen markets, the entry of foreign banks into trust business and the opening of membership in stock exchanges to foreign securities firms. US pressure had thus begun to manifest in the inhibition of resistance to reform.

However, laying the groundwork for fundamental system reforms requires time, and implementation must be deliberate and accomplished in phases. As long as a banks' securities business is severely restricted, the development of securities markets will cause a reduction in bank business and a decline in bank position. Therefore, banks demand the expansion of a securities business in which they can participate. In actuality, it was not optimal to squeeze banks out of the securities market, even from the standpoint of developing financial institutions in Japan that are capable of competing with powerful internationalized foreign banks. However, speedy deregulation was difficult due to a strong sense of caution regarding the greater influence of banks on corporations that arise by allowing banks to participate in a securities business.

For example, the most innovative reform plan at the time provided for separate subsidiary companies for banking, securities and insurance. This system was considered in earnest beginning in 1985, and the Financial System Reform Act became law in 1992. Furthermore, bank participation in the securities business through the establishment of a securities subsidiary was done incrementally to alleviate the impact of the move. The first banks allowed to have securities subsidiaries were the Industrial Bank of Japan, the Long-Term Credit Bank of Japan and Norinchukin Bank. These subsidiaries began operations in July 1993, whereas the securities subsidiaries of banks that had to wait the longest for permission, Tokai Bank and Hokkaido Takushoku Bank, began operations only in March 1995, 10 years after reforms began to be considered.

7.3 Reform of Japan's Financial System and the Problem of Bad Loans

The internationalization of financial markets, which began in many countries in the 1980s, unexpectedly picked up speed and energy in the 1990s, with progressive borderless globalization that could not be constrained. As a result, financial markets

³The securities business of banks dealing in public bonds was specified in a 1981 revision to the Banking Act, and an amendment was made to Article 65 of the Securities and Exchange Act. Recruitment for public bonds began in 1983, and dealing started in 1984.

were no longer managed by states, and there was a growing awareness of the tremendous influence of these markets on the world economy.

In the 1990s, financial deregulation, which also began in countries throughout the world in the 1980s, resulted in the removal of many factors blocking the international flow of capital and the market participation of foreign capital. In addition, advancements in information and telecommunications technology greatly decreased the cost and time required for international investment. Even the cost of opportunities generating small profits could now be justified, and enormous sums of capital throughout the world could be moved instantly.

The trend towards international speculative capital became a factor in wide swings in exchange rates and stock prices. Because sharp rises and falls in stock prices and sudden fluctuations in foreign exchange markets greatly influence the real economy, governments in many countries attempted to intervene in markets, but the capital these governments infused into the markets was relatively small compared with the speculative capital, and it soon became clear that governments could not achieve the desired result.⁴ The 1992 British pound crisis was the most emblematic of these events.

The hedge fund run by George Soros viewed the British pound, which was participating in the European Exchange Rate Mechanism (ERM), as overpriced and initiated a large-scale shorting of the currency in June 1992. The Bank of England responded by propping up the pound with infusions of large sums of capital and simultaneously raising the official discount rate from 10 to 15 %. Even after this, the bank could not stop the wave of selling due to speculative capital and failed to maintain the pound exchange rate. Speculative investors that had shorted the pound and bet on its rapid drop quickly made enormous profits, and the incident resulted in the United Kingdom leaving the ERM. It was a complete loss for the UK government. The failure to protect the pound demonstrated not only that government lacked the power to defend markets but also that if investors attacked market inadequacies such as huge differences between values and market prices, they could reap vast profits. Investors began seeking market inadequacies that could become the source of profit, and governments who were on the defensive needed new countermeasures. If attempts to control markets ended by merely generating large losses, then it was deemed wiser to explore ways to work with market movements than work against them. In doing so, the US provided a good reference point.

However, the reason Europe and Japan oriented themselves towards a US-style market was not that they feared being attacked by speculative capital. In the 1990s, the US economy was the sole winner, and the successful model of the US financial

⁴ However, Japan's financial authorities have repeatedly conducted large-scale interventions in the foreign exchange market since the 1990s. At the same time, despite the failure of the government's 'price-keeping operations' in the stock market in 1992, many people demand government intervention when stock prices plummet. Japanese people may be placing too much faith in the government's ability to support the market because the rapid rise in the yen's strength after the Plaza Accord left a strong impression on their mind.

market propping up the healthy US economy was, to many countries, the only model worthy of emulation. The Japanese and German economies, which were sceptical of US-style market principles, had stagnated for a long period during the 1990s: Japan because of the collapse of the bubble and Germany because of the reunification of East and West Germany.

In Europe, regional market integration was completed in 1992, and when the common currency of the Euro was introduced in 1999, the superiority of currency-producing countries vanished, with all of them forced to compete under the same conditions as other financial markets in the region. Reforms were enacted to draw closer to the US market, the most functional, so that these markets could attract investment capital and survive the competition among markets.

The US economy was booming, and even Europe accepted Americanization, desiring rapid progress through market reforms. Thus, to avoid being left behind, Japan was left with no alternative.⁵

The Japanese Big Bang concept (for financial system reform) was announced in 1996 and had three rules: free, fair and global. For the first, it was noted that a place was needed to more effectively utilize personal financial assets totalling 1,200 trillion yen in order to maintain the domestic economy's vitality in spite of Japan's society ageing in the twenty-first century.⁶

In addition, Japan had set a goal of 'revitalizing the Japanese financial market commensurate with the international markets of New York and London by the year 2001'.⁷ That is, Japan announced the Americanization of its financial market, aiming to correct the traditional financial system that overwhelmingly favoured banks and to stabilize the flow of capital via securities markets. Moreover, Japan wanted to transform securities markets into engines of great profit, similar to that in the United States.

The concept of a financial Big Bang was embodied in the Financial System Reform Act of 1998. The reforms were extensive, expanded the definition of securities, redefined professional services and the move from a licensing system to a registration system for securities firms, liberalized fees for stock brokerages, lifted the ban on private placement investment funds, reset the disclosure system and the accounting system. This included the expansion of the scope of business for the individual subsidiaries of banking, securities and insurance. A law based on these ideas was implemented almost in its entirety beginning in December 1998. Taking little more than 2 years from announcement to implementation, it progressed significantly faster than did the market reforms of the 1980s.

The Big Bang was regarded as bold and ambitious, and much of it was implemented. It also had many benefits, depending on the area. For example,

⁵ There are a lot of book the Japanese Big Bang and a financial system reform. Special researched Osaki (2003) and Hayashi and Horaguchi (1998). Under the Influence of financial crisis, refer to Aizawa (2006).

⁶ From the Ministry of Finance website, 'What Is Financial System Reform (the Financial Big Bang)'.

⁷ *ibid.*

securities firms moved from an approval system to a registration system, which enabled the creation of internet-based securities firms that competed at a low cost, allowing easy entry for firms from non-financial industry. This strategy greatly reduced stock brokerage fees for individual investors. The law introduced a fixed-fee system for internet tradings as a new pricing structure, after which individual investors began day trading, buying and selling several times per day.

However, overall, the law did not lead to the expected dramatic benefits. Financial markets were not revitalized and stock prices continued to languish. The main reason for the lack of benefits from the financial system was the severe financial crisis that left banks holding huge sums of bad debt as the bubble collapsed. Banks expected real estate and stock prices to recover soon, and they blocked the discovery of their underestimates of the amount of bad debts, but the passage of time revealed a worsening economy. As stock and land prices continued to decline, the amount of bad debt only increased. The collapses of financial institutions that began with credit unions expanded to the first post-war bank collapses in 1995. In 1997, these collapses even brought down Hokkaido Takushoku Bank, one of the top 21 in Japan. Japan's financial system continued spiralling into a crisis, and numerous banks faced problems. Although the severity differed, all banks had huge amounts of bad debt, and there were several candidates for collapse, including the Nippon Credit Bank and the Long-Term Credit Bank of Japan. The fact that banks did not publish the amount of bad debt they carried led to suspicion, and rumours suggested that bankruptcy was inevitable for many banks, which were then exposed to speculative attacks, worsening the situation.

The government delayed the progressive systemic reforms it had hoped to implement with the financial Big Bang and was forced to stabilize the financial system. It poured large sums of public capital into banks to enable them to provide the capital required to dispose of extremely bad loans. In addition, a plan to abolish the practice of providing a full deposit guarantee was temporarily suspended not to allow depositors to select financial institutions and then stop the outflow of deposits. Banks were required to set a market price on their shareholdings from 2002 onwards, and they had to sell their cross-holdings. However, selling stocks on the market would cause a drop in prices; therefore, Banks' Shareholding Purchase Corporation was established as temporary holding institutions for shares to be sold by the banks. However, this corporation was difficult to use, and when it was discovered that shares were not being sold, the Bank of Japan took the unprecedented step of directly purchasing shares held by banks. Furthermore, the government financial institutions increased its lending in lieu of private financial institutions that had lost their ability to lend. The government expanded public guarantee of credit guarantee corporations. Thus, in the process of rebuilding the financial system, government and government financial institutions were deeply involved in the financial system in diverse ways. The government had no intention of impeding reforms, and though it was forced to intervene, the result was a decline in the speed and effectiveness of reforms.

Another reason for the lack of benefits from reforms was a shortage of risk-tolerant participants in the market. Even with government recognition of expanded

services, banks struggled with excessive bad loans and had no capacity for investment banking operations that required great risk. Securities firms that had a monopoly on the securities business not only experienced worsening performance through a stock market that continued to flounder but were also slow to act because of loss-covering scandals and *sokaiya*, or corporate racketeers who were given payoffs. Institutional investors, reeling from steep declines in asset prices due to the bubble's collapse, increasingly sought safe harbours. Even if a market would be developed, there was no one to participate in it.

However, amid the confusion surrounding the bubble's collapse, the removal of three factors potentially blocking the function of the financial market proved to be of particular significance. Cross-holdings, the main bank system and the Ministry of Finance-led convoy system of financial administration were all characteristic—or rather, were peculiarities—of the Japanese economy. Cross-holdings and the main bank system still exist, though they do not exist in every company as they did in the past. In the mid-2000s, shareholders exerted tremendous power, drastically changing market in Japan. Would these changes not have occurred if these factors had persisted?

With regard to cross-holdings, in the post-bubble era corporate earnings and stock prices continued to decline, causing many firms to rethink their shareholdings and sell all shares other than those they deemed worth holding. This action quickly resolved the cross-holding issue. When shares that were held by what had until recently been friendly shareholders hit the market in large quantities, it became possible for foreigners, investment funds and other institutional investors to buy sufficient stock to influence management, if not seize management outright.

The weakening of the second factor, the main bank system, resulted largely from the main banks falling into dire straits. Until then, main banks had tacitly consented to bear some responsibility for the management of companies with which they did business, and they were criticized when they did not support struggling companies. However, with large amounts of bad debt, banks themselves suffered from worsened performance, and they had neither the will nor the ability to salvage struggling firms either with additional funding and financial support or through collaboration in a coordinating role. From the end of the 1990s through the start of the 2000s, many large banks that had served as main banks merged among themselves, and the lack of regard for long business relationships diluted the main banks' responsibility. This generated criticism against the main banks that did not discharge their responsibilities, and companies came to regard their main banks as unreliable.

The third factor, the Ministry of Finance's financial administration through the convoy system, came to an end through the ministry's dismantling of the authority to grant permission and exercise great discretionary power. The shift of authority from the Ministry of Finance's Financial Supervisory Agency to the Financial Services Agency began in 2000 as part of the central government reorganization. In this process, the financial administration in principle was modified from a priori to *ex post* regulation, and the administration's discretionary power was also reduced. Not only was this an international trend but it also resulted from the weakened trust in the power of the Ministry of Finance that arose from its failure to save the major banks.

The financial administration known as the convoy system continued through the post-war era. It established conditions for regulations that identified the most inefficient financial institutions and did not hesitate to occasionally overextend itself by forcibly coordinating or intervening to ensure the continuity of existing financial institutions. When circumstances worsened in the 1990s, it abandoned the policy of 'not allowing the failure of even one bank' and even tolerated the weeding out of weaker small- and medium-sized financial institutions. In spite of its public promise to the world that it would not allow any of the 21 top banks, which had the most international influence, to fail, the Ministry sought buyout partners for banks in crisis as well as other tactics to avoid the public discovery of bankruptcies. Even with these efforts, the government could not prevent the collapse of one of the 21 top banks, Hokkaido Takushoku Bank, in 1997. In an instant, the notion of the Ministry of Finance as all-powerful evaporated.

As with the British pound crisis, this collapse demonstrated that the Japanese government was unable to stop market inertia.

7.4 Financial Market Globalization and Its Influence on Japanese Firms

As of 2003, there was no progress in terms of the disposal of bad loans, and Resona Bank, a major bank long rumoured to be on the verge of bankruptcy, received an injection of two trillion yen in public funds. Thus, the bank was effectively nationalized, and the long financial instability began to subside. Japan's bank crisis ended in 2005, when the last bank unable to escape crisis, the large UFJ Bank, agreed to a relief merger with Mitsubishi Tokyo Bank.

Apart from the short period after the announcement of the financial Big Bang, in the more than 20 years since the bubble's collapse in the early 1990s, the country has been constantly extinguishing domestic fires such as repeated steep drops in stock prices, financial institution bankruptcies and severe credit crunches. These tended to consume public interest, but the globalization of the Japanese market began steadily progressing through overseas investors in the stock market. Many foreign investors participating in the Japanese market were global institutional investors that freely moved capital across national borders and drove many countries' progress in financial market globalization. On market value basis, the ratio of shares held by foreign investors in the Japanese stock market was 4.2 % in 1989, prior to the bubble's collapse. It then rose to 10 % in 1995 and more than 20 % in 2003, finally peaking in 2006, at 27.8 %. Domestic financial institutions and business entities gradually decreased their stock holdings to 43.5 and 29.5 %, respectively, in 1989 and 30.7 and 20.8 %, respectively, in 2006. The amount of decrease almost exactly corresponds to the increase in foreign holdings.

At the end of March 2011, the percentage of foreign investor holdings (on a fair value basis) was 26.7 %, second only to financial institution holdings (29.7 %).

Viewed as trading value, the shadow cast by these foreign investors looms even larger. The ratio of stocks bought and sold by them in 2011 on the Tokyo, Osaka and Nagoya stock exchanges (based on price) was 65.7 %. Of the remaining 34.3 %, 21.9 % was attributed to individuals (Tokyo Stock Exchange (2012), pp. 25 and 128).

Based on these figures, the companies most affected by the globalization of Japan's financial market are estimated to be those receiving such investment. The emergence of global institutional investors as shareholders means that common companies are continually viewed as targets for investment and are evaluated according to certain investment criteria, that is, global standards, which were a new experience for many Japanese firms.

Traditional major shareholders in Japanese firms were other firms with cross-holdings. In these cases, it was assumed that the cross-holding firms would retain the shares for the long term, and companies implicitly understood that they would not involve themselves in other companies' business as long as there were no particular issues. When companies held stock in companies with whom they did business, their good relationships were reflected in actual commercial dealings, not merely in the direct investment profits gained as shareholders. These benefits, as well as the long-term, total and broad effects of investment were regarded as positive. In contrast, the investment objective of institutional investors is simply to gain profit. Investment timeframes differ by investor, but even for long-term holdings, performance is commonly calculated on a short-term basis. Thus, institutional investors often demand that companies generate results and specifically, increase their stock price, in the short term. When companies cannot meet these demands, institutional investors either make comments regarding management as noisy shareholders or sell their holdings. In either case, corporate management is pressurized. When globalized institutional investors become large shareholders, the management of Japanese companies must consider the impact of management decisions on the stock price.

For Japanese companies, factor making it difficult to deal with share price include t the fact that foreign investors with the power to greatly influence share prices evaluate these prices using foreign currencies.

Figure 7.1 depicts the change in the Nikkei stock average from January 2000 to August 2012 in both yen and dollars. The yen vs. dollar rate fluctuated between 135.15 yen at its lowest (January 2002) and 75.55 yen at its highest (October 2011). At certain times, the yen rate differed greatly. Thus, as the graph illustrates, the yen-based stock price does not necessarily match the dollar-based stock price. For example, the lowest closing price on the Nikkei at the end of a month was for February 2009, 7,568 yen (or 78 dollars at an exchange rate of 97.58 yen to the dollar). However, the lowest dollar-based price was for April 2003, 66 dollars (7,831 yen at 118.84 yen to the dollar). Both the timing and the amount are different. In addition, during the long-term period of a strong yen, from mid-2007 to the end of 2011, the spread between the two stock prices increased. The yen-based price dropped dramatically in mid-2007 and then slumped, but the dollar-based drop was ameliorated and has climbed considerably from 2009 to the beginning of 2011.



Fig. 7.1 Change in Nikkei stock average over time (in yen and dollars)

The percentage of foreign investors buying and selling stock is extremely high, exerting a strong influence on share prices, whereas stockholding is less than 30 %. When we consider that domestic investors hold more than 70 % of shares, there may be differences of opinion as to whether yen- or dollar-based stock prices are more important. Using the traditional revenue and profit growth as management objectives is inappropriate and regressive because they focus on efficiency rather than on scale; moreover, they may invite criticism from foreign investors interested in share price. However, share price is a difficult objective for Japanese companies, and actions to maximize it sometimes go against current Japanese systems and commercial practices. The absence of a clearly defined objective to work towards is perhaps a factor in the aimlessness of certain Japanese companies.

The anti-social behaviour of certain companies and investors that speak with strident insistence on ‘capitalist theory’ is a side effect of financial market globalization. Immediately prior to the subprime mortgage crisis, when the world’s investment capital was wildly circulating, the symbol of financial market globalization, or Americanization, was generally regarded as young entrepreneurs who had generated great wealth by taking a company public and were now living an ostentatious lifestyle or as investors that greedily pursued personal profit at the expense of others.

The investment fund known as the Murakami Fund bought massive quantities of Hanshin Electric Railway stock. The fund’s investment claims were specific and easy for the common person to understand, but the Hanshin purchases were shocking. The fund proposed to purchase Hanshin’s stock at a price lower than the value of assets held by the company in order to wrest control, after which the fund would dismantle Hanshin and sell the assets. In addition to Hanshin Electric Railway being a railway company, a core business, it also owned unused, high-priced land around train stations; a baseball stadium that was treated as a special site; and a professional baseball team with a very loyal local fan base. The

Murakami Fund thought that selling these operations individually would generate greater returns than the value of the company stock.

Eventually, all the shares held by the Murakami Fund were sold to Hankyu Holdings, inc., concluding the case. At the same time, the US investment fund Steel Partners made hostile takeover bids for Bull-Dog Sauce and Sapporo Holdings. Steel Partners was not involved in the acquisitions or management of the companies in which they invested, but they derived large profits from dividends and sales of their stock at high prices, which increased their investment capital. Because friendly mergers and acquisitions are an unfamiliar concept for many, and because these companies would object, Steel Partners intimidated companies and proposed forceful, hostile acquisitions. In doing so, the behaviour of the investors that receive large profits attract public scrutiny, which could have repercussions in the future.⁸

It was later discovered that a series of deals by the venture firm Livedoor, which had worked with the Murakami Fund, were illegal, and that many other dealings that were not technically illegal were unfair and improper. It has been noted since the beginning of the reforms that a failing of Japan's market reforms that began with the financial Big Bang was the inability to quickly eliminate or punish improper or unfair practices that arise in new forms when pursuing liberalization and shifting market monitoring policies from a priori to *ex post* regulation. That is, in the current situation, skilfully exploiting inadequacies of the system could bring large profits through improper, though not illegal, dealings that unfairly damage the profits of interested parties, including other investors.

These scandals required an immediate response. However, because of the series of international financial crises resulting from 2007s subprime mortgage crisis, the Lehman Brothers incident and European debt crisis, action was suspended before countermeasures could be drafted. The current situation remains the same. The shift in financial crises kept capital out of speculative investors, and not only did the capital disappear from the market but also financial institutions and investors in Japan were indirectly affected by steep declines in stock prices amid the globalized stock market and have struggled to respond. Thus, Japan's financial institutions and investors have suffered even though they were not significantly involved in the subprime and European debt crises and their direct losses from these crises were minimal. As things stand, the financial crises have ended, and international speculative capital is regaining momentum, which could revive the confusion that temporarily ceased in 2007.

⁸ In 2006, Japan's largest paper manufacturer, Oji Paper Co., Ltd., failed in a hostile takeover bid of the sixth largest paper manufacturer, Hokuetsu Paper Mills, Ltd. Oji Paper's proposal was for a business consolidation not unheard of in industries with excess capacity. Objectively, it was not a bad deal for Hokuetsu, and observers believed that the deal would have succeeded if investors who had become used to the new market had made a rational decision to approve it.

However, Nomura Securities was working with Oji Paper as a financial advisor. The emotional backlash against a hostile acquisition was significantly stronger than expected, causing Oji to abort its attempt. The fact that economic rationality gave way to emotional arguments in swaying public opinion conveys that traditional elements remain firmly in place in the stock market.

7.5 Conclusion

The United States is attempting to implement regulations to control bloat in the financial sector and avoid a recurrence of a financial crisis. They are specifically developing the Volcker rule to limit proprietary trading of commercial banks in order to stabilize the financial system. However, the negative effects of the financial crisis will eventually be left behind, and it appears that the restrictions will not be as severe as initially imagined. Nevertheless, as experienced in the past, it will be difficult to strike business deals given the high degree of complexity and risk.

However, there is an abundance of capital that needs investment targets, and as long as financial institutions can respond to institutional investors willing to take on risk as well as to the needs of institutional investors, then even if the names and forms of investors and financial institutions change, the US financial market will continue to be American. If necessary, they can survive by developing unregulated, high-risk/high-return financial products and investment methods as they have done in the past.

But what about the Japanese market? In the few years preceding the Lehman crisis, there were some loud investors who unsuccessfully attempted hostile takeovers, and the Japanese market appeared to become more like that of the United States. However, neither were institutional investors willing to take on risk and nor could financial institutions meet the needs of aggressive institutional investors. Institutional investors and financial institutions in Japan had an abundance of fund, but it was concentrated in the public bond market, which promised extraordinarily low risk and return. After the financial crisis, the Japanese market ceased to attract global attention and continued to quietly languish.⁹

However, rather than being the manifestation of ‘Japanese temperament’, Japan’s institutional investors and financial institutions have avoided risk because of the business situation was unstable and the situation did not allow them to take on risk. Recently, management of financial institutions and institutional investors has stabilized, and their trust has largely been restored. Conditions are such that they can finally begin to take on risk. In the future, Japan’s financial market must become a place for speculation and asset operation. The current situation of large sums of capital concentrated in the public bond market is not sound, and above all, dangerous.

Globalization of financial markets cannot move backwards, and it is not good policy for governments of major countries to resist powerful markets that strongly affect them.

However, the current Japanese market was created with the primary objective of preventing a market collapse similar to that during the late 1990s financial crisis.

⁹ With the expectations surrounding ‘Abenomics’, the Nikkei average stock price climbed dramatically at the end of 2012. However, as of 18 December 2013, the Nikkei average has been unable to move past the 15,000 yen mark. A full-blown market recovery has not yet occurred.

The Japanese market does not consider the convenience of Japanese investors or firms and was not conceived as the best response strategy to globalization.

Now, more than ever, global financial markets struggle and foreign influences are weak. The Japanese market has the opportunity to dramatically reform itself into a market that is usable for Japan.

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Chapter 8

Electronic Book Publishing Formats and the Response of Japanese Publishers

Sumiko Asai

Abstract The Japanese publishing industry was originally built on a closed, domestic system. International file formats for electronic publishing, EPUB and AZW, developed after the Japan-specific file formats had already been established, and the coexistence of these multiple file formats has complicated the Japanese electronic publishing market. In Japan, the electronic book exchange format that converts formats from one to another has been established to solve the compatibility problem. Although it is hard to evaluate the usefulness of the electronic book exchange format at this stage, the publishing industry needs to respond to globalization while maintaining the diversity found in Japanese culture.

Keywords Electronic publishing • File format • Publishing industry

8.1 Introduction

The revenues for the Japanese book publishing market declined to 801 billion yen in 2012 from a peak of 1,093 billion yen in 1996, according to the *Annual Report on the Publication Market* 2013. Meanwhile, book publishing markets in foreign countries grew steadily during the same period, making Japan's decreasing book sales an anomaly.

The Japanese publishing industry is based almost entirely on the country's domestic market, while English-language publishers such as Random House operate globally. Japanese publishers produce books written in Japanese and sell them domestically¹; few Japanese publications are translated into foreign languages and sold abroad.² When Amazon announced entry into the Japanese electronic

¹ According to trade statistics, book exports were limited to be 7.3 billion yen in 2012, and the ratio of exports to total book sales was less than 1 %. The Japan Society of Publishing Studies (2010) stated that the majority of exported Japanese books were sold at foreign branches of Japanese bookstores, and the main purchasers were Japanese people who live abroad.

² The exceptions include works by Haruki Murakami and several popular comics.

S. Asai (✉)

Professor, Micro Economics, School of Political Science and Economics,
Meiji University, Chiyoda-ku, Tokyo, Japan
e-mail: asai@meiji.ac.jp

publishing business via Amazon Japan, Amazon Japan was compared to U.S. Commodore Matthew C. Perry, who played a leading role in the opening of Japan to the world economy in the early 1850s. This comparison symbolizes the closed market characteristics of Japanese book publishing.

There are a number of factors that can explain the absence of Japanese publishers in overseas markets. First, the Japanese language is not a global one. Second, the majority of Japanese publishers are small or mid-sized enterprises and do not have the human resources to sell publishing rights abroad.³ Although the Japanese market has been shrinking, it remains relatively large in comparison with many foreign markets. Japan's market size and the cost structure of publishing, a business that requires minimal investment, enables many smaller companies to survive without having to expand into overseas distribution channels.

However, a few large-scale publishers have recently attempted to sell Japanese novels and comics in foreign countries to compensate for lost domestic revenues. The shrinking domestic market has caused Japanese publishers to enter international markets.

Goods and services provided over the Internet often have instantly global impacts. For example, the introduction of electronic publishing by Amazon attracted global attention, and Google's book search posed copyright problems in the United States and many other countries. The Internet and globalization of the publishing industry have likewise had a profound effect on Japanese publishers, especially with respect to the electronic publishing market.

In Japan, the distribution of comic books and short novels via cellular phones began in 2000, before the entrance of electronic publishing services by Amazon, and cellular phone reading became popular among young people. However, Japanese electronic publishing failed to gain traction on the global market for the following reasons: First, the distributed comic books and novels were written in Japanese, as were the physical books. Second, the Japanese formats for electronic publishing were specific to Japan and incompatible with the formats and devices of other countries. Japanese book style differs from western counterparts.⁴ When the Japanese electronic publishing providers began their services in the early 2000s, no international file formats existed, prompting Japanese companies to develop file formats specific to Japanese-style books. Before international de facto standards such as EPUB 3.0 and AZW were introduced, Japanese file formats had been well established and used in Japan. Japanese electronic publishing developed as a closed system beginning in the 2000s, and Japanese publishers missed the opportunity of first-mover advantages in the worldwide electronic publishing business.

In 2012, certain changes occurred in the Japanese electronic publishing market. First, the largest Internet shopping provider in Japan, Rakuten, acquired Kobo, a

³Total employee of the Japanese publisher that produced the highest number of first-run books in 2012 was less than 1,000.

⁴For example, most Japanese novels adopt a top to bottom writing format, whereas western-style format is from left to right.

Canadian manufacturer of electronic publishing devices, and began electronic publishing services using Kobo's devices. Second, Amazon Japan also entered the market through its Japanese Kindle store in the same year. Rakuten and Amazon Japan adopted the file formats EPUB and AZW, respectively, which had already penetrated foreign markets. Although Japanese electronic publishing developed using Japan-specific file formats up to this point, Japanese publishers that wanted to sell their manuscripts via Rakuten and Amazon Japan had to create EPUB- and AZW-based digital files. Therefore, the entry of these two companies into Japan's electronic publishing market gave Japanese publishers the opportunity to engage in the global environment. This heralded the start of globalization in the Japanese electronic publishing industry.

The file formats for electronic publishing are technical standards that generate network externalities, and the selection of file formats has a great impact on business growth. This chapter examines the response of the Japanese publishing business to globalization with respect to file format.

The rest of this chapter is organized as follows: Sect. 8.2 explains the economic implications of the standardization of file formats and briefly surveys the economic literature on standardization. Sections 8.3 and 8.4 provide an overview of electronic publishing in the United States and Japan, respectively. Section 8.5 discusses the implications of the electronic book exchange format created in Japan to solve the conversion problem. The final section offers concluding remarks.

8.2 File Formats as Technical Standards

Technical protocols generally specify the characteristics and technological capabilities of products and services. In the case of electronic publishing, various features such as re-flow, embedded hyperlinks, sound and video support, and embedded annotation support depend on the combinations of file formats and devices available on the market. Multiple file formats and devices enable product differentiation and thereby expand the menu of services available to consumers.

Electronic publishing consists of three elements: a manuscript, a website to execute sales transactions, and a viewing device used by the end consumer. These three elements have a vertical relationship to one another. Consumers often use a particular device once purchased for several years, although device prices have recently decreased. Moreover, when electronic publishing subscribers change providers, they are sometimes required to purchase devices designated by the new providers.⁵ Such customers may not read the products that they bought from their

⁵ However, consumers now have access to all-purpose devices such as smart phones in addition to designated devices to read electronic publications.

former provider.⁶ Thus, users are locked-in by a specific digital book seller due to the switching cost of changing providers. Consumers often choose the electronic publishing provider that offers an extensive array of book titles to avoid the inconvenience of having to change providers.

When publishers sell a manuscript through an electronic publishing provider, they must create data files in the format designated by the provider. Differing file formats among electronic publishing providers require publishers to create multiple data files based on each provider's requirements, which is a burden for publishers. Thus, publishers are likely to contract with electronic publishing providers that offer access to more users. In this way, a positive feedback functions between users and publishers thereby the electronic publishing market is a two-sided market, as proposed by Rochet and Tirole (2006). The selection of file format that influences the number of electronic book titles is a significant factor with respect to electronic publishing provider business strategy.

Although technical standards are broadly classified into *de jure* and *de facto* standards, other classifications also exist. A technical specification that everyone can access free of charge is termed an open standard, and the technical specification that only specific person or organizations can access is termed a closed standard. The firms holding specific technical standards often take strategic action in industries where network externalities exist.⁷ Considering the importance of the standards ownership, David and Greenstein (1990) classified technical standards into four types: unsponsored standards, sponsored standards, agreements within voluntary standards writing organizations, and direct government promulgation. They then conducted a survey on the economic implications of each type of standard. With respect to file formats for electronic publishing, AZW is a closed and sponsored standard, whereas EPUB is an open standard established by a voluntary standard writing organization.

Shintaku and Eto (2008) stated that when a technical specification is open and sponsoring firms are committed to the standardization of the technology, the product market using the technology rapidly expands. However, standardized products do not facilitate product differentiation, and this could lead to fierce competition in pricing. In the case of electronic publishing, there is no difference among the contents of the same book title. Electronic publishing providers compete on factors such as pricing,⁸ service features, and website design and functionality,

⁶ When subscribers in Japan change cellular phone service providers, they cannot transfer music and electronic books downloaded onto the original cellular or smart phone to the new provider-designated device. This is because the software for electronic publishing differs among cellular phone service providers.

⁷ For example, firms set low initial prices to increase early stage purchasers or users and exploit network externalities.

⁸ Resale price maintenance has been applied to physical books in Japan, whereas the prices of electronic publications are set by contracts between publishers and providers. Regarding the setting of prices, there are two scenarios: either the publishers set electronic publishing prices or the provider sets the prices.

instead of products. Therefore, competing with the same file format may limit a provider's service differentiation.

Standardization is expected to improve production efficiency owing to economies of scale, but it may also reduce the degree of product variety. Farrell and Saloner (1986) analyzed the tradeoff between the advantages of standardization and the disadvantages associated with reduced product variety using a theoretical model. Compatibility between different protocols, however, may achieve the benefits of standardization without losing variety. Farrell and Saloner (1992) discussed the role of converters in the relationship between compatibility and social welfare. The electronic book exchange formats discussed in Sect. 8.4.3 serve as converter between multiple file formats.

8.3 Electronic Publishing in the United States

8.3.1 *Overview of the United States Market*

In 2007, Amazon began selling its Kindle electronic reading devices, in addition to selling physical books via the Internet. Several companies such as Sony, Barnes & Noble, and Apple followed Amazon and entered the U.S. electronic publishing market.

Amazon was an early entrant into the electronic publishing market in the U.S. and gained a competitive advantage over its counterparts for a number of reasons: First, Kindle devices have gained popularity among consumers, and Amazon provides an extensive catalogue books and newspapers through its electronic publishing website, the Kindle Store. This has fueled a positive feedback function between hardware and software for Amazon.⁹ Second, Amazon does not charge users communication fees for downloading digital files. The absence of download charges is attractive to users. Third, the Amazon website is familiar to Internet users and Amazon had already acquired a large number of users prior to launching its electronic publishing services.

In contrast, Apple entered the electronic publishing market with an all-purpose device, its iPad, in 2010. Prior to this, Apple had been engaged in music distribution with the use of the popular iPod since 2003 and had acquired many customers who were loyal to Apple's products and services. This customer base helped Apple gain market share, making the Apple's electronic publishing services a success. Amazon and Apple are currently the main electronic publishing providers in the United States.

⁹ However, at the present, electronic books bought from the Kindle Store are compatible with devices such as smart phones.

8.3.2 File Format

The predominant file formats used in the United States and Europe are AZW established by an Amazon subsidiary and EPUB. Although the specification of AZW is not open, the tool for making AZW files is provided at no cost, allowing authors and publishers are able to create AZW files for their manuscripts independently. EPUB files can be converted into AZW files. Therefore, Kindle users can read electronic books initially stored in EPUB, which enhances the utility of the Kindle users. In contrast, AZW data files cannot be transformed into EPUB files, making compatibility between AZW and other file formats asymmetric.

The file format adopted by Apple, Google, Sony, and other providers is EPUB. EPUB can be accessed free of charge and the program specifications are publicly available. It was created by the International Digital Publishing Forum (IDPF) based on XML (extensible markup language). The IDPF's predecessor is the Open eBook Initiative that consisted of software companies, publishers, printing companies, and computer manufacturers. The Open eBook Initiative was reorganized as the Open eBook Forum (OeB) in 2002, and the name "OeB" was changed to "IDPF" in 2005. The standards-setting process that is discussed and formulated publicly through the input of many related entities is referred to as a forum standard. The forum standard can be often observed in the information and communications field, and EPUB is a prime example.

The IDPF organization approved file format OEBP1.0 in 1999, EPUB2.0 in 2007, and the latest version, EPUB3.0, in 2011. The original EPUB format was created for western country electronic publishing; this made OEBP1.0 and EPUB2.0 unsuitable for the Japanese top-to-bottom book style. However, several functions were added to EPUB3.0 to enable its application to the Asian country book style.

8.4 Japanese Electronic Publishing

8.4.1 Overview of the Japanese Market

Papyless founded by the former employees of the Japanese computer manufacturer Fujitsu began distributing digital books to personal computers in 1995. This was the first electronic publishing provider in Japan. In 2000, NTT docomo, Japan's largest cellular phone service provider, began distributing comic books and short novels via cellular phone, and several publishers collaborated with the company in establishing websites to distribute and sell electronic book data to personal computers and cellular phones. Additionally, Matsushita (currently Panasonic) and Sony entered electronic publishing business in the early 2000s by selling specialized devices for reading electronic publications. However, these two services did not succeed in penetrating the market because they offered a limited number of

titles and their services were not user friendly. Consequently, both services were suspended by 2009. Electronic publishing using specialized devices such as Kindle began in the United States in the late 2000s, whereas a similar business model was failing in Japan at the almost same time.

Impress R&D (2011) stated that revenue from electronic publishing distribution through personal computers was 5.3 billion yen in 2010, whereas that through cellular phones was 57.2 billion yen. This highlights the fact that the vast majority of Japanese electronic publishing business comes from distribution via cellular phones. However, the ratio of digital books to total books (physical and digital books) sales was small at 7.1 % in 2010.

8.4.2 The Japanese File Format

Electronic publishing file formats developed in the United States and Europe could not initially be applied to Japanese books because of style and typesetting differences. This prompted the development of Japan-specific file formats. The main formats that were adopted in Japan are XMDF (ever-extending mobile document format), established by an electronics manufacturer Sharp, and .book. Sharp entered the electronic publishing services industry using XMDF in 2001, and this format became widely used for electronic publishing by cellular phone providers. The format .book was established by Voyager, a company that operates an electronic publishing website in Japan, and has been used by many Japanese publishers.

The XMDF format is based on XML (extensible markup language). Although XMDF is not directly compatible with other file formats, XML files can be converted to XMDF. Contrastingly, .book is based on the TTX format, which expanded HTML (hyper text markup language)—the markup language used for the majority of web pages. Although TTX can be converted to XHTML (extensible hypertext markup language), .book is also not directly compatible with other formats.

XMDF and .book are Japan-specific file formats. Japanese publishers and authors who intend to sell their manuscripts via Apple or Amazon must create new data files based on EPUB or AZW. The creation of multiple files for each manuscript constitutes an additional burden for publishers. Furthermore, in order to view digital books made in different file formats, users must download format-specific software. The coexistence of a plurality of file formats is inconvenient for publishers and readers, even though they facilitate a wider choice of services.

8.4.3 Electronic Book Exchange Format

There are various formats worldwide; thus, the problems occurring because of multiple file formats are not unique to Japan. However, the problem is more serious

in Japan, because Japan-specific file formats penetrated prior to the introduction of international formats. Adapting to new file formats represents a heavy burden, especially for small publishers.

A software program, electronic book exchange format, that converts data files between formats has been developed in Japan to solve the conversion problem. Data files created using the electronic book exchange format can be easily converted into other file formats that an electronic publishing provider might designate. Although publishers are required to create exchange format files, the burden of conversion to another file format may be reduced to some degree by the conversion capability of the electronic book exchange format.

The motivation to develop electronic book exchange format stemmed from a government proposal. In 2010, the Ministry of Internal Affairs and Communications (MIC); the Ministry of Education, Culture, Sports, Science and Technology (MEXT); and the Ministry of Economy, Trade and Industry (METI) jointly established an Advisory Committee to Promote the Use of Publications in the Digital Networked Society. The advisory committee proposed the development of the electronic book exchange format that converts files created in other formats.¹⁰ Based on the proposal, the electronic book exchange format standardization project was launched in 2010 using monetary support from the Japanese government. The conversion tool between .book and exchange format, and between XMDF and exchange format, was subsequently created and announced by the Electronic Book Publishers Association of Japan (2011). The Electronic Book Publishers Association of Japan, jointly established by the major Japanese publishers, is currently carrying out file format research.

8.5 The Implications of Electronic Book Exchange Format

Although the unification of file formats reduces costs for publishers and is expected to increase the number of electronic book titles available, it may reduce the variety of services now available to consumers. Moreover, under a unified file format, technological progress might deteriorate because competition between formats is eliminated. Both the coexistence of multiple formats and unification of formats have disadvantages as well as advantages.

The electronic book exchange format acts as a converter between different formats and may contribute to cost reductions for publishers without losing service variety. Developing the electronic book exchange format as a converter may be a realistic measure considering the market penetration of several other formats.

The Japanese government has recently supported the overseas distribution of cultural products such as movies and music to increase the international exposure of Japanese culture. If Japanese digital content can be easily converted into foreign

¹⁰To access the proposal, see the Ministry of Internal Affairs and Communications (2010).

formats via the electronic book exchange format, this could increase the dissemination of Japanese publications overseas. The electronic book exchange format is, therefore, expected to contribute to overseas sales of Japanese cultural goods.

However, the exchange format possesses certain limitations. First, accuracy in the conversion of different formats is essential. Furthermore, when other file formats are updated, the exchange format must be revised according to these updates.

Second, several Japanese providers that recently entered the business, such as Rakuten, have adopted EPUB as a file format, although Amazon Japan entered the electronic publishing business using AZW. Consequently, the use of the EPUB format is growing in Japan. If EPUB becomes the de facto standard in Japan, the demand for electronic book exchange format may decrease. Some believe that the exchange format that enables the conversion between file formats is useful, whereas others state that the electronic book exchange format will soon be unnecessary because of market penetration by EPUB. The utility of the exchange format depends on the adoption of future file formats.

Third, the Japanese government has often facilitated standardization in the information industry and initially exercised an initiative to establish electronic book exchange format. However, the publishing business developed originally without government support. Although the Japanese government started supporting the export of cultural goods, the effects of this support remain unclear. The roles of the government in the standardization process and the promotion of cultural industries need to be readdressed.

8.6 Concluding Remarks

Amazon Japan, an online bookstore, introduced new services such as multi-page viewing and website recommendations, demonstrating a pioneering spirit. Despite these innovations, Amazon Japan was just a large bookstore that sells books at prices set by publishers. Contrastingly, Amazon Japan's entrance into the electronic publishing business in 2012 had a substantial impact on the Japanese market that distributed comic books and short novels via cellular phones. Compounding this change, a Japanese company acquired a foreign manufacturer of electronic publishing devices and entered the electronic publishing business using EPUB that same year. Although the Japanese publishing industry was originally built on a closed system, the market took the first step toward globalization in 2012. However, Japanese electronic publishing providers that initiated services in the early 2000s exited the market several years later, and the ratio of digital books sales to total books sales remains small. It is uncertain whether the Japanese electronic publishing market will successfully expand, as has been the case in both the United States and the United Kingdom.

Although Japanese large-scale publishers have recently explored overseas markets, file formats, copyright protection periods, the setting of book prices, contracts

between authors and publishers, and other business customs differ between Japan and many foreign countries. Whereas international coordination toward unification is essential for the development of borderless Internet businesses, publications are cultural goods for which diversity is an asset. At first glance, this presents the publishing industry with contradictory requirements, to both respond to globalization and maintain the diversity or originality found in Japanese culture. Generally, when social systems such as customs and rules differ across countries, there are rational reasons for the differences. Regarding the publishing market, it may be necessary to distinguish between systems that should be unified internationally and those that should have Japanese characteristics.

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Chapter 9

“Limited Regular Employees” and Boundary of Employment: An Analysis by the Three-Layered Labor Market Model

Mitsuthoshi Hirano

Abstract This chapter insists that it is possible to set up new classifications of “utilized non-regular employee” and “limited regular employee” as intermediate labor markets aside from the “regular employee” in the internal labor markets, which is historically recognized in Japanese companies; non-regular employees are recognized in the external labor market. Here, the “limited regular employee” refers to an employee whose employment period is indefinite (with limitations on the working place, type of job, and working hours). The “regular employees” supported Japanese management, but “non-regular employees” are playing a very important role in the management activities of today’s Japanese companies. This chapter indicates the possibility of further classification of “regular employees” instead of generalizing them in one segment.

Keywords Boundary of employment • Employment Category • Limited Regular Employees • The three-layered labor market model

9.1 Introduction

Japan’s economy straggled with the global financial crisis that originated with the Lehman Shock that occurred in fall 2008. The Japanese manufacturing companies, which are dependent heavily on foreign demand, reduced a large number of non-regular employees, such as temporary workers and part-time workers (hereafter referred to as “non-regular employees”), to prepare for a drastic economic recession that would entail reduced production and serious inventory adjustments. The majority of these non-regular employees were primarily discharged based on a legal method that terminated their contract periods on their contractual maturity dates. However, the employment adjustment that targeted non-regular employees was referred to as the “dismissal of temporary employees” or the “dismissal of

M. Hirano (✉)

Professor, Human Resource Management, Graduate School of Business Administration,
Kobe University, Kobe, Hyogo, Japan

e-mail: hiranom@kobe-u.ac.jp

non-regular employees.” These actions caused social problems. Since that time, discussions have been actively conducted among government, labor, and management. The goal of these discussions is to facilitate the conversion of non-regular employees of fixed term contracts into non-fixed term regular employees. In an effort to stabilize non-regular employees’ employment and develop their skills, measures were introduced to create a new form of employment known as “limited regular employees.” Although progress has been gradual, policy measures are being formulated to solve the problems of non-regular employees.

For example, the Revised Labor Contract Act enacted in 2012 mandated that companies must convert the fixed-term employment contracts of non-regular employees to non-fixed term employment contracts if non-regular employees have worked in the same workplace for more than 5 years. However, because companies are hesitant to immobilize employment by freezing staff assignments, they may hesitate to engage in contract renewal (i.e., to convert non-regular employees to regular employees). Thus, a number of issues remain unsolved and additional efforts are required to achieve anticipated results from stabilization of non-regular employees’ employment and the correction of unbalance treatment between non-regular and regular employees.

First, the situation described above might be attributed to the ambiguous boundary that exists between regular and non-regular employees. In other words, answers must be found for the questions: “What is a *seishain* (regular employee)?” and “What is a non-regular employee?” In reality, it is impossible to differentiate between these employees based on employment period, length of labor hours, and job content. Although many part-time employees continue to work under contracts that do not specify employment periods, some regular employees work under contracts that specify employment periods.

It is apparent that attempts to classify employees into regular and non-regular groups is useless because “diversification of employment categories”¹ (Sato 2008; Nishimura, and Morishima 2009) has been increasing. In other words, the concept of “limited regular employees and unlimited non-regular employees” (Sato 2012) continues to spread. This indicates an increase in “limited regular employees” who possess more limited comprehensiveness and constraints than the affiliated organization might impose on regular employees at its own discretion. These limitations and constraints include personnel changes in work locations and job contents.

In an attempt to address changes surrounding the internal labor market, Hirano (2010) modified the two layers of the internal labor market (for regular employees) and the external labor market (for non-regular employees) and proposed the “Three-Layered Labor Market Model” that created the intermediate labor market. This new labor market is comprised of qualitative utilized non-regular employees and “limited regular employees.” This hybrid labor market is interpenetrated both

¹Employment category is a mechanism used to divide employees (including non-regular employees) into several groups to ensure efficient and effective development, securement, utilization, and treatment. It involves HR management suitable to respective groups (Imano 2010).

by the internal labor market and the external labor market. Hirano (2011) partially verified the reasonability and rationality of the model. This chapter attempts to analyze the term, “limited regular employees,” as an employment category positioned around the “boundary of employment” in the Three-Layered Labor Market Model. It presents a discussion of the rationality of the Three-Layered Labor Market Model based on the characteristics of companies that actually introduced the human resources (HR) management policy of “limited regular employees.”

9.2 Limited Regular Employees and Unlimited Non-regular Employees

9.2.1 What Is a *Seishain* (Regular Employees)?

Since the 1990s, many Japanese researchers have examined the qualitative utilization of non-regular employees. On the other hand, the term, “diverse regular employee” or “limited regular employee,” is a keyword that has attracted attention since the 2000s. In all likelihood, Hisamoto (2003) first clearly insisted on the use of the phrase, “diverse regular employee,” in Japan. Recently, a significant number of studies have actively examined the use of the term, “diverse regular employee” including “limited regular employees” (See, e.g., Morishima 2011; Ministry of Health, Labor and Welfare 2012). What factors have been used to differentiate between the terms “limited regular employee” and “so-called regular employee,” in the literature until now?

Hisamoto (2010) examined the meaning of the term, “*seishain* (regular employee),” from the perspectives of “job benefits” and “duties.” The treatment of a regular employee can include long-term stable employment, regular pay raises based on performance assessment, and opportunities for promotion. Duties can be characterized by uncertainty and comprehensiveness of job scope (As a result, it is expected that a regular employee will perform tasks as requested by his/her company), and by such restrictions as overtime work, reassignment to a different position, and transfers to a different work place. In this paper, regular employees affected by these job benefits and duties will be referred to as “so-called regular employees.”

Tsuru (2011) pointed out the following three factors in his definition of “so-called regular employees:” (1) They are employees who will receive indefinite future assignments. It is assumed that these employees will accept all requirements, including unexpected overtime work, relocation, and changes in job scope. (2) They signed contracts that did not specify employment periods; and (3) they are subject to application of the legal principle related to the Employment Dismissal Regulations in Japan.

Sato (2012) indicated that indefinite operations for utilization, indefinite offices, and locations for transfer, overtime work, and full-time service were the four criteria that could be used to differentiate “so-called regular employees.” In other

words, the employment category that satisfies all four criteria based on the non-fixed term employment contract would be “regular employee.” The “limited regular employee,” is an employment category that is unable to satisfy one or several of the four criteria noted above. This category is subject to other criteria, such as limited job scope, limited working hours (part-time and full-time working hours without overtime work), and limited work locations.

9.2.2 Changes of the Internal Labor Market in Japan

The Labor market theory, pioneered by Doeringer and Piore (1971), helped developed the dual labor market hypothesis that allows the separate coexistence of the internal labor market (the “so-called regular employees”) and the external labor market (the “so-called non-regular employees”). The former is characterized by generous employment security, provisions and opportunities for career development and fair evaluation and treatment: this can be observed in large companies. The latter is characterized by low wages, a lack of employment security, and scarce learning opportunities and can be observed in the lower rungs of the “in-company labor market” and outside corporate setups.

To handle the internal labor market, centralized HR management must operate that isolates regular employees from the job change market. Non-regular employee allows on-demand recruitment from the market that serves as a buffer that supports the employment security of regular employees. At the same time, the internal labor market exists because it constructs a “conversion wall” that cuts off the positions of regular and non-regular employees. This wall causes difficulties for a non-regular employee who hopes to become a regular employee.

However, Genda (2008) found that non-regular employees actually have a positive coefficient between the length of continuous service and annual salary. They enjoy evaluations based on work experience similar to regular employees. This finding is contrary to the dual labor market hypothesis. That is, the upper layer of non-regular employees is positioned directly below the lower layer of regular employees in the internal labor market. This is to say, when the replacement of regular employees by non-regular employees during operations occurred, non-regular employees expanded their job scopes, advanced their operations, and, on occasion, were promoted to supervisory positions as a result of qualitative utilization.

Alternatively, however, non-regular employees’ qualitative utilization deteriorated the fairness of treatment of “so-called regular employees.” Although the number of non-regular employees who accepted jobs performed by regular employees increased, wages and treatment of non-regular employees did not improve. This demonstrated that companies struggled to provide balanced treatment. This resulted in non-regular employees’ growing dissatisfaction. As a result, policy measures that attempted to correct disparities, such as the Revised Part-time

Employment Act, and the above-mentioned Revised Labor Contract Act, were enacted.

Currently, the introduction of policies to address “limited regular employees” might include one of the above-mentioned policy measures. The quantitative utilization of non-regular employees developed first. The qualitative utilization that occurred following the development of the initial quantitative utilization exposed difficulties related to the unbalanced treatment of non-regular employees. To address the unbalanced treatment that occurred between regular and non-regular employees, companies had to improve the system that allowed non-regular employees to become regular employees. In fact, Morishima (2011) compared companies that introduced the “limited regular employees” policy and those that failed to introduce it. He found that the former companies recognized that limited regular employees’ system was an important policy for management.

However, from the standpoint of companies’ demand for HR, it can be too difficult to convert qualitative utilized non-regular employees to “so-called regular employees.” In addition, from the viewpoint of work life balance, some non-regular employees dislike the constraints placed on “so-called regular employees.” A gentle coefficient exists between the upper layer of non-regular employees and the lower level of regular employees because a conversion system is required to overcome the “wall of conversion.” This may lighten burden that requires regular employees to do virtually all tasks required, while maintaining conditions of long term stable employment.

9.3 The Three-Layered Labor Market Model and the Boundary of Employment

9.3.1 The Background Information Related to the Increase in “Limited Regular Employees”

This section presents a summary of the facts related to the increase in “limited regular employees.” The efficiency of Japan’s large companies was established by dual utilization that employs the internal labor market that is subject to the “organization principle” that allows companies to allocate human resources by authority of HR management. The external labor market is subject to the “market principle” that allows companies to decide to participate in or withdraw from the market at their own discretion by the use of prices (wages) as signals. Dual utilization was achieved by the development of the “wall of conversion” that enforces the positions of both “so-called regular employees” and non-regular employees. This occurred because it is possible to improve organizational capability (functional flexibility) to cope with environmental uncertainty promptly and flexibly by utilizing regular employees who have been developed internally. The utilization of non-regular employees drawn from the external labor market as

needed increases companies' numerical flexibility to respond to business fluctuations and allows companies to reduce total labor costs as financial flexibility (Atkinson 1985).

The employment system is affected by the expansion and contraction of the macro economy. The Japanese economy entered into a stagnant period because of monetary restraints and subsequent falling stock and land prices, declines in demand, and excessive supply. The failures of *Hokkaido Takushoku Bank* and *Yamaichi Securities* in 1997 prompted Japanese companies to perform active reviews of their employment systems. In particular, companies' efforts to control and manage the number of regular employees grew stricter. Significantly more non-regular employees were hired to replace decreasing numbers of regular employees (that is, quantitative utilization). At the same time, qualitative utilization that allowed non-regular employees to perform responsible jobs traditionally performed by regular employees increased.

The overlapping roles and responsibilities assumed by non-regular employees and "so-called regular employees" created difficulties related to balanced treatment. However, even though the number of qualitative utilized non-regular employees increased, attempts to convert them into "so-called regular employees" meant that supply exceeded demand in HR management. It also impaired the financial and numerical flexibility provided by non-regular employees. At the same time, from the viewpoint of work life balance, many non-regular employees wanted to work without restrictions. As a result, discussions related to the introduction of "limited regular employees" between the internal labor market ("so-called regular employees") and the external labor market (non-regular employees) as a buffer employment category became active.

9.3.2 *Boundary of the Firm*

How can the creation of the Three-Layered Labor Market Model be organized theoretically? The term, "Three-Layered Labor Market," is used to describe the birth of the "intermediate organization that is interpenetrated by organization and market principles" that developed between the internal labor market that is subject to the organization principle, and the external labor market that is subject to the market principle. This is based on the viewpoint of transaction cost economics (TCE) that positions market and organizations in the mechanism of alternative coordination (Williamson 1985, 1996).

TCE designates a transaction as the unit of analysis for the uniform understanding of markets and organizations. Each transaction has its own transaction attributes. Different transaction forms are selected to economize transaction cost. TCE specifies that the transaction cost is the cost to search for a trading partner, to negotiate and conclude a contract, monitor its execution, dispute settlements, and engage in contract renewal. Transaction cost increases based on the premise that a contract is incomplete. This increase occurs because it can be difficult to collect all

information necessary for the transaction in advance and because people often engage in opportunistic behavior. Moreover, if a transaction has a certain attribute, management may attempt to absorb it into the company by vertical integration to economize the transaction cost.

The three attributes that affect transaction cost are asset specificity, uncertainty, and frequency. Asset specificity includes the construction of a distribution center adjacent to the trading partner’s factory, the purchase of fabrication machinery specially designed for the production of parts for the trading partner, and the development of human resources that learn and share the firm specific knowledge. Transaction uncertainty can induce the opportunistic behaviors of the trading partner. Transaction frequency decreases uncertainty and increases asset specificity because an increase in transaction frequency encourages both parties in the transaction to increase learning to achieve sequential adaptation. These kinds of adaptive behaviors can be observed in the form of additional investments for specific transactions, namely relation-specific investments that create far larger value if an investment is made in the assets of both parties involved in the transaction.

In this case, the parties concerned are locked in partnership with each other because it would be difficult to change from the current trading partner to another trading partner. If each party is locked in, the possibility exists that one of the parties concerned may be exposed to the opportunistic behavior of the other party. This is called a “holdup problem.” In other words, because one of the parties is afraid of being betrayed by the other party, that party holds back when the relation-specific investment arises. Therefore, it is necessary to make an accurate selection from three alternatives: (1) spot market (free exchange relationships in the market), (2) relational contract or intermediate organization (long-term continuous transaction as observed in industrial grouping), and (3) internal organization (vertical integration) to control opportunistic behavior and decrease ineffectiveness in the transaction.

9.3.3 Relation-Specific Investment and the Holdup Problem

In this section, the above-mentioned discussion is expanded to address the “boundary of employment” problem. Human resources become specific assets when they acquire firm specific skills that cannot be easily reallocated in the market. When a worker makes a relation-specific investment in the firm specific skills, he responds to risk created by the employer’s opportunistic behaviors (e.g., dismissal and wage cuts) unless he is provided with long-term employment security. This creates an incentive for insufficient investment in the firm specific skills (i.e., the holdup problem).

Bilateral commitment by both parties to execute the contract again in relation to risk sharing is required to solve the holdup problem. Employers must commit themselves to long-term employment periods for workers and workers must commit themselves to improving the firm specific skills. The conversion of an

non-regular employee into a regular employee whose employment is protected by the Employment Dismissal Regulations are applied functions as the commitment mechanism to ensure stable and continued employment relations. As a result, labor and management facilitate the relation-specific investment without worrying about the occurrence of the holdup problem. This is the “significance of employing regular employees.”

On the other hand, the employment of regular employees generates internalization (bureaucratic) cost. For example, training investment is required to develop the firm specific skills. This may enforce staff assignments, decrease incentives, and cause increases in surplus workforce. Accordingly, human resources are traded in the market when workers’ relation-specific investments are low. This strengthens the association with the external labor market. Introduction of the transaction form derivative of the market can increase efficiency in the internal labor market. This is the “significance of non-regular employment” based on the premise of fixed term contracts.

9.3.4 Task Uncertainty and Moral Hazard Problem

Another factor that affects transaction attributes in TCE is uncertainty. If uncertainty is applied to the employment issue, a manager can assign specific tasks to workers. Workers concentrate their efforts on those tasks and receive wages in exchange for their efforts. Based on this relationship, it is possible to state: The higher the task uncertainty, the higher the cost to monitor workers’ behaviors. It is also more difficult to evaluate personal performance and the effort levels of each worker. Therefore, increases in task uncertainty may cause workers’ opportunistic behaviors (labor slowdown and free-riding). In other words, moral hazard problems may arise.

To remedy this situation, introduction of the promotion incentive system on a long-term employment contract relationship, rather than a short-term contract relationship, will be effective. Promotion will exhibit indirect incentive effects because workers are interested in the influence of current results and abilities over their future career formation (Gibbons and Murphy 1992). Repeated negligence and free-riding causes bad reputations with colleagues. These behaviors may decrease the possibility of future promotions and long-term employment security. Incremental promotions and advancement are effective ways to increase workers’ effort levels. As a result, moral hazard problems can be reduced.

In conclusion, providing workers with promotion incentives based on long-term employment, (that is, treatment of regular employees), is recommended because of the greater likelihood that increased task uncertainty can increase moral hazard problems on the workers’ sides. Alternatively, if tasks distributed to workers have low uncertainty, the provision of spot incentives for short-term employment (that is, treatment of non-regular employees), can be effective.

9.3.5 *The Three-Layered Labor Market Model*

Figure 9.1 illustrates the concept of the Three-Layered Labor Market Model that is based on the discussions presented above. The vertical axis indicates relation-specific investment (RSI); the horizontal axis shows task uncertainty (TU). Managers attempt to internalize employment with high RSI and TU to economize transaction cost. Employment relations are the internal labor market that motivates the development of the firm specific skills and provides organizational incentives to facilitate collaboration. The employment category is the “so-called regular employee.” Adversely, if the degrees of the two axes are low, the transaction must strengthen its association with the market. In other words, the external market is the location where workers are recruited as needed and human capital is not invested. Here, the employment category is the “non-regular employee.”

The intermediate labor market lies on the boundary of employment. In the intermediate labor market, it is possible to observe diverse categories interpenetrated by the market principle and the organization principle. Here, line RSI_1-TU_1 is the “boundary of employment,” which is the boundary that divides fixed term and non-fixed term employment. The intermediate labor market is divided into two parts by the boundary of employment. The lower side consists of qualitative utilized non-regular employees who improve the firm specific skills up to the medium level by the repetition of fixed term employment contracts. The upper side consists of “limited regular employees” who are exempted relocation, transfer, and job changes in site of they possess non-fixed term contracts. (However, employer’s commitment to employment security is not as strong as the commitment maintained for “so-called regular employees.”)

The model presented above provides proposition related to selection in the labor market. As task uncertainty—primarily, relation-specific investment that occurs between employee and employer to increase the firm specific skills—increases, the intermediate labor market (that is, qualitative utilized non-regular employees and limited regular employees) would be appropriate rather than the external labor market (that is, non-regular employees), and the internal market (that is, “so-called regular employees”) would be appropriate rather than the intermediate labor market.

9.4 Characteristics of Companies That Introduced the “Limited Regular Employees” Policy

9.4.1 *Basic Hypothesis*

The “limited regular employees” policy consists of the category of existing regular employees. Therefore, as Morishima (2011) indicates, decisions related to whether or not the “limited regular employees” policy should be introduced, affects the HR

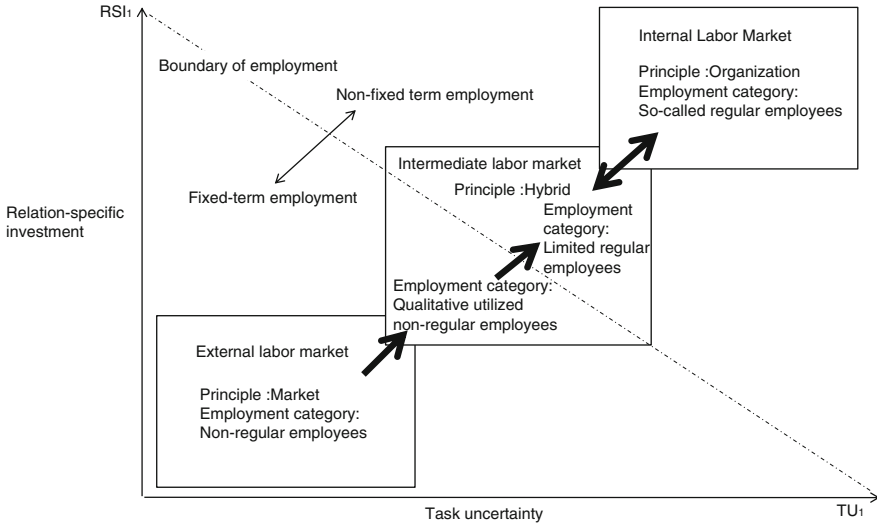


Fig. 9.1 The three-layered labor market model

management of “so-called regular employees.” Similarly, if transition to “limited regular employee” status means a step in the process of career development for qualitative utilized non-regular employees, the introduction of the “limited regular employees” system will be affected by the treatment of qualitative utilized non-regular employees.

The Three-Layered Labor Market Model locates “limited regular employees” on the upper right of the “employment boundary” in the intermediate labor market. Accordingly, companies that introduced the “limited regular employees” policy demand more relation-specific investment in “so-called regular employees” than those that did not introduce the policy. In other words, the greater the relation-specific investment a company requires for “so-called regular employees,” the greater the need to introduce the “limited regular employees” policy. In particular, the relation-specific investment in this case is a way that HR management can ensure a broad range of job rotations aimed at the development of the firm specific skills and organizational identification, adaptation to the corporate culture, and a broad range of organizational socialization activities. At the same time, strong employment security must have been provided to solve the holdup problem that might have occurred due to relation-specific investment.

On the other hand, qualitative utilized non-regular employees are positioned at the lower left side of the boundary of employment in the intermediate labor market. Accordingly, companies that introduced qualitative utilization policy appeared to enjoy entrusting non-regular employees with supervisory positions. Companies that introduced the system to convert non-regular employees to regular employees are supposedly more advanced in the introduction of the “limited regular employees” policy. Thus, it may be advisable to create the employment category of “limited

regular employees” who are less demanding than the “so-called regular employees” to overcome the development of a “conversion wall” between qualitative utilized non-regular employees and regular employees. The following section examines the characteristics of companies that introduced the “limited regular employee” policy based on the survey data.

9.4.2 *Survey Data*

The survey data used in this paper was collected from a questionnaire survey (hereafter referred to as the “survey”) that Kobe University conducted jointly with the Japan Management Association (JMA) and Kobe Institute for Management and Personnel Studies (KIMPS). The survey targeted HR managers of major companies located throughout Japan. The questionnaire was sent to 5,000 companies on February 2, 2009. Follow-up calls were made to 3,500 companies between February 10, 2009 and February 19, 2009. A total of 365 company respondents returned the completed questionnaires. (The collection rate was 7.3 %.)²

9.4.3 *Results and Analyses*

Relationship of HR Management Policy with “So-Called Regular Employees”

The review of the “limited regular employees” policy included three “limitations:” “employee system with limited work locations,” “employee system with limited job type,” and “short working hours system.” The respondents were sorted into the categories of “policy introduced” and “policy not introduced.” Based on data collected from 365 companies, the ratio of companies that introduced the “work locations limitation employee system” equaled 30.8 % (N = 351). The ratio of companies that introduced the “job type limitation employee system” equaled 19.8 % (N = 353). The ratio of companies that introduced the “part-time working hours limitation employee system” equaled 53.3 % (N = 354). The results of the survey conducted by the Ministry of Health, Labor and Welfare in 2012 revealed that 50 % of the surveyed companies introduced limited regular employees. Of those companies, 90 % introduced the job type limitation employee system, 40 % introduced the work locations limitation employee system, and 10–20 % introduced the short working hours limitation employee system. In comparison with data collected by the Ministry of Health, Labor and Welfare, the data collected during the survey conducted jointly by Kobe University et al. revealed that a much higher

² Please refer the survey report edited by Kobe University et al. (2009) for further details.

ratio of companies had instituted the “short working hours employee system.”³ Because the survey inquired about the existence of a short working hours system, some respondents may have assumed that the question referred to primary short working hours allowed during the child-care leave provided for regular employees. Therefore, it is necessary to note that the “short working hours system” in the survey may not be similar to regular work performed on a part-time basis.

The degree of relation-specific investment can be confirmed by a review of HR management policy. Specific factors were selected from items related to the development of firm specific skills and the facilitation of organizational identification from the HR management policy that was used to organize Hi-Commitment HR management in Baron and Kreps (1999). The factors include (1) strict observance of employment security, (2) implementation of a broad range of socialization and education (aimed at the development of human resources suitable to the needs of the company), (3) implementation of a wide range of job rotations, (4) development of a strong culture to achieve excellent results based on a company’s philosophy and mission, (5) selection of a broad range of promising employees who can align themselves with management philosophy, and (6) strong emphasis on ownership, both symbolic and financial (through stock). Each of the six items was scored on five levels that ranged from “Not important at all” to “Very important.”

Tables 9.1, 9.2, and 9.3 illustrate the results of scoring. Results for companies that introduced the “limited employees” policy are higher than the results for companies that failed to introduce the policy in all personnel management policy areas that organized relation-specific investment. The differences between these groups were statistically significant, with the exception of the degree of observance of employment security in the “job type limited employees” system category.

Relationships Between HR Management Policies and Qualitative Utilized Non-regular Employees

Two aspects of HR management policies related to non-regular employees were examined: “Qualitative utilization of non-regular employees (e.g., appointment to supervisory positions) and “Conversion to regular employee system.” Each company received a score of 1 if it introduced these policies. Each received score of 0 if it did not introduce these policies. Therefore, the scores revealed the ratios of companies that introduced the qualitative utilization policy or the conversion to regular employee system.

³ The question used by the Ministry of Health, Labor and Welfare to categorize employees who work limited amounts of hours in its survey states, “The specified hours of labor are relatively shorter than the hours of labor required for other employment categories in the same company” or “Employees are not required overtime works that are specified in the current rule and labor contract.”

Table 9.1 Relationships between HR management policies related to “so-called regular employees” and the existence of the “employees with limited work location” system

Limited work location system	Not introduced	Introduced	t-test
Employment security	4.17	4.36	-2.00*
Broad range of socialization and educational activities	4.05	4.25	-2.03*
Wide range of job rotations	3.72	4.01	-2.84**
Development of a strong culture	4.23	4.52	-3.26***
Selection of a broad range of employees who can align themselves with management philosophy	4.02	4.32	-3.32**
Strong emphasis on ownership	3.11	3.36	-2.21*

Note: Respondents were asked, “How important are the following HR management policies respectively?”

1 = Not important, 5 = Very important

N: Not introduced = 243, Introduced = 108

*p < 0.05, **p < 0.01, ***p < 0.001

Table 9.2 Relationships between HR management policies related to “so-called regular employees” and the existence of the “employees with limited job types” system

Limited job types system	Not introduced	Introduced	t-test
Employment security	4.21	4.28	-0.56
Broad range of socialization and educational activities	4.07	4.33	-2.33*
Wide range of job rotations	3.76	3.99	-1.93*
Development of a strong culture	4.25	4.56	-2.91***
Selection of a broad range of employees who can align themselves with management philosophy	4.07	4.30	-2.17*
Strong emphasis on ownership	3.13	3.43	-2.27*

Note: Respondents were asked, “How important are the following HR management policies respectively?”

1 = Not important, 5 = Very important

N: Not introduced = 283, Introduced = 70

*p < 0.05, **p < 0.01, ***p < 0.001

Tables 9.4, 9.5, and 9.6 illustrate the results of the survey. Companies that introduced the “limited regular employees system” were more advanced in the introduction of qualitative utilization of non-regular employees and conversion system to regular employees. All results were significant statistically. With respect to the ratios of introduction, the qualitative utilization policy (e.g., appointment to supervisory positions) demonstrated ratios between 16 % and 20 %. The conversion to regular employee policy demonstrated ratios between 66 % and 71 % in companies that introduced the “limited regular employees system.”

The results shown above support the hypothesis. In other words, if a company addresses the qualitative utilization of non-regular employees by adoption of the Three-Layered Labor Market Model, then the “limited regular employees” system will be improved because it forms the foundation for the career formation of

Table 9.3 Relationships between HR management policies related to “so-called regular employees” and the existence of the “short working hours” system

Short working hours system	Not introduced	Introduced	<i>t</i> -test
Employment security	4.10	4.33	-2.55*
Broad range of socialization and educational activities	4.00	4.22	-2.41*
Wide range of job rotations	3.68	3.90	-2.32*
Development of a strong culture	4.18	4.43	-3.08**
Selection of a broad range of employees who can align themselves with management philosophy	4.00	4.22	-2.57*
Strong emphasis on ownership	3.10	3.26	-1.55*

Note: Respondents were asked, “How important are the following HR management policies respectively?”

1 = Not important, 5 = Very important

N: Not introduced = 165, Introduced = 189

p* < 0.05, *p* < 0.01, ****p* < 0.001

Table 9.4 Differences in ratios with respect to the introduction of the qualitative utilization policy for non-regular employees and conversion to regular employee system in relation to the existence of the “employees with limited work location” system

Limited work location system	Not introduced (%)	Introduced (%)	<i>t</i> -test
Qualitative utilization of non-regular employees	9	16	-1.71
Conversion to regular employee system	51	70	-3.46***

N: Not introduced = 243, Introduced = 108

p* < 0.05, *p* < 0.01, ****p* < 0.001

Table 9.5 Differences in ratios with respect to the introduction of the qualitative utilization policy for non-regular employees and conversion to regular employee system in relation to the existence of the “employees with limited job types” system

Limited job types system	Not introduced (%)	Introduced (%)	<i>t</i> -test
Qualitative utilization of non-regular employees	9	20	-2.57*
Conversion to regular employee system	53	71	-2.79**

N: Not introduced = 283, Introduced = 70

p* < 0.05, *p* < 0.01, ****p* < 0.001

non-regular employees. In sum, the “limited regular employees” system will effectively eliminate problems related to balanced treatment, improve employees’ willingness to work, and make screening more responsive. At the same time, with respect to intense searches for relation-specific investment for “so-called regular employees,” the conversion from non-regular employees to “so-called regular employees” will be more demanding. Therefore, it would be effective for

Table 9.6 Differences in ratios with respect to the introduction of the qualitative utilization policy for non-regular employees and conversion to regular employee system in relation to the existence of the “short working hours” system

Short working hours system	Not introduced (%)	Introduced (%)	t-test
Qualitative utilization of non-regular employees	7	15	-2.59**
Conversion to regular employee system	47	66	-3.69***

N: Not introduced = 165, Introduced = 189

*p < 0.05, **p < 0.01, ***p < 0.001

companies to develop an employment category for “limited regular employees” that gently associates “so-called regular employees” with non-regular employees.

The Three-Layered Labor Market Model consists of three classifications: (1) the external labor market (non-regular employees), (2) the intermediate labor market (qualitative utilized non-regular employees and limited regular employees), and (3) the internal labor market (“so-called regular employees”). It functions as the mechanism that can be used to balance wages and treatment of the three employment categories. At the same time, because many non-regular employees, unlike “so-called regular employees,” supposedly cannot accept comprehensiveness and constraint (i.e., conversion of job types, relocation, and long working hours) without complaint, the establishment of Three-Layers will help these employees smoothly overcome the conversion wall. Thus, it is desirable to increase alternatives from the viewpoint of work life balance.

9.5 Summary and Issues

To rely on TCE as a theoretical background, this paper provides a theoretical illustration of the rationality that suggests that companies should convert utilized non-regular employees into “limited regular employees” to transcend the “boundary of employment” when further relation-specific investment is made in the utilization of non-regular employees. This paper conceptualized the changes that occurred in the in-company labor market (employment principle: employment category). It provides a depiction of the change from the dual labor market comprised of the internal and external labor markets to the Three-Layered Labor Market Model comprised of the external labor market (market principle: non-regular), internal labor market (organization principle: “so-called regular employees”), and intermediate labor market (hybrid classification interpenetrated by both market and organization: qualitative utilized non-regular employees or “limited regular employees”) that acts as a buffer between non-regular employees and “so-called regular employees.”

The paper then presents an analysis of the characteristics of companies that introduced the “limited regular employees” system by comparing them with

companies that failed to introduce it. The results of the analysis indicate that companies that introduced the “limited regular employees” tend to be more active in the qualitative utilization of non-regular employees and in improving HR management that requests higher relation-specific investment (e.g., building the firm specific skills) for “so-called regular employees.” Table 9.7 below summarizes the treatment rules for each labor market based on the above discussions.

The “Revised Labor Contract Act” was enforced in 2013 in Japan. It is expected to facilitate the introduction of the “limited regular employees” system. On the other hand, companies that are hesitant to immobilize employment by freezing staff assignments may refuse to renew contracts (i.e., convert non-regular employees to regular employees). This paper illustrates criteria required to make rational judgments related to the conversion of non-regular employees to regular employees. Stated another way, it is necessary to encourage non-regular employees to convert to “limited regular employees” by strengthening employment security if a company wants to eliminate the holdup problem because of further requirement of relation-specific investment.

As Sato (2012) predicts, an issue will develop related to the balance of employment security and treatment between “so-called regular employees” and “limited regular employees” during conversion. For example, “limited regular employees” will not have secure employment if their offices close or if their job type is abolished because they already established work locations and job types. However, it might be possible for workers to maintain their employment if they accept changes in work location and job type proposed by their organizations. Yet, problems will arise if companies must make these efforts to avoid dismissal. It may be advisable to require companies’ HR management to handle these issues or for these issues to be negotiated between labor and management. However, it is

Table 9.7 Contrasts between treatment rules for different labor markets

Labor market	External labor market	Intermediate labor market		Internal labor market
Employment principle	Market	Hybrid		Organization
Employment category	Non-regular	Qualitative utilized non-regular	Limited regular	So-called regular
Employment period	Short-term	Repetition of fixed-term contract	Non-fixed term contract	Non-fixed term contract
Employer’s commitment to employment security	No	Weak	Strong (but conditional)	Strong
Relation-specific investment	Weak	Medium		Strong
Internal promotion	No	With upper limit		Yes
Constraint	Low	Medium		High

recommended that companies publish guidelines to clarify reasons for dismissal to avoid confusion. This would be an important subject for future discussion and research.

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Chapter 10

Changes in Performance Appraisal in Japanese Companies

Naoto Fukui

Abstract This paper investigates the changes in performance appraisal in Japanese companies, with a focus on the purpose of appraisals. It begins by critically reviewing existing literature on the purposes of performance appraisal, and then analyzes secondary data on the purposes of appraisal in Japanese companies, emphasizing that the purposes of appraisal should be congruent with Japanese-style management. It then reviews the concepts of performance management (PM) and shows how PM offers a useful framework for analyzing the expansion of the purpose of appraisal in Japanese companies. PM design is currently one of the hottest issues among researchers in the U.S. This paper also involves a case study on the expansion of purposes of appraisal, using the PM framework. Finally, it concludes that the purposes of appraisal in Japanese companies have expanded in a manner that is consistent with changes in Japanese-style management.

Keywords Human resource management • Japanese-style management • Performance appraisal • Performance management • Purposes of appraisal

10.1 Introduction

This paper investigates changes in performance appraisal in Japanese companies from the point of view of the purpose of appraisal, and discusses the future directions of performance appraisal.

Performance appraisal is a human resource management (HRM) subsystem for evaluating employees' performance. All managers constantly form judgments of their subordinates and, in that sense, continuously make appraisals. However, in human resource management, the term "performance appraisal" is applied to a formal and systematic evaluation made in a prescribed and uniform manner at a set time. The specific definition of a performance appraisal system is still controversial. In this paper, performance appraisal is defined as a system for periodically

N. Fukui (✉)

Associate Professor, Human Resource Management, Faculty of Economics and Business Administration, The University of Kitakyushu, Kitakyushu, Fukuoka, Japan
e-mail: fukuinaoto@kitakyu-u.ac.jp

evaluating an employee's performance based on the approaches of industrial organizational psychology.

Performance appraisal is the most important subsystem in the entire HRM system (Mohrman et al. 1989), because the result of evaluation is reflected in the size of salaries and bonuses that employees receive. Performance appraisal helps managers decide the amount of salary raise to be given to subordinates based on their performance, and determines staffing and speed of promotion. Overall, performance appraisal determines the future use of employees. For instance, it determines whether an employee should remain in his or her present job or be transferred, promoted, demoted, or dismissed. It also indicates the training needs of an employee. If appropriate training is then given, it is possible to confirm the areas of performance where improvements have occurred.

Nevertheless, in Japan, performance appraisal has never been studied, except for in the work of Endo (1999), and no researchers have tried to analyze the influence that performance appraisal has on total HRM systems. As Nomura (2003) has pointed out, little attention has been paid to the purposes of performance appraisal. This issue is very important, as the principles for designing performance appraisals should change depending on the purpose of the appraisal. In order to develop guidelines for the logical design of performance appraisal strategies, it is necessary to analyze their purposes.

As the first step in my analysis, I examine the purposes of appraisal in Japanese companies and analyze how they have changed, which makes it possible to understand actual problems more precisely and to offer recommendations for Japanese companies. This paper also provides fundamental data for determining future research directions.

Considering the analytical perspectives already discussed, this chapter can be summarized as follows. In Sect. 10.2, academic research in the U.S. is reviewed, with a focus on the purposes of appraisal. In Sect. 10.3, secondary data on the purposes of appraisal in Japanese companies is analyzed. Section 10.4 emphasizes that the purposes of appraisal should be congruent with Japanese-style management. In Sect. 10.5, the concepts of performance management (PM) are reviewed to construct an original PM framework, which is useful for analyzing the expansion of the purposes of appraisal. In Sect. 10.6, a case study is carried out on the expansion of appraisal purposes, using the PM framework. In Sect. 10.7, the contents of this paper are summarized briefly, and its theoretical and practical implications are addressed.

10.2 The Purposes of Performance Appraisal

In the U.S., information from performance appraisals has historically been used as a basis for administration (Whisler and Harper 1962), but the purposes of performance appraisal have expanded over time. Drucker (1954) first developed the management by objectives (MBO) approach, suggesting that appraisal organization

should be planned and that managers and subordinates should communicate with each other through MBO.

In 1957, McGregor created X–Y theory, proposing that performance appraisal should be used for feedback and employee development. According to McGregor (1957), performance appraisals should be designed to meet a number of specific needs. First, they should provide systematic judgment that backs up salary raise, promotions, transfers, and sometimes demotions or terminations. Second, performance appraisals should act as a means of telling subordinates how they are doing, and of suggesting needed changes in behaviors, attitudes, skills, or job knowledge. In doing so, they let subordinates know “where they stand” with managers. Performance appraisal is also increasingly used as a basis for coaching and counseling by superiors. It thus has both administrative (judgment) and developmental (counseling) purposes. McGregor emphasized the latter of these two purposes. He insisted that both managers and subordinates communicate with each other frequently in appraisal interviews. He also suggested the use of MBO, which Drucker emphasized as effective for the developmental purpose of appraisals. McGregor also insisted that MBO encourages the use of open-ended appraisal methods and appraisal interviews, and thus, acts as a theoretical basis for bidirectional performance appraisal.

Meyer et al. (1965) stated that appraisal interviews should attempt to accomplish the two purposes described above. However, he argued that the two purposes are in conflict, meaning that the traditional appraisal system essentially becomes a salary discussion in which a manager justifies the action taken. This conflict prevents traditional appraisal discussions from having any major influence on employees’ future job performance. Meyer, Kay and French concluded that an appreciable improvement in employee performance is realized only when specified goals and deadlines are mutually established and agreed on by the subordinate and manager in an interview apart from the appraisal interview.

Early experts of performance appraisal predicted that appraisal would continue to be used for human resource planning and development in the 1990s and beyond (DeVries et al. 1981; Bernardin and Beatty 1984), and it continues to be put into practice today. Since the passage of the 1964 Civil Rights Act and the Age Discrimination in Employment Act, performance appraisal has increasingly been used to safeguard organizations against discrimination lawsuits (Mohrman et al. 1989; Latham and Wexley 1994). Performance appraisals can be used to defend an organization from such lawsuits in the face of stricter regulations on employment discrimination, such as the revision of the Civil Rights Act in 1972. Reinhardt (1985) has explained how the documentation of appraisal results has recently become more important as a measure to protect organizations against lawsuits.

The above information clarifies that the purposes of performance appraisal in the U.S. have expanded over the past 50 years. Further, Cleveland et al. (1989) have provided a useful classification of the purposes of appraisal based on a review of research published in 11 professional and trade journals during the period 1980–1986, in which they develop a comprehensive list of uses for performance appraisal

Table 10.1 Means and factor structure for 20 purposes of performance appraisal

Rank	Purposes	Mean	Factors
1	Salary administration	5.85	Between-individual comparisons
2	Performance feedback	5.67	Within-individual comparisons
3	Identify individual strength and weakness	5.41	Within-individual comparisons
4	Document personnel decisions	5.15	Documentation
5	Recognition of individual performance	5.02	Between-individual comparisons
6	Identify poor performance	4.96	Between-individual comparisons
7	Assist in goal identification	4.90	System maintenance
8	Promotion	4.80	Between-individual comparisons
9	Retention or termination	4.75	Between-individual comparisons
10	Evaluate goal achievement	4.72	System maintenance
11	Meet legal requirements	4.58	Documentation
12	Determine transfers and assignments	3.66	Within-individual comparisons
13	Layoffs	3.51	Between-individual comparisons
14	Identify individual training needs	3.42	Within-individual comparisons
15	Determine organizational training needs	2.74	System maintenance
16	Personnel planning	2.72	System maintenance
17	Reinforce authority structure	2.65	System maintenance
18	Identify organizational development needs	2.63	System maintenance
19	Criteria for validation research	2.30	Documentation
20	Evaluate personnel systems	2.04	System maintenance

Source: Cleveland et al. (1989), p. 132, table 1

information. They combined and edited redundant entries, creating a list of 20 separate uses for performance appraisal information (see Table 10.1).

The methodology adopted in Cleveland, Murphy, and Williams' study was the survey method. They asked 243 respondents who were psychologists employed in companies to rate on a seven-point scale the degree to which information from performance appraisals had an impact on each of the 20 listed activities. The scale anchors were as follows: no impact (1), moderate impact (4), and primary determinant (7). Their factor analysis suggested that the organizational purposes of appraisal can be grouped into three categories: (1) between-person uses, including salary administration, promotion, retention/termination, recognizing individual performance, layoffs, and identifying poor performers. (2) within-person uses, including identifying individual training needs, performance feedback, determining transfers and assignments, and identifying individual strengths and weaknesses. (3) system maintenance uses, including use of appraisal for workforce planning, determining organizational training needs, evaluating goal achievement, assigning goal identification, evaluating personnel systems, reinforcing authority structures, and identifying the organization's developmental needs.

Cleveland, Murphy, and Williams suggest that a critical decision in using information from performance appraisal is whether to focus on satisfying individual needs (e.g., employee development and feedback) or organizational needs (e.g.,

administrative decisions such as promotion and salary increases). On the other hand, they also distinguish between administrative decisions and the identification of employee strengths and weaknesses, or between-person decisions and within-person decisions. As has been mentioned in previous research, Table 10.1 shows that both administrative purpose (e.g., feedback regarding strength and weakness) and developmental purpose (e.g., feedback regarding strengths and weaknesses) are most frequently cited as the purpose of appraisals, while systems maintenance (e.g., workforce planning) and documentation (e.g., documenting personnel decisions) are less frequently cited as important purposes of appraisal.

From this investigation of existing literature, we can confirm that the information from performance appraisals is used for various purposes. With the proliferation of the organizational and individual uses of information from performance appraisal, researchers and practitioners have begun to observe that a performance appraisal system that is used for one purpose may not yield the same outcome when it is applied for a different purpose, even under similar circumstances. This also applies to information about performance collected with a particular purpose. As such, the use of a single type of appraisal for a wide range of purposes is not always effective or efficient. When the purposes involved are incompatible or in conflict, attempts to use performance appraisal as an all-purpose tool may fail.

This literature review also shows that the purposes of appraisal have diverged in American companies. All the studies cited in this section have focused on the U.S., and little academic research has paid attention to the purposes of appraisal in Japan (Fukui 2008). Therefore, the purposes of appraisal in Japanese companies are not clearly understood. This issue is examined in more detail in the section below, based on secondary data.

10.3 Secondary Data on Performance Appraisal in Japanese Companies

According to Nikkeiren Shokumu Bunseki center (Job Analysis Center in Japan Federation of Employer's Association) ed. (1989), the use of performance appraisals spread across Japan from the mid-1950s to the mid-1970s. The most important purposes of appraisal at that time were "for salary increases and bonus determination." Most of the Japanese companies assessed by Nikkeiren Shokumu Bunseki center (1989, p. 13) did not cite purposes such as promotion, staffing, training, and development as important. However, the purposes of appraisal in Japan have been changing.

Figure 10.1 shows the results of a study conducted by Kansai Keieisha Kyoukai (the Kansai Employer's Association) in three different years: 1957, 1975, and 1986. Of the sample companies, 97, 98, and 99 % cited pay raise as the purpose of appraisal in 1957, 1975, and 1986, respectively. The companies that cited staffing as the purpose of appraisal increased in number in 1957, 1975, and 1986, making up 12, 43, and 46 % of the total sample, respectively. Even the companies that

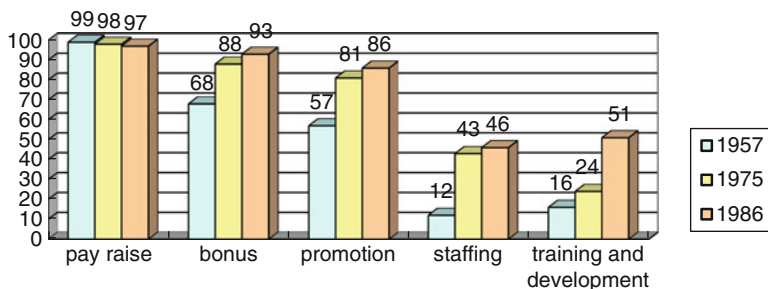


Fig. 10.1 Changes in the purposes of performance appraisal in Japan (Source: Kansai Keieisha Kyoukai (1986), p. 8)

considered training and development to be the purpose of appraisal increased rapidly and were 16, 24, and 51 % of the sample in 1957, 1975, and 1986, respectively.

Further, Shakai Keizai Seisansei Honbu (the Japan Productivity Center) (2005) has investigated the purposes of appraisal. It asked companies whether performance appraisal was reflected in efforts such as OJT and training, and whether it has been fully harnessed in training and development. Of the companies asked, 1.6 % answered that it was, and 43.5 % answered that this was somewhat the case. Approximately half of the personnel managers in these companies cited training and development as an important purpose of appraisal.

As mentioned above, there is clear evidence that changes have occurred in the purposes of appraisal in Japanese companies. In traditional Japanese companies, performance appraisal was used only for administrative purposes. In recent years, however, performance appraisal has come to be used for training and development. This shows that the purposes of appraisal have expanded in Japanese companies, and are converging with those of American companies. Despite this, no investigation has been made of purposes of appraisal in Japan, such as the maintenance of HRM systems and documentation as a defense against lawsuits, although evidence shows that these purposes have been insufficiently recognized in Japanese companies, unlike in the U.S.

10.4 Relationships Between the Purposes of Performance Appraisal and “Japanese-Style Management”

It is likely that traditional Japanese companies cite administrative purposes, rather than training and development, as the most important purpose of appraisal, because this approach is congruent with the traditional style of Japanese management.

In general, American companies are considered very different from Japanese companies in terms of management style (Ouchi 1981; Pascale and Athos 1981). HRM systems in Japanese companies are focused on providing employees with

long-term employment and working with a seniority salary system that enhances employees' organizational commitment. Both the company and employees establish a mutually beneficial relationship through these means.

One of the most notable features in traditional Japanese companies lies in the process of strategy formulation. The Japanese process is emergent, whereas the American process is planned by top management. Hence, we can make the point that traditional Japanese-style management is characterized by the term "bottom-up management." The fundamental concept that underpins management processes in Japanese companies is closely related to the design of work organizations and HRM systems.

Compared with American-style management, which emphasizes top-down strategic management, traditional Japanese-style management is characterized by empowering production workers in manufacturing departments. Under this system, both company management and employees share significant information with regard to the company's philosophy and vision.

Additionally, job boundaries were traditionally very loose in Japanese companies. In the past, employees in Japanese companies were often forced to work flexibly beyond their job boundaries or subunits, and thus, usual job descriptions were not given to these employees. These unbounded jobs actually created precious knowledge for innovation (Nonaka and Takeuchi 1995) and helped companies develop the core competencies (Prahalad and Hamel 1990). Close interactions were involved in jobs, with employees acting as multi-skilled workers that could cope with various problems arising from uncertainty (Koike 1994). In Japanese, this management style is called *Genba Shugi*.

Furthermore, white-collar employees of traditional Japanese companies share dense information about the inside of their company with others. Japanese management in these companies consider competent employees to be those who are multi-skilled, with firm-specific skills, and not those with generic skills and professional competence. The abilities required by traditional Japanese management have been conceptualized as *Syokumu Suikou Nouryoku (Shokunou)*. This concept was described as "ability based personnel management" by Nikkeiren (1969). *Shokunou* in Japanese management includes not only the ability to do a job but also personality and communication skills.

However, in the 1970s, an increasing number of companies in Japan began adopting ability-based approaches to personnel management. Performance appraisals including *Shokunou* are still being used, but it is difficult to objectively evaluate *Shokunou*, as it includes ambiguous skills, and to express it in terms of distinct performance standards. Therefore, performance standards in Japanese companies have often been ambiguous. This has led to major differences in the results of employee appraisals. While the ambiguity of performance standards has increased the spirit of competition among employees, based on salary differentials and speed of promotion, performance appraisals have not been able to provide employees with useful information for training and development.

In recent years, the introduction of ICT and the increase in global competition have reduced the competitive advantages of Japanese-style management, and

increased the need for top-down business strategy. Due to this change, there is an increasingly great tendency to distinguish between individual job boundaries in Japanese companies. At the same time, Japanese companies are beginning to value individual professional competence, which has led to a need for employees who can create added value and have general professional competence.

At this time, performance appraisal needs to change along with changes in Japanese-style management. Task performance and role behavior have become more important as performance standards, and the distinction of job boundaries has clarified the ability requirements for particular jobs. This has made it possible to set up rigorous performance standards and evaluation criteria, providing more information that can be used to promote employee training and development. For employees, information about individual strengths and weaknesses can be accessed, and opportunities for training and development can be offered depending on needs.

Of course, it will continue to be important to integrate the results of appraisal with salary increases, bonus decisions, and speed of promotion, because these are indispensable to motivating employees. Indeed, with the ongoing spread of “pay for performance systems,” performance appraisal has continued to have a great influence on salary. When performance appraisal is used to determine higher wages, positions, and ranks, competition among employees may intensify. On the other hand, the clarification of performance standards can improve perceived fairness in the results of appraisal.

These issues make it clear that with changes in Japanese-style management, performance appraisal must not only have administrative purposes but also developmental ones. We can call this phenomenon “the purpose expansion of appraisal.” From the viewpoint of HRM theory, it is important that performance appraisal be incorporated with other HRM subsystems. None of the HRM subsystems, such as the performance appraisal system, salary system, promotion system, and training and development system, should be isolated and independent parts of the total HRM system, and performance appraisal can be one of the most important means of promoting internal fit.

The concept of internal fit is crucial to the configuration approach in strategic HRM theory. Strategic HRM theory has been positioned as the inheritor of HRM, and has been intensively studied in the U.S. since the 1990s. While its focus is American companies, a tendency to converge with American approaches is beginning to be seen in Japanese companies.

This raises a number of questions for further exploration. What kind of system of appraisal should be designed to expand appraisal purposes and how should appraisal be carried out under such a system? How can administrative purpose and developmental purpose be reconciled? As Fukui (2008) has pointed out, little attention has been paid to the developmental purposes of appraisal in academic research in Japan. This makes it difficult to come up with practical proposals for Japanese companies that hope to expand the purposes of their appraisal systems.

This also makes it necessary to build an original framework for this analysis. To construct this analytical framework, we make use of the theory of performance management (PM), which has been developing greatly in the U.S. since the 1990s.

The PM framework integrates the salary system and the training and development system with the performance appraisal system. PM can be applied as a guideline for changes in performance appraisal in Japanese companies. In the section below, several studies and models of PM are briefly reviewed.

10.5 The Conceptual Framework of Performance Management

In the U.S., since the mid-1990s, researchers and practitioners of performance appraisal have passed a major turning point, introducing a paradigm shift. Performance appraisal now refers to a variety of activities through which organizations seek to evaluate employees and develop their competence, enhance their performance, and distribute rewards. It is sometimes a part of the broader approach to integrating human resource management strategies called performance management (PM), which involves a paradigm shift away from performance appraisal. PM design is now one of the widely discussed issues among researchers in the U.S.

Despite this, the definition of PM is still a matter of controversy (Fukui 2012). In this paper, PM is tentatively defined as “the continuous process of identifying, measuring, and developing the performance of individuals and teams and aligning their performance with the organization’s goals” (Dessler 2011, p. 357). The distinction between performance appraisal and PM is the contrast between a yearly event—the completion of the appraisal form—and a process that starts the year with performance planning and is integral to the way people are managed throughout the year. PM never means just meeting with a subordinate once or twice a year to review his or her performance. It means continuous, daily, or weekly interactions and feedback to ensure continuous improvement. Whereas performance appraisal is a one-time event each year, PM is a dynamic, ongoing, continuous process.

Every person in the organization is a part of a PM system. PM requires the effort of each worker to be directed toward achieving strategic goals. Hence, PM is always a goal-directed process. Continuing performance reviews compare employee or team performance against the company’s strategic goals. PM’s strategy-oriented nature thus fits American companies that are used to developing top-down corporate strategies.

PM encompasses performance appraisal, objective setting for individuals and departments, appropriate training programs, and pay for performance. Each part of the system, such as training and development, performance appraisal, and rewards, is integrated and linked for the purpose of continuous organizational effectiveness. Performance appraisal is positioned as the most important subsystem of PM, and involves a system of review and evaluation of individual or team task performance by managers. At the end of the appraisal period, managers and subordinates review work performance together and evaluate it against established performance standards. Managers as well as their subordinates, peers, people in other departments,

and even customers can be included as appraisers. This review helps to determine how well employees have met standards, determines reasons for deficiencies, and develops a plan to correct problems. The feedback review promotes communication between managers and subordinates.

The results of appraisal in the PM system provide a basis for rational decisions regarding salary increases. Furthermore, performance appraisals point out an employee's specific needs for training and development. Training and development or coaching can bring about behavioral changes. PM is a system for managing both organizational performance and employee performance, and integrating the management of both levels. That is to say, PM means continuously reevaluating and, if need be, modifying how employees and teams get their work done. Depending on the issues involved, this may mean additional training and development, changing work procedures, or instituting incentive plans. Owing to the PM process, both employee and organizational performance can be improved as part of a spiral. Therefore, PM is not a mere substitution for performance appraisal.

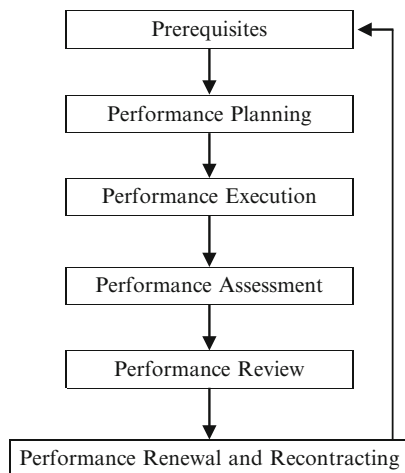
Many researchers have introduced conceptual frameworks for PM, but there is no single established framework for performance management processes (Fukui 2012). In this study, the PM model of Aguinis (2009) is used, as it involves a convincing conceptual framework (Fig. 10.2) and is in line with the purposes of this research. Our case study in Sect. 10.6 uses this framework to analyze changes in performance appraisal in Japanese companies.

The meaning of PM as defined by Aguinis (2009) is as follows. Traditional performance appraisal was a rather basic process involving line managers who completed annual reports on a subordinate's performance and discussed it with subordinates in appraisal interviews. The performance appraisal system was also independent of other HRM subsystems. While the results of appraisal were used for a variety of purposes, the main purpose was administrative.

In contrast, PM includes behavioral changes, and training and development to improve employee and organizational performance. Performance appraisal in PM expands the purposes of appraisal to realize its horizontal integration with other HRM subsystems. The most important aspect of PM is the vertical integration of the PM process and business strategy. Performance appraisal in PM needs to be congruent with business strategy, and therefore, PM performance standards must include role behaviors based on business strategy. PM emphasizes both external and internal fit within HRM systems. Both PM and performance appraisal work best in conjunction with a strategy-oriented system.

The PM model shown in Fig. 10.2 could be used to help renovate the performance appraisal system in Japanese companies. However, we should not overlook the fact that PM is a framework contrived within the context of American companies, and may not be directly applicable to the practices in Japanese companies. As academic research in Japan has not analyzed the purposes of appraisal, the theoretical framework to analyze performance appraisal and management is lacking. Regardless, it is clear that the PM model is a useful means of constructing theory for analyzing performance appraisal in Japan. People with job-related skills are currently needed by Japanese companies. Thus, American-style management systems

Fig. 10.2 Performance management process
(Source: Aguinis (2009), p. 32, Figure 2.1)



like PM should be introduced to these companies. It is thus best to make the most of the theoretical contributions of American researchers to change performance appraisal in Japanese companies. In the next section, a performance appraisal system in a Japanese company (Company A) is analyzed with regard to the PM framework. In this case study, the performance appraisal system of Company A is analyzed with regard to its purposes.

10.6 Case Study

Before presenting our empirical research, it is best to explain the methodological perspective of this study. A case study was adopted as the research method for several reasons. First, there has been little research focusing particularly on the purposes of appraisal. Second, case studies are suitable for addressing questions of “how” or “why” (Yin 1994). This paper tries to explore the following questions: “Why does performance appraisal in Japanese companies focus on expanding purposes?” and “How can we design performance appraisal systems for Japanese companies?”

The company where this study was carried out was pharmaceutical Company A. One reason that Company A was selected was that it revised its approach to performance appraisal earlier than other companies in Japan did. The performance appraisal system in Company A shifted away from the traditional appraisal system in the late 1990s, making it a pioneering organization. Moreover, Company A was selected for its positive attitude toward our study. We were able to collect rich data on performance appraisal from Company A. Through intensive interviews and a review of numerous documents, we were able to acquire critical information that is often difficult for researchers to access. Thus, the case study of Company A is

detailed, and includes information acquired from magazines articles and interviews. The company's human resources staff was interviewed in May 2007.

Company A is one of the largest major domestic pharmaceutical companies. Its main business domain is the manufacture and sale of medical and over-the-counter drugs (mainly ophthalmology medicines), and medical devices. Company A has sustained and expanded an overwhelming competitive advantage in the Japanese ophthalmology medicine market. In addition, it has developed its business in the global market (mainly in the U.S.), and has accomplished favorable growth.

However, Company A began to experience negative growth in 1997, and so was obliged to revise its management style. The pharmaceutical industry as whole has increasingly faced intensified global competition, and so, in order to sustain its competitive advantage, Company A needed to set up new goals and business objectives. With this in mind, the human resource department of Company A announced its "human resource management changing plan 21 for Company A" as a part of a mid-term corporate strategy target, which radically revised its HRM system. It set up some main targets, such as "changing the evaluation and reward system," "organizational reform," "changing human resource development," and "changing the corporate culture and climate." In addition, Company A began applying a new performance appraisal system and reward system for all full-time employees in 1999.

Prior to 1999, Company A had long used an ability-based personnel management system, which included an ability-based rank hierarchy that ranked employees in ten steps in proportion to their abilities. However, most members were actually promoted according to the length of their service, which meant that individual employees' salaries and bonuses were not always consistent with their job scope and responsibility.

Company A then abolished the ability-based personnel management system and introduced a job-based personnel management system in 1999. The job-based personnel management system in Company A grades employees based on the value of their jobs, based on a synthesis of the employee's scope of role and responsibility, job difficulty, and contributions to the company. The job grading system has eight steps of job families, and basic salary is determined based on job grade. The job grading system in Company A is a broadband system (Milkovich and Newman 2008). The range of pay is broadly set up for each job family, and the salary of each employee is determined through a combination of job grades and the results of appraisal. The revised system for performance appraisal determines the speed of promotion, and has brought about an expansion in the salary differential among employees.

The traditional performance appraisal in Company A consisted of three performance standards. The adoption of ability-based personnel management led to the establishment of the most popular form of performance appraisal at the time, which weighted three factors: trait-oriented factors, job-related factors, and ability-based factors (Kusuda 1981). Employees' direct managers evaluated their performances, and the results of appraisal were often adjusted and forced to fit into a predetermined distribution pattern. The Personnel Department assigned the results

of appraisal through fixed distribution. Therefore, the results of first-stage appraisal sometimes differed from the results of later-stage appraisal. Because of the pre-existing practice of adjusting ratings to fit into a normal distribution curve, first-tier appraisers had difficulty explaining the final ratings to their subordinate employees. Appraisers were not able to give employees convincing feedback about the results of appraisal, which made training and development based on performance appraisal impossible.

The performance appraisal in Company A was reformed to overcome these problems in 1999. The new performance appraisal system consists of three evaluation systems: MAP (My Action Plan) Evaluation, Performance Behavior Evaluation, and Core Skill Evaluation. MAP Evaluation influences the bonuses that employees receive. Performance Behavior Evaluation influences salary increases and decreases. Core Skill Evaluation does not influence salary, bonuses, or promotion, but offers useful information for training and development. These evaluation systems are briefly examined in the next paragraph.

MAP Evaluation¹ evaluates quantitative individual performance for every half year, and involves management by objectives. It is a system for evaluating short-term achievements. In MAP Evaluation, employees set objectives at the beginning of a term, and the scope and degree of achievement of these objectives is then evaluated. The scope of the objectives is determined based on the degree of contribution to the department that the employee belongs to. Employees set up their own objectives through communication with their manager (supervisor or appraiser). Each objective must be broken down from the job description into daily tasks. Objectives need to be connected with management plans and the targets of department heads. The cascading of objectives among levels is also considered important. The number of objectives set up by employees diverges, but all employees must set up at least five and at most eight. One of the objectives must be relevant to their training and development. One cycle of MBO in MAP Evaluation is a financial half-year, either April–September or October–March, so there are two cycles per year. The results of MAP Evaluation are determined by the degree of achievement of the set-up objectives. If the degree of achievement of objectives is high, but the scope of objectives is small, the results of MAP Evaluation will be low. The degree of achievement of each objective is evaluated through seven steps, and the total MAP Evaluation score is calculated by weighting the degree of achievement of each objective.

Performance Behavior Evaluation evaluates quantitative and qualitative performance. It is conducted only once a year, and estimates the total contribution for the year. Performance Behavior Evaluation evaluates processes of actions in which employees generate quantitative performance. It evaluates long-term and total

¹ MAP evaluation rules out employees who are ranked in the lowest job grade and those engaged in routine jobs. They are evaluated by “Task Achievement Evaluation,” which involves simplified management by objectives. The principles for designing this system are the same as those for designing MAP Evaluation.

performance from five viewpoints that are determined in relation to an employee's department or job. Performance Behavior Evaluation consists of two parts, "total score of MAP Evaluations per year," and "evaluation of behaviors to attain performance standard." It evaluates not only short-term performance but also long-term performance such as role behavior and competencies. "Evaluation of behaviors to attain performance standard" refers to standards for behavior based on the management philosophy of Company A. Performance Behavior Evaluation evaluates these behaviors in five steps.

Finally, Core Skill Evaluation evaluates only qualitative performance, and is conducted once a year. It does not influence salaries or bonuses, but its results deeply affect employee training and development. It evaluates employees' abilities and knowledge, as needed for each job in Company A. The job posting system in Company A makes the most of Core Skill Evaluation. It is carried out through the intranet, and profiles of abilities and knowledge required for each job are shown, so that employees can understand the requirements to apply for the posting. The data from Core Skill Evaluation depict each employee's ability level. If an employee wishes to transfer from his or her present job to another, the employee's ability level must, to some extent, satisfy the requirements for the new position. If the employee's ability level does not satisfy the requirements for job at all, he or she must develop the required skills or abilities through training and development. The Off-JT program is also available through the company intranet, and provides employees with information about formulating skills or abilities. Employees who want to develop skills, abilities, or knowledge must submit a request to their manager to be allowed to participate in Off-JT. If managers approve their requests, they are able to take part in lectures through the program. Core Skill Evaluation offers not only guidelines for Off-JT but also for OJT and human resource development, by clarifying employee deficiencies in ability and their training and development needs. As a result, both managers and subordinates can understand how OJT should be carried out. Core Skill Evaluation puts the right employees in the right places.

In Company A, employees' direct managers evaluate their performance. Individual performance is evaluated on an absolute scale. The personnel department does not adjust ratings to fit into a normal distribution curve.² Evaluation on an absolute scale enables appraisers to give feedback on results to subordinates. The specification of performance standards facilitates training and development planning for the next term.

Below, we analyze the performance appraisal approach of Company A in relation to the research questions of this paper, with an emphasis on the separated evaluation system (combination of MAP Evaluation, Performance Behavior Evaluation, and Core Skill Evaluation).

²The personnel department sometimes intervenes and checks the validity of the appraisal results. It can adjust the appraisal results for different departments.

While MAP Evaluation and Performance Behavior Evaluation is mainly used for administrative purposes (e.g., pay, bonus, and promotion), Core Skill Evaluation is used for developmental purposes, and provides managers and employees with useful information for human resource development. Performance appraisal in Company A is purpose-oriented. Evaluation interviews for administrative purposes and feedback interviews for developmental purposes are separated. This enables employees to promote their own training and development.

Performance appraisal in Company A was traditionally used only for administrative purposes, but it began to be used for developmental purposes after the 1999 revision of performance appraisal approaches. We can call this phenomenon “the purpose expansion of appraisal” in this paper. The performance appraisal in Company A, which emphasizes developmental purposes is similar to the American PM Model. For example, job-related performance standards, feedback on results of appraisal, frequent communication between managers and subordinates in feedback interviews are some of the practices regarded as important in the PM model. Additionally, MAP Evaluation is a form of MBO, by which cascading from business strategy is carried out. In Company A, the strategy-oriented appraisal system is designed like a PM model.

Furthermore, the HRM system integrates information acquired from results of appraisal. According to the framework for the PM model, the internal fit of the HRM system in Company A has been enhanced. The renovation of the appraisal system has enabled employees to facilitate their development and increase their motivation. Our investigation made it clear that performance appraisal in Company A is in fact similar to the American PM model. Company A has not used the concept of PM, but the principle behind the design of its performance appraisal system is equivalent to that of the PM model.

Despite these similarities, the performance appraisal system of Company A is not identical to the American PM model. The HRM system in Company A has clearly shifted to a job-based one, and the performance standards have shifted to address job-related factors. On the other hand, person-related factors remain a part of the Performance Behavior Evaluation and Core Skill Evaluation, meaning that Japanese characteristics of performance appraisal have been retained. Although the conclusions in this paper cannot necessarily be generalized to any other Japanese company, they suggest that changing performance appraisal systems in Japanese companies is more complicated than just directly applying the intact American PM model.

In Company A’s early days, the traditional performance appraisal system was likely consistent with orthodox Japanese-style management approaches. However, in order to change management style in accordance with environmental changes over recent years, the performance appraisal approach of Company A required the expansion of its purposes. This case study makes it clear that principles for designing performance appraisals can benefit from shifting toward the American PM model.

10.7 Conclusion

This paper has investigated changes in the purposes of performance appraisal in Japanese companies and discussed the future direction of performance appraisal. In the first section, academic research on the U.S. was reviewed, focusing on the purposes of appraisal, which confirmed that information from performance appraisals has been used for a variety of purposes. Performance appraisal has both administrative and developmental purposes, including documentation and HRM systems maintenance. In the following section, secondary data on the purposes of performance appraisal in Japanese companies are analyzed. In Japan, information from performance appraisals has mainly been reflected in salary increases, bonuses, and promotions, meaning that the main purposes of appraisal in Japanese companies have been administrative. However, these purposes have been expanding for 50 years, and developmental purposes have more recently become important. It is clear that the purposes of appraisal must be congruent with the approaches of Japanese-style management, and should expand with changes in that management. In the next section, the concept of performance management (PM), which has been widely practiced since the last half of the 1990s by American companies, was reviewed briefly to construct an original analytical framework. Finally, a case study was carried out; it focused on changes in performance appraisal in Company A. This case study confirmed that performance appraisal in Company A has changed from the traditional system, and that its purposes have expanded. Although Company A has not directly used the concept of PM, its performance appraisal has shifted toward a system like that of the American PM model. Its results suggest that performance appraisal in Japan should shift in approach to be more like the American PM model.

The theoretical implications of this study make important contributions to Japanese academic research on performance appraisal, which thus far has been lacking. Through a review of previous research on the purpose of performance appraisal and a case study, this paper demonstrates how a new conceptual framework can be used to expand the purposes of appraisal. Its practical implications and conclusions strongly suggest that Japanese companies should begin to change their performance appraisal systems and expand the purposes of their approaches to appraisal. This paper also shows that it is important to design performance appraisal systems, such as performance standards or appraisal processes, in ways that are congruent with its purposes.

This paper has some limitations. First, it only investigated Company A in a single-item sample, and so other cases need to be analyzed. Second, to statistically generalize the results of this paper, statistical analysis must be conducted through survey research. Third, this paper was not able to demonstrate the effects of performance appraisal revision on skill formation and financial indicators. In the future, this should be addressed by applying relevant concepts, controlling various variables, and conducting quantitative analysis.

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Chapter 11

Leadership Skills for Enhancing Subordinates' Ability to Learn from Experience

Makoto Matsuo

Abstract I examined managers' leadership skills for enhancing subordinates' ability to learn from experience. Using data from an open-ended questionnaire given to middle managers ($n=51$) at a Japanese manufacturer, I found that excellent managers with capabilities to develop their subordinates have the following leadership skills: they (1) help subordinates understand the meaning of tasks and goals, (2) accept proposals from subordinates, and (3) encourage subordinates to think and complete their tasks by themselves. The results suggest that excellent managers develop their subordinates by facilitating their "sense-making" and "knowing."

Keywords Knowing • Leadership skills • Learning from experience • Sense-making

11.1 Introduction

Learning from work experience is viewed as a critical factor in personnel growth (Lombardo and Eichinger 2010). Research on this topic has mainly investigated the special characteristics of the experiences that facilitate managers' growth, and these results have been integrated into the concept of developmental challenges (DeRue and Wellman 2009; Dragoni et al. 2009; McCauley et al. 1994; Ohlott 2004).

However, not everyone is assured to grow simply by accumulating experiences considered to be "developmental challenges." To acquire knowledge and skills through experience, it is also necessary to have an *ability to learn* from such experiences. Although Spreitzer et al. (1997) performed experimental studies on

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M. Matsuo (✉)

Professor, Organization Studies, Graduate School of Economics and Business Administration,
Hokkaido University, Sapporo, Hokkaido, Japan
e-mail: mmatsuo@econ.hokudai.ac.jp

the ability to learn from experience, no clear result has yet been found, and there is a lack of any theoretical backing. Thus, research on this topic seems to be stalled.

However, the ability to learn from experience is also related to on-the-job training (OJT) and coaching because these methods have been developed to help others learn from experience. Nonetheless, very few studies have attempted to reinterpret OJT and coaching from the learning experience perspective.

In the present study, I analyzed free-response survey data provided by managers based on the “Model for Learning from Experience” (Matsuo 2011b) to identify the characteristics of training methods that help personnel grow.

11.2 Theoretical Background

11.2.1 *Experiential Learning*

Experience refers to the interaction between individuals and their external environments (Dewey 1938), as well as events that occur in their daily lives. Work experience refers to events related to individuals’ attitudes, desires, and achievements at work (Quinones et al. 1995; Tesluk and Jacobs 1998). According to Kolb (1984), people learn from experience by: (1) having concrete experiences, (2) reflecting on their content, (3) drawing some sort of lesson from them, and (4) applying them to subsequent circumstances.

Previous research in this field has focused on investigating the special characteristics of the specific experiences that help managers grow. For example, McCall et al. (1988) conducted an interview survey of successful managers and found that these managers had learned balanced lessons by accumulating various experiences that could be categorized as issues, other people, and hardships. Subsequent studies have been integrated into the concept of developmental challenges, which refers to experiences that facilitate a manager’s growth (DeRue and Wellman 2009; Dragoni et al. 2009; McCauley et al. 1994). The term “developmental challenge” signifies a challenging experience, such as unfamiliar work, the generation of change, a high level of responsibility, and overseas work experience.

11.2.2 *Ability to Learn from Experience*

However, it is not a given that personnel will automatically grow when they face several challenging experiences. To grow through such experiences, they must also have the ability to learn from their experiences. Spreitzer et al. (1997) provided dimensions, such as seeking feedback, using feedback, responding positively to diverse cultures, seeking opportunities to learn, and being open to criticism, as necessary factors to allow learning from experience. The ability to learn from

experience has also been studied from the perspectives of self-confidence (Brutus et al. 2000), learning orientation (Dragoni et al. 2009), and conviction (Matsuo 2011a). However, compared to research that categorizes experience characteristics, studies on the ability to learn from experience have not made much progress and have been lacking in terms of theory.

Matsuo (2011b) evaluated previous research in this area and proposed a “Model for the Ability to Learn from Experience,” consisting of five elements: stretch, reflection, enjoyment, thought, and connection. Stretch refers to aiming for ambitious goals, reflection to reflecting on the content of work, and enjoyment to having a sense of work satisfaction and purpose. Individuals’ thoughts are described as their goals and values, as well as their connections, which are their relationships with others that activate these elements.

In this section, the background to Matsuo’s (2011b) theoretical model is briefly described. First, the importance of stretch or reaching for ambitious goals and challenging work has been emphasized consistently in experiential learning research, as well as in goal-setting theory (Locke and Latham 2002). Similarly, reflection has been considered a key concept in studies on organizational and workplace learning (Cunliffe 2004; Gray 2007). In addition, studies on intrinsic motivation (Amabile 1988) and flow theory (Csikszentmihalyi 1990) indicate that interest in the task itself or task enjoyment facilitates learning. Furthermore, educational psychology and career theory have emphasized factors, such as thought or learning orientation (Dweck and Leggett 1988; Porter et al. 2010), as well as having a developmental network of interpersonal connections, to facilitate individual learning.

11.2.3 OJT

How can we improve employees’ ability to learn from experience? One way is to provide guidance from senior colleagues. In this section, a literature review of studies on OJT and coaching investigating the concept of guidance is provided.

OJT refers to workplace-based training, and usually takes the form of one-on-one guidance (Jacobs 2003; Rothwell and Kazanas 2004; van Zolingen et al. 2000). Because direct, on-the-job experiences are believed to substantially influence the development of competency in adults, OJT has the potential to be an effective educational technique, considering its impact on experiential workplace learning.

The fundamental principles of OJT are: (1) show (demonstrate what learners ought to do), (2) tell (explain what learners ought to do, and why they should do it), (3) do (ask learners to perform tasks), and (4) check (praise learners when they correctly complete the tasks, and provide feedback on areas that need improvement) (Dooley 2001; Rothwell and Kazanas 2004). This teaching technique spread across the United States as the “Training Within Industry” (TWI) program. It was subsequently adopted by Japanese manufacturing industries, starting with Toyota

Motor Corporation, and is still being used as the foundation of its lean production system (Usko 2008).

A problem with OJT studies is that they have only focused on a form of guidance where specific skills, used in specific work processes, are transferred from experienced workers to new employees (Kim and Lee 2001). However, in most corporate environments, closed tasks, with clear pre-determined work steps, are decreasing, and open tasks, involving complex tasks with no clearly defined procedures or workflow, are increasing. Thus, successful methods vary according to circumstances (Yelon and Ford 1999). Previous studies on OJT have not sufficiently investigated open tasks. However, managerial coaching research has examined methods to provide efficient open-task guidance.

11.2.4 Coaching

Coaching is typically defined as helping someone to execute a task. It is an activity that occurs frequently, from childhood to adulthood (Hackman and Wageman 2005). Numerous types of coaching exist, but managerial coaching of subordinates is the focus of this section (henceforth, the term “coaching” refers to *managerial* coaching in this paper).

Coaching refers to managers providing one-on-one feedback to subordinates, aimed at improving their work performance (Heslin et al. 2006), which assists them in acquiring effective daily interaction skills. According to Hamlin et al. (2006), coaching is a required skill that must be incorporated into managers’ daily management activities.

Like OJT, coaching is more cost effective than official training and is a suitable educational method for promoting learning and improvements required in all enterprises and workplaces (Liu and Batt 2010). Although few studies exist on how managers should coach, Ellinger et al. (2003) identified eight approaches: (1) using metaphors and analogies to facilitate learning, (2) broadening perspectives by showing the bigger picture, (3) providing constructive feedback, (4) seeking opinions from subordinates about coaching effectiveness, (5) providing resources to facilitate work, (6) encouraging subordinates to think about problems by asking questions, (7) clarifying what is expected of subordinates and explaining how this fits within organizational goals, and (8) changing perspectives through role playing.

In addition, Heslin et al. (2006) reviewed the coaching literature to develop a coaching measurement scale, consisting of guidance, facilitation, and inspiration (Table 11.1). Guidance refers to providing constructive feedback and advice to improve performance, facilitation to stimulating creative thinking to solve problems, and inspiration to encouraging employees to grow and undertake new challenges continuously.

Table 11.1 Coaching measures (Heslin et al. 2006, p. 879)

<i>Guidance</i>
Provide guidance regarding performance expectations?
Help you to analyze your performance?
Provide constructive feedback regarding areas for improvement?
Offer useful suggestions regarding how you can improve your performance?
<i>Facilitation</i>
Act as a sounding board for you to develop your ideas?
Facilitate creative thinking to help solve problems?
Encourage you to explore and try out new alternatives?
<i>Inspiration</i>
Express confidence that you can develop and improve?
Encourage you to continuously develop and improve?
Support you in taking on new challenges?

11.2.5 Research Framework

The literature review revealed that research on experiential learning ability is ongoing. In addition, OJT and coaching are aimed at improving employees' workplace performance and achievements. However, methods to help employees improve their experiential learning have not been discussed.

Thus, this study focuses on the three elements proposed by Matsuo (2011b) in the Model for the Ability to Learn from Experience: stretch, reflection, and enjoyment. In addition, leadership skills aimed at increasing experiential learning abilities among subordinates are illustrated.

As demonstrated in Fig. 11.1, managers' approaches towards guiding subordinates are aimed at developing their goals (stretch), reflecting on their performance (reflection), and experiencing a sense of work satisfaction and joy (enjoyment).

11.3 Methodology

From September 2013 to October 2013, a free-response questionnaire survey was conducted at a major manufacturing company (Company A). The survey targeted 30 high-performing section-head managers who were considered extremely effective personnel developers, as well as 25 other managers. The questionnaire was distributed and collected from the personnel department of Company A, and 51 responses were received (29 from the highly competent managers, and 22 from the other managers, a response rate of 92.7 %).

The following questions were included in the questionnaire: (1) When you develop subordinates' goals, which factors do you keep in mind while guiding them? (guidance method related to 'stretching'), (2) When subordinates reflect on their work, which factors do you keep in mind while guiding them? (guidance

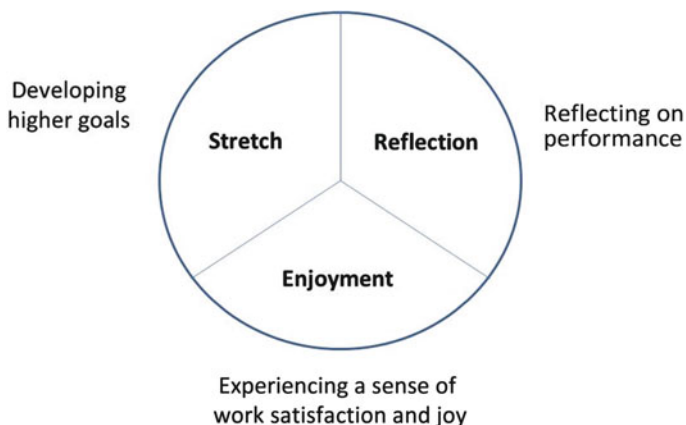


Fig. 11.1 Research framework

method related to ‘reflection’), and (3) To help subordinates to experience a sense of work satisfaction and joy, which factors do you keep in mind while guiding them? (guidance method related to ‘enjoyment’).

The survey data were analyzed using the following steps: (1) the data from competent managers and other managers were analyzed separately, (2) if the respondent described multiple methods for the respective elements of stretch, reflection, and enjoyment, these were separated into individual leadership skills, and then each method was categorized into method groups containing similar content, and (3) the responses from competent managers were compared to those of other managers, and the similarities and differences were summarized.

11.4 Results

11.4.1 Leadership Skills for Stretch

Table 11.2 indicates the managerial leadership skills to develop ambitious goals for subordinates. The methods described by both competent managers and other managers were the setting of short- and medium-term growth targets, setting goals that match the subordinates’ potential and ambitions, and allotting work that subordinates could accomplish on their own by trying hard.

The leadership skills described by competent managers included the following: explaining the meaning of the goals in a convincing manner, setting goals in stages to make subordinates aware of the process, and supporting subordinates in accomplishing tasks according to their abilities.

Concrete examples of leadership skills to explain the meaning of the goals in a convincing manner:

Table 11.2 Leadership skills for stretch

Competent managers	Other managers
Setting short- and medium-term growth targets	
Setting goals that match the subordinate's potential ambitions	
Allotting work that the subordinate can accomplish by trying hard	
Explaining the meaning of the goals in a convincing manner	No mention
Setting goals in stages to make subordinates aware of the process	No mention
Supporting subordinates in accomplishing tasks according to their abilities	A few mentions

- Explaining the need for the goals in a manner that satisfies subordinates and allows adequate time for discussion.
- Goals should not be imposed from above. Instead, it is essential that subordinates design their own goals and are satisfied with them.
- Although explaining why goal stretching for work duties is important, it is also necessary to discuss how subordinates' goals relate to the company's goals, as well as linkages with personal growth.

The following responses were received concerning guidance to set goals in stages to make subordinates aware of the process:

- Regardless of how ambitious the goals are, it is important to inform subordinates that if they divide the path leading to the goal into individual processes, and implement the plan for each, it is possible to reach the goals, and thus to reduce anxiety.
- If goals are too challenging, it will be difficult for subordinates to find motivation to achieve them. I thus determined milestones and controlled their progress in a manner that allowed them to achieve their goals in stages.
- By demonstrating goals in the form of milestones from the beginning, subordinates are able to see how their level improves, one step at a time.
- By setting up the process to achieve goals in concrete terms, we can come to a mutually agreement on whether the goals are realistic. Based on this, I inform my subordinates of my expectations, provide advice, and then we develop ambitious goals together.

Finally, the following responses were received concerning guidance to support subordinates in accomplishing tasks according to their own abilities:

- Providing indirect support with advice, and supporting them without making the goals and duties easier, even if subordinates appear to be struggling with them.
- It is not enough to set goals. I also provide necessary support, such as illustrating specific actions required to achieve them, as well as providing additional resources.
- If it is necessary to ease subordinates' anxieties to sustain and increase their motivation, it is essential to provide support based on daily changes, for example, offering hints for solving issues or helping them draw up a recovery plan.

To summarize, competent managers do not simply stretch goals but also support subordinates in achieving ambitious goals. In concrete terms, managers explained the meanings of ambitious goals in a manner that ensured subordinates' satisfaction with them, they illustrated the processes or stages involved in achieving the goals, and also provided support when required to help subordinates achieve their goals.

11.4.2 Leadership Skills for Reflection

Table 11.3 indicates the leadership skills used to encourage subordinates to reflect on their work. Both the competent managers and the other managers described the following methods: reflecting while keeping your goals in mind; reflecting objectively, concretely, and quantitatively; providing feedback on positive results first; and reflecting on failures and thinking about how to prevent them from recurring.

The competent managers indicated the following guidance method characteristics: carefully listening to subordinates, encouraging them to think by asking questions, and linking the results of the reflection to the next step.

Some concrete examples of these leadership skills were also provided. The following responses were received concerning carefully listening to subordinates:

- I first arrange meetings to listen to my subordinates. I only share my opinions after I have asked them to share their thoughts, and to describe how much progress they think they have made towards achieving their goals. While guiding them, I focus on their realizations and try to help them to reflect objectively on their work.
- First, I allow them to express their opinions freely (good points, bad points, problems, etc.). I subsequently explain the areas I, myself, need to improve on, and explain in a straightforward manner the areas in which I want them to improve.
- I emphasize listening to my subordinates regarding their work, and watching over them in the workplace.

Examples of guidance related to encouraging subordinates to think by asking questions included:

Table 11.3 Leadership skills for reflection

Competent managers	Other managers
Reflect while keeping your goals in mind	
Reflect objectively, concretely, and quantitatively	
Provide feedback on positive results first	
Reflect on failures and think about how to prevent them from recurring	
Listed to the subordinate carefully	No mention
Make the subordinate think by asking questions	A few mentions
Link the results of the reflection to the next step	No mention

- Superiors should not point out subordinates' mistakes. Rather, they should ask questions to make them recognize areas that need improvement.
- When discussing something with a subordinate, I continuously ask "why" to encourage them to reflect on their work.
- I ask them to compare the work goals with their accomplishments, and to analyze and evaluate their own work by asking questions, such as why they think they were able, or unable, to complete a task, as well as the causes. I then discuss their answers with them and provide feedback from both a superior's and objective perspective on what they were able to achieve, what they were unable to achieve, and how to overcome the problems related to the latter.

Finally, the following responses were received related to guidance to link the results of reflection to the next step.

- I encourage subordinates to reflect deeply, and avoid anxiety by emphasizing that reflection is a constructive activity aimed at making improvements in the future, and not to reproach them.
- I reflect on work with my subordinates and explain the results as well as the path leading to them. During this process, I encourage them to reflect upon areas where there is scope for improvement while considering future tasks.
- Do not be preoccupied with failure or success. Evaluate a phenomenon and its outcome accurately, and share your findings with colleagues without hesitation.
- I provide instructions to create and revise work manuals based on the reflections.

To summarize, competent managers emphasize subordinate-initiated reflection and develop links to future work. In concrete terms, they first listen to their subordinates carefully, ask questions to encourage deeper reflection among them, and ensure that the results be applied to future tasks. Although these are considered basic coaching elements, differences in managerial guidance skills are likely to emerge and thus determine whether they are able to implement them in the workplace.

11.4.3 Leadership Skills for Enjoyment

Table 11.4 illustrates leadership skills to assist subordinates in experiencing a sense of work satisfaction and joy. Both competent managers and other managers mentioned the following methods: allowing employees to experience a sense of work satisfaction by assigning more challenging work to them, allowing them to experience a sense of achievement by providing opportunities to announce their results, praising the positive aspects of their performance, and praising small acts on various occasions.

Competent managers described the following guidance method characteristics: listening to subordinates' opinions and incorporating them, conveying the purpose of tasks to subordinates and encouraging them to think, and allowing subordinates

Table 11.4 Leadership skills for enjoyment

Competent managers	Other managers
Making the subordinates feel a sense of satisfaction by giving them a higher level of work	
Making them feel a sense of achievement by providing opportunities to announce the results	
Praising the positive aspects of the performance	
Praising small acts on various occasions	
Listening to the subordinate's opinions and incorporating them	No mention
Conveying the purpose of task and encouraging subordinates to think	No mention
Allowing subordinates to produce results by thinking for themselves	A few mentions

to produce results by thinking for themselves. Concrete guidance method examples were also shared. The following responses were received for listening to subordinates' opinions and incorporating them:

- Get to know the employees' values and ways of thinking better by not talking exclusively about work but also about aspects of their private lives in meetings.
- Listen carefully to what they want to do, and assign that type of work to them. The basic rule to facilitate a sense of satisfaction, joy, and a sense of achievement is to conduct experiments that will lead to a better workplace, based on improvements initiated from within the group.
- I try to listen to suggestions and feedback from my subordinates carefully, and encourage spontaneous, creative actions by having them think about tasks together.
- I incorporate all suggestions from my subordinates that appear correct.

Responses on guidance to convey the purpose of the task and make subordinates think included:

- Encourage employees to do their best by once again making them aware of the purpose of their current task within the bigger process to achieve their medium- and long-term goals.
- I attempt to cultivate a sense of satisfaction among employees by highlighting the novel aspects of their work, and making them realize that they are the leaders.
- I continuously tell my subordinates that they should treasure the value of their existence, responsibilities, and pride themselves for being able to contribute to society as product developers.
- I attempt to motivate employees by explaining to inexperienced team members the meaning and joy related to the products they have worked on in the world.

Finally, the following responses were received concerning allowing subordinates to produce results by thinking for themselves.

- I attempt to guide them to produce results by thinking for themselves, even if it takes a little longer.
- I make a conscious effort to help them come up with answers on their own by asking them questions.

- I do not give them the answer; instead, I guide them to allow them to figure out the answer for themselves. For example, I tell them whether data are usable, but let them do the analysis on their own. After we discuss the overall image and policies, I let them develop the plan themselves.
- I ask them to execute the work and think for themselves.

To summarize, to facilitate work enjoyment, competent managers not only praise employees but also help them develop a sense of work satisfaction and joy. In concrete terms, they help their subordinates feel satisfied and pleased with their work by listening to their opinions, conveying the significance of their work, the value and purpose of tasks, and encouraging them to produce results by thinking for themselves. These results revealed that intrinsic leadership skills like these, which encourage subordinates to consider and realize the meaning of their work by themselves, are more effective subordinate development methods than extrinsic methods such as assigning challenging tasks and providing positive feedback, which were common responses provided by both types of managers.

11.5 Discussions

11.5.1 Findings

In this study, I have examined leadership skills to facilitate personnel growth based on the Model for Ability to Learn from Experience. The leadership skills for personnel development preferred by successful managers are summarized in Fig. 11.2. These methods include: (1) stretch—explaining the purpose of the goals and helping subordinates achieve ambitious goals according to their own abilities while stage-by-stage stretching the goals; (2) reflection—carefully listening to subordinates and encouraging them to think by asking questions and guiding them to apply the results of their reflection to future tasks; and (3) enjoyment—incorporating subordinates' opinions and encouraging them to consider the meaning of their work and produce results according to their own abilities.

Leadership skills such as encouraging subordinates to understand the meaning of their work and goals and encouraging them to think and produce results on their own form part of both the stretch and enjoyment elements. This indicates that guiding subordinates to achieve higher goals and helping them to experience work satisfaction and joy are closely related to each other. Taking on new challenges could thus be linked with being satisfied with one's work, which, in turn, encourages people to take on new challenges.

The leadership skills illustrated in Fig. 11.2 can also be rearranged according to content similarity, as indicated in Fig. 11.3. Managers who are highly capable of developing personnel: (1) ensured that subordinates understood the purpose of their tasks and goals, (2) valued the opinions of their subordinates, (3) supported them to execute their tasks by encouraging independent thought, and (4) encouraged them

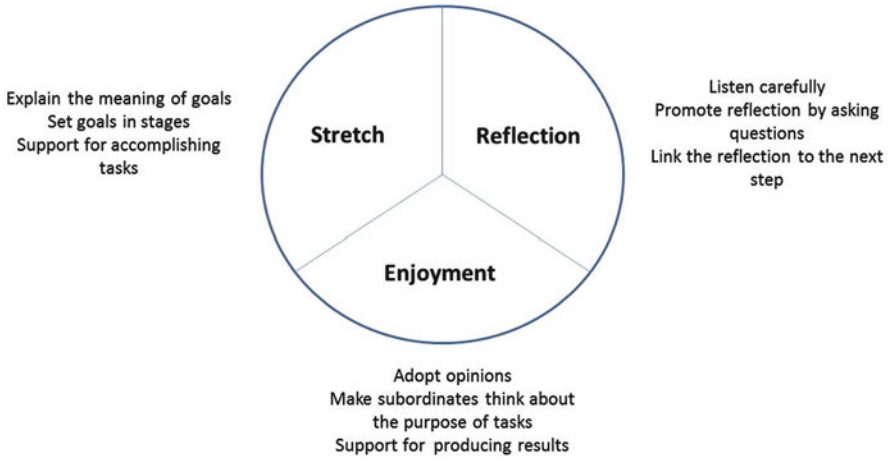


Fig. 11.2 Leadership skills to facilitate personnel growth

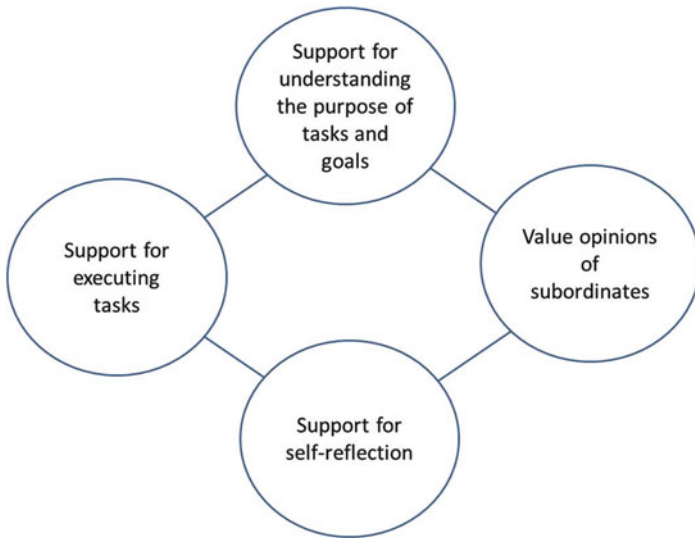


Fig. 11.3 Characteristics of leadership skills to facilitate personnel growth

to accomplish tasks and produce results according to their own abilities. These results indicate that guidance that emphasizes subordinate independence or self-reliance enhances the ability to learn from experience. In addition, the managers who fell short in providing subordinates with adequate explanations concerning the purpose of their goals and tasks, and were unable to understand their interests and values sufficiently, were unable to provide support to promote subordinates' self-reflection and self-fulfillment.

11.5.2 Theoretical Implications

First, facilitating sense-making (Weick et al. 2005), which means attaching meaning to goals and tasks, plays a vital role in developing human resources. Although the three coaching dimensions of guidance, facilitation, and inspiration identified in the literature (Heslin et al. 2006) include support for self-fulfillment and self-reflection, they do not include leadership skills to encourage subordinates to consider the purpose of goals and tasks. Thus, this research fills this gap in the literature by highlighting the importance of facilitating sense-making in guidance.

Sense-making, concerning the features of goals and tasks, stimulates the desire to take on new challenges, and to experience work satisfaction and happiness. While supporting sense-making in their subordinates, it is essential that managers also understand their interests and values, and respect them. Thus, supporting subordinates in understanding their goals and tasks, and respecting their interests and values are closely related.

Second, this study emphasizes the importance of “knowing” when developing personnel. Cook and Brown (1999) referred to knowing as “the creation of knowledge through an interaction with the real world.” They emphasized that knowledge is not transferred from one person to another. Instead, we create new knowledge using our own powers while we use other people or writings as knowledge tools. The self-reflection and self-knowledge methods illustrated in this study are leadership skills for subordinates to facilitate knowing or the creation of new knowledge using their own capabilities.

In addition to encouraging knowing, managers who were more effective at personnel development divided goals into stages. Burton et al. (1984) argued that an effective way to assist people in acquiring complex skills is to create a learning environment, based on increasingly complex micro worlds (ICMs). Competent managers thus create ICMs by setting goals and dividing them into stages to make the work process more manageable.

Third, this study demonstrated that similarities exist between facilitating stretch to take on new challenges and assisting enjoyment to ensure that subordinates experience work satisfaction and joy. Csikszentmihalyi (1990) pointed out that people who are engaged in appropriately challenging work are able to become engrossed in and enjoy it. Therefore, stretch and enjoyment leadership skills should be viewed as being interconnected.

11.5.3 Practical Implications

First, several managers assigned problems of appropriate difficulty, based on subordinates' characteristics, to stretch goals, but they failed to adequately explain the meaning of goals and help subordinates achieve them. In addition to

communicating the reason for setting ambitious goals, it is also necessary to support subordinates with distinct measures to achieve their goals, according to their own abilities, such as dividing goals into stages to more effectively manage the work process.

Second, many managers do not listen carefully enough to subordinates. They also do not adequately encourage them to think by asking questions, or encourage them to apply the results of their reflection to future tasks, which are basic aspects of facilitating reflection. There is a need to shift from superior-driven to subordinate-driven reflection.

Third, to increase enjoyment, it is inadequate to assign meaningful work alone; managers should provide a platform to announce results, and praise subordinates in various ways. In addition, managers should help subordinates accomplish their work based on their own abilities and help them understand the purpose of the work assigned to them. Even if a superior thinks that a subordinate has been assigned meaningful work, subordinates might not agree. Therefore, it is essential that superiors infuse subordinates' work with a sense of joy by actively conveying the meaning of their work to them and encouraging them to think about it.

11.5.4 Limitations and Future Research

This study has some limitations and further research is required. First, because this study was based on a survey of managers within a particular company, managers from various companies need to be surveyed in future studies. Second, it is challenging to interpret differences between competent managers and other managers using a free-description survey. Clearer results might have been obtained if the leadership skills were analyzed quantitatively to clarify certain factors that this study was unable to address. Third, it is also important to conduct surveys in diverse types of enterprises and jobs to determine variability in leadership skills specific to particular tasks. This approach might clarify the unique aspects of the ability-to-learn-from-experience approach compared to leadership skills suggested in previous studies on coaching.

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Chapter 12

The Study of Career and Promotion Systems in Japan

Ryoko Sakurada

Abstract This chapter shows the need for a new career framework that assumes a delayed and flat organizational structure and an unstable business environment. Traditional organization and career research investigated the framework of growth and stability in the middle and latter twentieth century. However, a highly unstable global business environment has resulted in company downsizing and delayering. The delayering organizational structure has caused a new relationship between organizations and individuals. We assume that it has led to the career plateauing of middle managers, though few previous studies, especially in Japan, have examined the relationship between the delayed hierarchies and career plateauing. This study surveys this topic and determines which organizational factor and HRM practice can help plateaued managers succeed in Japanese companies.

Keywords Career • Career plateau • Delayering • Employability • Promotion systems

12.1 Introduction

In the middle and latter twentieth century, the growth era, organization and career research was conducted on the framework for growth. Feldman (1996) pointed out that organizations and individuals had become interested in growth and advancement from the mid-1940s to the mid-1980s. Traditional studies of organizational behavior and career management have primarily investigated how organizations selected talented employees and how individuals developed their careers to reach senior positions. Rosenbaum (1984) conceptualizes corporate career mobility as a tournament career system. In Rosenbaum's tournament model, promotion systems function not only as schemes of selection but also as schemes of incentives. These findings have also proven relevant to Japanese companies. Although the features of

R. Sakurada (✉)

Associate Professor, Human Resource Management, Faculty of Economic and Business Administration, Fukushima University, Fukushima, Fukushima, Japan
e-mail: e040@ipc.fukushima-u.ac.jp

the promotion system in Japan differ slightly from those of Rosenbaum's model, many Japanese studies point out that they also function as both selection and incentives procedures (Hanada 1987; Imada and Hirata 1995; Takeuchi 1995).

However, in Japan, this situation has been changing since the mid-1990s. Information and communication technology and globalization are shifting company boundaries. To address these changes, companies need to reposition themselves in globalized markets and transform their organizational structures. Specifically, Japanese companies have been downsizing and delayering organizational hierarchies to survive under global competition. These imperatives influence human resource management (HRM) strategies and practices. As a result of downsizing of organizational hierarchies, employees now have fewer opportunities to ascend to higher positions.

In this changing era, assumptions about the framework of organizations and career studies should also change. Researchers should focus on this new framework, which is based not on growth but on an assumed flattened world with fewer boundaries. In this situation, researchers need to study how organizations and individuals attain successful positions based on own their criteria and not on those set by others and also how the career concepts of both Japanese companies and employees have changed in unstable situations. Nonetheless, few studies have adopted this new framework in Japan. This study addresses this new and global view of career systems.

“Career” is one of the terms commonly used in Japan in recent years. In the educational field, in particular, the interest in and need for the career concept has been rising. For example, in order to evoke a concrete image of working, career education has become more apparent in junior high and high schools. Even at the universities, lectures on “career education” are often given. However, many Japanese employees argue that the concept of career is ambiguous and they cannot have clear career images related to their own career goals.

Taken together, these facts show that Japanese society is interested in accepting the new career concept, although it is still ambiguous. Therefore, this chapter makes the dynamic and transitional process of the Japanese career concept clear.

As Schein (1978) mentions, a career is built through the interaction of an organization and an individual. In other words, we can grasp the change in the career concept, if we follow the altered relationship of these two actors. However, this chapter does not deny the Japanese traditional career. We follow and clarify the change that has occurred in the relationship between the organizations and the individuals, especially with regard to promotion and incentive systems in Japan. Furthermore, this chapter proposes the need for a new Japanese career approach that assumes delayed organizational hierarchies and a shrunken social situation.

This chapter consists of four parts. The first part explores the Japanese interest in careers and the changes and trends that exist in career assumption in Japan. The second part reviews the previous career literature and confirms the traditional Japanese career assumption. The Japanese notion of career is based on the lifetime employment and internal labor markets. Therefore, the promotion system has played an important role in it. In this part, we especially focus on this system and

also discuss the problems of the Japanese promotion system. The third part shows the need for accepting a new career approach that assumes shrunken and unstable environment. In this part, we focus on a career plateau and examine the relationship between organizational structure, HRM, and career plateauing in promotion. The fourth part contains the chapter’s conclusions and suggests the implications of its findings.

12.2 Growing Interest in Career in Japan¹

To understand the current Japanese interest in careers, this study collects book data from CiNii Books. The number of Japanese published books, including both academic and practical books with keyword “career,” shows that the trend in Japanese careers has embodied three dynamic changes (Fig. 12.1).²

In the first stage, from the 1960s to the early 1970s, only a few career books existed. In the second stage, which began the latter half of the 1970s and extended to the 1990s, the keyword of career received attention and the number of books gradually increased. The titles of career books that were published in this period include the words or phrases, “relocation,” “promotion of permanent employees within the same company,” “careers for women,” and “careers for special professions.” The third stage, which started in the early 2000s, has witness the rapid



Fig. 12.1 Trends in Number of Japanese Books with Keyword “career”.
Source: This figure is based on a count of books by using information from CiNii Books

¹ Section 12.2 and 12.3 is based on a discussion of the section 2 of Sakurada (2014). 12.2 and Fig.12.1 are based on updated data.

²This figure is based on the data of CiNii Books search engine (<http://ci.nii.ac.jp/books/>, Cited 1 March 2014) with the keyword “career.” We count the books with the keyword “career” in Japanese.

gain in attention paid to the concept of career. In addition, career books have addressed concepts that are more complex. For example, they include broader career material, such as “careers for non-regular employment” and “global careers”.

In sum, the trend in Japanese books with the keyword “career” show two principal features. One is that the term “career” is a fairly new concept in Japan,³ but it has rapidly been gained in popularity since the early 2000s. The other is that the career concept has addressed more complex and broader phenomena and problems, especially in the new century.

We have to ask why these features of the trend exist. The following data provide clues by which to analyze this situation. According to a survey of the Research Institute for Advancement of Living Standards (2003), the three widespread organization reform measures implemented by Japanese companies in the past 3 years were (1) the streamlining of divisions and departments in the head office (implemented by 60.3 % of respondents); (2) the downsizing and integration of business divisions and offices (implemented by 56.2 % of respondents); and (3) the flattening of the organization (implemented by 47.1 % of respondents).⁴ These findings show that the period of greater interest in careers overlaps with that when Japanese companies shrank their organizations and businesses.

Thus, the possibility exists that organizational restructuring and delayering have affected the career concept and the relationship between the organizations and the individuals. This chapter focuses on the relationship between hierarchical change and the new career concept. Before undertaking this discussion, we need to confirm the traditional Japanese view of career through a review of the literature on the subject.

12.3 Theory of Traditional Career Studies

12.3.1 *Patterns of Career Research (Long-Term Career)*

The literature on organization management and careers of the middle and latter twentieth century were based on the framework for growth. Arthur (1994) suggested that traditional career studies have two basic assumptions. One assumption is that organizations and their environments are stable, and the other is that they are hierarchical and embody advancement principles. Feldman (1996) pointed out that organizations and individuals were interested in growth and advancement from the mid-1940s to the mid-1980s. Accordingly, traditional studies of organizational

³ We can find Japanese books with the keyword “career” only from the 1960s. The data of Gunz and Peiperl (2007) indicates that there are books with the keyword “career” before the 1960s. Compared to these data, we can say that career is a fairly new concept in Japan.

⁴ This survey was sent to managers in the departments of human resources and general affairs of 2,000 companies between October and November 2002 to study the change of company organization and its influence on work and ways of working (valid response rate: 6.05 %).

behavior and career management primarily investigate how organizations selected talented employees and how individuals developed their careers to reach senior positions.

This trend, which has included traditional basic assumptions, is also seen in Japanese career literature. First, it has assumed that the business environments of organizations are stable. Second, it has held that organizations and employees can grow. Third, it has posited that organizational structure is hierarchical.

Since the 1960s, Japanese companies have adopted a lifetime employment system. As a result of this system, internal labor markets developed in Japan, and one's status in a company referred to not only personal performance and position on the job but also to social status outside the company. Therefore, it was essential to motivate employees by promoting them in pyramid-shaped organizations. In addition, since the 1960s, Japanese companies have grown in their markets and have accepted growth advancement principles. Hence, the Japanese promotion mechanism has been one of the important subjects of Japanese researchers and considerable research of this topic has been conducted.

Rosenbaum conceptualizes corporate career mobility as a tournament career system. As Rosenbaum (1984) indicates, the promotion structure of the U.S. is a "tournament competition model," without the possibility of a consolation match, such that only the winner of the competition obtains the right to participate in the next level. This tournament model gives better career chances for early promoted employees, although it does not offer any assurances of later promotion process for them (Rosenbaum 1984).

As Koike mentioned, the Japanese promotion systems have been known as one that incorporates "long-term competition" (Koike 1990). Even though Japanese companies have used this "long-term competition," Hanada revealed the existence of a strict competitive principle in Japanese promotion system (Hanada 1987). Imada and Hirata (1995) also showed that the Japanese promotion systems was a multi-layer promotion structure.

This multilayer promotion structure is composed of three models: (1) the *Ichiritsu Nenko Model* (the uniform seniority model) that allows all employees to be equally promoted according to their seniority; (2) the *Shoushin Speed Kyousou Model* (the promotion speed competition model) that allows the loser to catch up with the winner within a certain period of time, despite the fact that promotion speed of each employee is different; and (3) the *Tournament Kyoso Model* (the tournament competition model) that is famous as Rosenbaum's model. These three types of promotion are used selectively, depending on the stages of career development (Imada and Hirata 1995).

The question arises, why did Japanese companies adopt this multilayer promotion structure? According to Imada and Hirata (1995), the multilayer promotion structure is a "highly suitable system" for both organizational factors and employee career development. By introducing it, Japanese companies could take the initiative in employee career development and allow each employee to acquire steadily the needed abilities in each stage and gain promotion over the long-term; even in situations where an organization can barely expand, this approach assumes

four organizational conditions: (1) a lifetime employment practice, (2) a seniority-based wage system, (3) a pyramid-shaped organization, and (4) a barrel-shaped age composition for workforces (Imada and Hirata 1995).

In sum, while Japanese companies had three traditional career assumptions—stability, growth, and hierarchical principles—they tried to remain flexible with unique promotion systems that included a multilayer promotion structure with long-term competition.

12.3.2 The Problems of Japanese Promotion and Employability

Though Japanese companies have unique promotion and career development systems, they eventually entered a new stage where this system cannot properly function. For example, they found it difficult to maintain the traditional promotion structure because of a large imbalance in barrel-shaped age composition of workforces, which Imada and Hirata pointed out. In other words, demographic distortions were created by providing the traditional promotion structure for those aged 30 or older, since these account for a large share of the age composition of workforces, while maintaining the other three conditions of which Imada and Hirata (1995) pointed out. This situation was symbolized by phenomena: a “larger number of titular managerial position applicants” and “slower promotion speed,” especially middle managers in the mid-1990s.

This study assumes that insufficiency of the Japanese promotion systems influences on the concept both of employability and career plateaus.

The concept of employability involves a new relationship between the organizations and the individuals. This concept first appeared in the U.S., but *Nikkeiren Kyoiku Tokubetsu Linkai* (the Special Committee on Education of the Japan Federation of Employers' Association) proposed the Nikkeiren Employability Development (NED) model as the Japanese employability model in 1999. While employability in the U.S. is based on a flexible external labor market, the NED model recommends the cooperation of companies and employees; the latter are guaranteed employment security and acquire general skills, which allow employees to switch their careers. The appearance of the NED model indicates that Japanese companies have been struggling with a new career development system because of the prolonged economic downturn and the increased uncertainty and complexity created by globalization. Accordingly, the NED model operates under the catchphrase “employee autonomy” and “company support.”

Further, in order to respond to a more global and challenging economic situation, the need for autonomous careers has attracted media attention. An analysis of the book data mentioned above also shows that keywords, such as an “autonomous career,” “inter-career,” “human resources for globalization,” “work-life balance,” and “careers of part-time workers” have been frequently used since 2000. Thus, it

appears that researchers and people are now interested in constructing a new relationship between the organizations and the individuals, as indicated by the concept of “employability.”

This chapter also focuses on the phenomenon—a career plateau. This is the one of the issues, which arises because of the insufficiency of the promotion systems. Given the labor conditions of Japan, a career plateau is an unavoidable. Nonetheless, until the late 1990s, there were few studies of this phenomenon.

12.4 New Opportunities for Career Studies

12.4.1 *New Assumptions of Career*

As Arthur (1994) and Feldman (1996) pointed out, early career studies contained assumptions about the stability of organizations and their environments and the hierarchical and advancement principles contained in the former. However, since the mid-1990s, these basic assumptions had been changing. Arthur (1994) defined careers that embody the new inter-career framework as boundaryless careers.

Why did this new career framework arise in the mid-1990s? The main reason is that the stability of organizations and their environments, the first assumption of early career studies, had weakened. For example, Arthur (1994) showed that shorter median employment tenures and decentralization are indications of boundaryless careers. Further, Feldman pointed to the “large-scale layoffs in the 1980s and the continued downsizing in the 1990s” (Feldman 1996, p. 145) arose in a new career framework. Therefore, the second assumption about hierarchical and advancement principles is no longer tenable. Researchers were thus forced to focus on a new framework (Arthur 1994; Arthur and Rousseau 1996; Hall 1996, 2002; Kanai 2002), one based not on the supposition of growth but on the supposition of a flattened world with fewer boundaries.

As the data of Research Institute for Advancement of Living Standards (2003) indicate, Japanese companies have downsized in the new century to survive under global competitions. Their delayed organizational hierarchies have resulted in fewer promotional opportunities and the placement of fewer employees on fast-track careers. This situation created serious problems for both organizations and individuals, since Japanese companies had depended on the internal labor market and since employees had regarded promotions in their companies as incentives. Therefore, we can say with fair certainty that researchers, especially Japanese researchers, need to study the new promotion systems, the alternative incentive schemes, and employee careers in flattened organizations. Nonetheless, few studies have adopted this new framework in Japan, which is why this study addresses this issue.

12.4.2 *Flat Organization and Traditional Careers*

Since the 1990s, Japan has suffered from low growth. In addition, information technologies and globalization are blurring the boundaries of companies. To respond to these changes, companies have conducted downsizing and delayering of organizational hierarchies. This has created a lower likelihood of promotion in Japanese companies; Ference, Stoner, and Warren (1977) regarded this situation as one in which a career plateau exists. The promotion systems are able to function as an incentive in Japanese companies only as long as employees see the possibility of career advancement. Therefore, this career plateau is the unavoidable issue for Japanese companies.

A career plateau is defined as “the point in a career where the likelihood of additional hierarchical promotion is very low” (Ference, Stoner, and Warren 1977, p. 602). Career plateaus occur naturally because organizational structures are pyramids (Ference, Stoner, and Warren 1977; Carnazza, Korman, Ference, and Stoner 1981), which limit promotions, since the number of higher positions is limited. In addition, demographic factors create career plateaus. For example, when the number of well-educated people with high career expectations entered career tournaments, they found fewer promotion opportunities in their corporations. The baby boom generation in the U.S. entered organizations with such expectations and they accelerated severe career plateaus in their companies (Slocum, Cron, Hansen, and Rawlings 1985; Cron and Slocum 1992).

Since the study of Ference, Stoner, and Warren (1977), “career plateaus” have received the attention of many scholars. They have probed the organizational factors that generate career plateaus and the relationship between career plateaus and specific individual factors. Moreover, recently career plateau research has been conducted from an international perspective

As mentioned earlier, promotion has played a key role in Japanese companies, since status in a company referred not only to a person’s performance on the job but also to his or her social status outside of a company. Given the labor conditions of Japan, career plateaus are unavoidable, and it is clear that managing them is an important issue for organizations and employees. Nonetheless, with few exceptions (cf. Yamamoto 2006⁵), there has been little attention given to career plateaus in Japan.

The question now arises: Have career plateaus occurred in Japan? Yamamoto (2001) confirmed whether career plateaus occur in Japanese companies. As a result, Yamamoto’s work confirmed career plateaus exist in any jobs and in many Japanese companies, independently of organizational macro factors, such as company fiscal performances.

There remains a second question: Why did career plateaus not become an issue until the mid-2000s? The main reason is that Japanese companies have dual “career

⁵ Yamamoto revised this book three times. The first edition is published in 2000, the second one is in 2001, and the third one is in 2003. Yamamoto (2006) is the fourth edition of the book.

ladders”: a rank ladder, which defines the position of an employee, and a grade ladder, which is called a “vocational-qualification system.” The vocational-qualification system is an internal career ladder, based on vocational ability, which is specific to a company. Japanese employees can be promoted in a rank ladder after receiving a promotion on a vocational-qualification ladder (Yashiro 1987, 2002; Imada and Hirata 1995). These dual ladders promotion systems functioned as incentive systems in pyramid-shaped organizations, and eliminated career plateauing in Japanese companies (Sakurada 2009).

However, these career ladders have to change when organizational hierarchies become flatter, and we assume that delayering hierarchies has a negative impact on career plateauing. Unfortunately, few studies have focused on the relationship between delayering and career plateaus. In addition, research into Japanese career plateaus has been limited. We found some studies conducted by Yamamoto (cf. 2006) that focus on career plateaus, although they assumed pyramid-shaped organizations. Therefore, we must draw attention to career plateaus in flattened organizations in Japan.

12.4.3 Data Analysis and Results

Models and Method

We derive hypotheses on the linkage between organizational and HRM practical determinants and career plateaus. We focused on three aspects; career plateaus in promotion, organizational factors (mainly hierarchical delayering and the delegation of power), and HRM (a reward system which has close affinity with the delegation of power).⁶ Thus, our aim is to examine the significance of the relationship between delayed hierarchies and career plateaus in promotions. We also focus on responsibility of middle managers.

Hanada (1987) points out that middle managers is the key turning point for further high promotion in Japanese companies. Therefore, we assume that the changes of the promotion system affect heavily on middle managers. To test our hypotheses, this study focuses on career plateaus of middle managers.

The sample includes data of 575 middle managers in 121 Japanese companies. About 70 % of the respondents (companies) are in manufacturing. Participants (middle managers) were surveyed on a variety of career and work related issues.

⁶ This survey was sent in 2006 with JMAM and Prof. Mitsutoshi Hirano of Kobe University. We asked the chiefs of HR division about payroll numbers, the delayering of hierarchies and HRM (Reward system) of this analysis model. We asked middle managers about other questions of this analysis model, for example controlled variations, the degrees of the delegation of power, and career plateaus.

To know the situation of the division and HR practices, their supervisors and the chiefs of HR division were also surveyed. We first controlled for payroll numbers, gender, ages, tenures, the tenures of rank positions, the lengths of vocational-qualification grades, and the numbers of subordinates (full-time and part-time). As mentioned earlier, Japanese promotion systems consist of dual career ladders, we need to control both rank tenures and vocational qualification tenures.

Dependent Variable

Career Plateaus

Yamamoto (2006) used both objective and subjective career plateaus, this study focus on subjective career plateaus to make the middle managers' perceptions of organizational and HRM change clear. We use the likelihood of promotion to measure career plateaus as a dependent variable for our annalistic model.⁷

Independent Variables

We used organizational structure and HRM (reward system) as independent variables for our annalistic model.

Organizational Structure

We used two variables for organizational structure. One is the delayed hierarchies. The other is the degree of delegated power. The first was measured by asking it to the chief of HR division, the second was measured by asking it to middle managers.

HRM (Reward System)

As Cron and Slocum (1992) discussed, lack of responsibility and reward result in career plateaus. Therefore, our annalistic model used a reward system for HRM variable, in terms of incentive. A reward system, which has a close affinity with the delegation of power, was established by asking about the weight placed on task responsibility in annual income appraisals of both non-managers and middle managers.

⁷The questioner surveyed other variables for career plateaus as well. Thus, we will investigate other type of career plateaus in other papers.

First, we examined whether a delayed hierarchy has negative impact on the likelihood of promotion. Though Yamamoto's study (2006) shows that there is no significant relationship between delayed hierarchies and career plateauing in Japan, we assume that there is a relationship between them.

Hypothesis 1 A delayed hierarchy will have negative impact on the likelihood of promotion.

Second, this study pays attention to responsibility and examines whether the delegation of power has a positive impact on the likelihood of the promotions of middle managers. Feldman and Weitz (1988a, b) define a career plateau as the point where an employee has a lower likelihood of receiving increased responsibility, since hierarchical promotion differs from the actual responsibility, which an employee can have. Further, Arthur (1994) cites decentralization as evidence of boundaryless careers. Therefore, this study makes clear the relationship between responsibility and career plateaus. We assume that middle managers are not in career plateaus when more power is delegated to them, because they can participate in higher decision making by the delegation of power.

Hypothesis 2 The delegation of power will be positively related to the likelihood of promotion.

Third, this study focuses on the gap between rank position and responsibility. Feldman and Weitz (1988a, b) focus on the gap between rank position and actual responsibility, and Cron and Slocum (1992) discuss career plateaus in terms of responsibility and reward. As a result, our research examines whether an appraisal system in which task responsibility has a higher weight in appraisals for annual income influences the likelihood of the promotions of middle managers and becomes an incentive.

Hypothesis 3 A higher weight on task responsibility in the appraisals of the annual incomes for non-manager is positively related to the likelihood of promotion.

Hypothesis 4 A higher weight on task responsibility in the appraisals of the annual incomes for manager is positively related to the likelihood of promotion.

Results (Table 12.1)⁸

As for the control variables, a payroll number has a positive impact on the likelihood of promotion ($p < 0.01$), and age has a negative impact on the likelihood of promotion ($p < 0.001$). The result, which the likelihood of promotion is high, means employee non-plateauing. The result, which the likelihood of promotion is low, means employee plateauing.

⁸This study matched HR division data and middle managers data. Following this procedure, we used 300 middle managers data in this annalistic model.

Table 12.1 Hierarchical regression summary

Variables	Likelihood in promotion	
	Step1	Step2
Payroll number	0.17**	0.15**
Tenure	-0.08	-0.04
Tenure of the rank position	0.03	0.01
The length of vocational-qualification grade	-0.02	-0.02
Age	-0.27***	-0.26***
Gender	-0.06	-0.06
Number of subordinates (full-time)	0.09	0.09
Number of subordinates (part-time)	-0.10	-0.07
Delaying hierarchies (R)		-0.10 [†]
Degree of delegation of power		0.15**
The weight on task responsibility in the appraisals of the annual incomes (non-managers)		-0.09
The weight on task responsibility in the appraisals of the annual incomes (managers)		0.17*
R²	0.15***	0.20***
ΔR²		0.05**
F	6.48	5.83

Note: Coefficients are standardized beta estimates.

Significance levels: [†]p < 0.10; *p < 0.05; **p < 0.01; ***p < 0.001

This study confirmed mainly three points. First, it demonstrated that delaying hierarchies have negative impacts on the likelihood of promotion, especially for middle managers. Our data show that delayed hierarchies weakly result in the career plateauing of middle managers ($p < 0.10$).

Second, our research confirmed that the delegation of power has a significantly positive impact on the likelihood of the promotions of middle managers ($p < 0.01$). This result indicates the possibility that middle managers can avoid career plateauing, if they are given responsibility.

Third, our research examined whether the adoption of a wage system, which places a higher weight on task responsibility in appraisals for annual income, influences the likelihood of promotion of middle managers. When this weight is higher, the career plateauing of middle managers lessens ($p < 0.05$). This result indicates that the adoption of a wage system with a higher weight of task responsibility in appraisals for annual income can prevent middle managers from career plateauing.

In summary, this study has paid attention to Feldman and Weitz's work (1988a, b), and it has examined the relationship between career plateaus in promotion and responsibility. It reveals three main findings: first, delaying hierarchies weakly results in the career plateauing of middle managers. Second, the delegation of power has a significantly positive impact on non-plateauing in middle managers, which shows the possibility that middle managers can avoid

career plateauing if they are given responsibility or chance to participation in decision making. Third, when responsibility is given more importance in the total assessments for the annual incomes of middle managers, the career plateauing of these persons lessens.

12.5 Conclusions and Implications

This chapter aimed to examine how Japanese career concept has changed under globalization. Japanese companies were famous for internal labor market-oriented human resource management (HRM) and long-term careers within a company. Each organization had a strong initiative for employee career. Under these circumstances, for employees, higher status in their organizational hierarchies was directly linked to their career success. However, Japanese companies downsized to survive under global competition, and delayed organizational hierarchies resulted in fewer promotional opportunities. Therefore, this chapter insists on the need for new career assumption in delayed and shrunken organizations and discussed Japanese career concept especially in terms of promotion systems.

We confirmed that Japanese career literature, as that of the United States, has traditionally basic assumptions of stability, growth, and hierarchy. Further, Japanese companies had a unique promotion system, one with a multilayer promotion structure and two career ladders. With this unique system, Japanese companies tried to avoid middle manager career plateauing in pyramid-shaped organizational structures with growth principle until the 1990s.

However, these assumptions are no longer hold, and we clarify the need for new career assumptions for flattened organizations. Nonetheless, in Japan, few studies examine this issue. For example, few studies examine the relationship between delayed hierarchies and career plateauing, and Yamamoto's study (2006) shows that that there is no significant relationship between delayed hierarchies and career plateauing. However, we assume that delayed organizational hierarchies result in more career-plateaued managers. We discussed whether there is a significant relationship between delayed hierarchies and career plateauing, and indicated which organizational factor and HRM practice can help plateaued managers succeed.

Our findings indicate two main facts. One is that delayed hierarchies weakly result in the career plateauing of middle managers, as we assumed. The other is that responsibility in a company has an important role for career plateauing in promotion under delayed organization. Accordingly, there is the possibility that responsibility will become a new incentive system in Japan, if companies can manage the responsibility of middle managers.

How can Japanese companies manage the responsibility as an incentive? One possibility is the delegation of power, and the other is a wage system that places a higher weight on task responsibility in appraisals for annual income. We think

management responsibility is important for both the delayering of Japanese companies and for their employees for the following reasons.

First, this study assumed that traditional Japanese in-house careers are still maintained and that middle managers still play important roles within the system in Japan, even though organizational hierarchies became flatter around the turn of the century.

Second, even though the Japanese employability concept was presented in 1999, the new employability concept is still not deeply rooted in Japan. For example, the “Fiscal 2012 Basic Survey of Human Resources Development” of the Ministry of Health, Labour and Welfare (2013) indicates that about 75 % of companies answered that company mainly have employee career initiatives. Thus, Japanese companies still believe that they have a responsibility for their employees’ careers.

Therefore, it can be assumed that Japanese companies still have an in-house-organizational career assumption, even though they have been delayering. If so, higher status in their organizational hierarchies is still linked to career success, especially for middle managers. Therefore, avoiding career plateaus in promotion in shrunken and flattened organizational structure is a key issue in Japan. We believe that responsibility management will become an efficient practice in Japan in the present phase.⁹

In summary, this chapter showed the need to accept new career assumptions in a diminished and flatter economic environment. We confirmed that delayering organizational structures cause career plateauing in middle managers and showed the possibility that the delegation of power and a wage system with a higher weight of task responsibility in annual income appraisals can help plateaued middle managers succeed.

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⁹Of course, in the future, boundaryless, and job-hopping careers may become more popular for Japanese employees. Therefore, we hereafter will have to examine whether more boundaryless career will appear even in Japan.

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Chapter 13

A Discussion of the Development of Work-Life Balance in Japan: From Quantity to Quality and Diversity

Norio Kambayashi

Abstract Recently in Japan, there have been increased efforts by government, workers, and employers to promote and enhance “work-life balance”. This paper first reviews the results obtained from hearing surveys of four Osaka-based companies conducted by the *Osaka Roshikaigi* (Osaka Workers and Employers Council) in which the author was involved. The results are summarized into four categories: (1) Definition and interpretation of the concept of work-life; (2) Motivation for and processes leading to efforts to enhance work-life balance; (3) Concrete efforts to promote work-life balance; and (4) Outcome of efforts. In addition, the paper outlines the various methods being implemented by Japanese businesses as policies for promoting work-life balance. In addition, based on the hearing survey results, the paper discusses measures for implementing work-life balance in a form appropriate for Japanese businesses.

Keywords Diversity • Japanese management • Work-life balance • Work-life integration

This paper reorganizes a report (written by this author) presenting and summarizing the findings of the Work-Life Balance Commission (June 2007–July 2008) conducted by the Osaka Roshikaigi (Osaka Workers and Employers Council) (collaboration between the Kansai Employers’ Association and Japanese Trade Union Confederation Osaka) in which the author was involved. The author wishes to express his deep appreciation to all the companies that cooperated in the hearing surveys and to the members of the Commission. The author would also like to express his gratitude to Ms. Mari Toyooka and Mr. Yoshinori Shibata of the Kobe University Graduate School of Business Administration’s doctoral program for their assistance with data processing and preparing the minutes of meetings.

N. Kambayashi (✉)

Professor, Human Resource Management, Graduate School of Business Administration,
Kobe University, Kobe, Hyogo, Japan

e-mail: nkamba@kobe-u.ac.jp

13.1 Introduction

Over the past several years, as Japan has experienced the rapid expansion of globalization and the full-scale arrival of an aging society with a declining birthrate, the country has also seen an increase in efforts by government, workers, and employers to promote and enhance “work-life balance”. For example, at the government level, the “Expert Panel on the Declining Birthrate and Gender Equality” (October 2004–February 2007), established under the auspices of the Cabinet Council for Gender Equality, showed the importance of re-evaluating the way people work and supporting work-home balance as a measure for countering the declining birthrate and furthering gender equality. Based on these results, the “Expert Panel on Harmony between Work and Life (Work-Life Balance)” was newly established in February 2007 and has been examining the meaning and importance of work-life balance as well as the direction of efforts in this area. In December of the same year, the “Work-Life Balance Charter” and “Action Guidelines for Promoting Work-Life Balance” were formulated by the Cabinet Office as important policy measures for enhancing work-life balance.

The Work-Life Balance Commission (June 2007–July 2008) conducted jointly by the Kansai Employers’ Association and Japanese Trade Union Confederation Osaka, and in which the author was involved, also carried out hearings of four Osaka-based companies—Company A (manufacturer), Company B (manufacturer), Company C (manufacturer), and Company D (information and telecommunications)—that have been proactively promoting work-life balance. This paper summarizes case examples of the work-life balance efforts by the four companies, based on the hearing surveys, and considers methods for realizing a “Japanese work-life balanced society” as well as future directions and issues for such efforts.

First, Sect. 13.2 summarizes the results and main points from the hearings with the four Osaka-based companies into four categories: (1) Definition and interpretation of the concept of work-life; (2) Motivation for and processes leading to efforts to enhance work-life balance; (3) Concrete efforts to promote work-life balance; and (4) Outcome of efforts. Based on the results presented in Sect. 13.2, Sects. 13.3 and 13.4 examine concrete measures for realizing a “Japanese work-life balanced society” as well as the direction of the development of individuals, businesses, and society in Japan.

13.2 Case Examples of Efforts to Promote Work-Life Balance and Characteristics of These Efforts

This section presents the following four points summarizing the information obtained from the hearing surveys with four Osaka-based companies.

1. Each company’s definition and interpretation of the concept of work-life: For example, are work-life balance efforts targeted at all employees, or do they focus

on women? How is the relationship between efforts to enhance work-life balance and improvements in performance (earnings) viewed?

2. When and why (due to what motivation) were efforts to improve work-life balance introduced, and what process was involved?
3. What kinds of systems or mechanisms have been introduced as concrete efforts to promote work-life balance? What departments (such as the Human Resources Department) undertake concrete efforts to promote work-life balance, and what kinds of measures are being taken?
4. Outcome of efforts: What results were achieved by the concrete efforts in (3)? Were there any impediments to this process or any problems that arose? What points does the company regard as being issues for the future?

These four points are summarized in Table 13.1.

As Table 13.1 shows, each company interprets the phrase “work-life balance” differently, positions work-life balance efforts differently, and uses different approaches and methods to realize work-life balance and achieve a diverse range of results. In the future, efforts to achieve and improve work-life balance can be expected to take various directions. The information provided here is deliberately simplified to summarize this overview while compactly showing common items and characteristic trends.

13.2.1 Definition of the Concept of Work-Life Balance¹

All four companies paid attention to aiming their work-life balance measures at all employees, regardless of gender. In particular, during the initial introduction stage, many companies interpreted “work-life balance measures” as prescribed systems that include making it easier for women to work. For example, these systems included the realization of gender equality and support for balance between work and motherhood protection/childrearing. It can be said that, in the past several years, the characteristic trend for these measures, which have mainly targeted women, has been development that attempts to include all employee groups.

13.2.2 Content of Concrete Efforts

With respect to system-related measures, all four companies made proactive efforts to formulate or revise childcare/nursing care leave systems. Furthermore, the companies implemented concrete efforts aimed at shortening working hours, such

¹This paper does not include consideration of work-life balance concepts and definitions or of the detailed content or possible related problems of work-life balance measures that are being discussed in the academic world. The author hopes to consider these issues at a later date.

Table 13.1 Case examples of efforts by companies to promote Work-Life Balance (WLB)

<p>Interpretation of WLB</p>	<p>Company A (Manufacturer)</p> <ul style="list-style-type: none"> WLB that responds to the needs of management, society, and individuals <p>Company A's thinking is to support WLB for a diverse range of human resources while responding to three needs of management, society, and individuals: (1) management's need to utilize a diversity of human resources; (2) individuals' need to realize a way of working that is in balance with their personal lives; and (3) society's need, as the birthrate continues to decline, to promote an environment that makes it easier to bear and raise children</p> <ul style="list-style-type: none"> <i>Action aimed for by the labor union as leverage against the company:</i> Establish the personal identity of each individual worker by improving and enhancing the balance between their personal lives and social lives 	<p>Company B (Manufacturer)</p> <ul style="list-style-type: none"> WLB linked to a performance-based system <p>Company B has a performance-based way of thinking according to which individuals gain a sense of their own growth and purpose as they work. The company is undertaking WLB measures that lead to a diversity of work styles aimed at the self-realization of individual workers. To ensure that all workers can work enthusiastically, the company aims to create a workplace in which employees can work in a range of working styles and with a sense of security. This way of thinking respects individuals' autonomy and independence, and aims at self-realization through work and continuous engagement with work for the medium-to-long term. Here, WLB is linked to a performance-based system in which individuals' approach their work with a sense of purpose in their life and work generates even higher results</p>	<p>Company C (Manufacturer)</p> <ul style="list-style-type: none"> WLB aimed at utilizing a diversity of human resources <p>Company C views the main factors in business growth and expansion to be (1) acceleration of business globalization; (2) differentiation/development of technological products; and (3) implementation of management centered on people. The company relies on the belief that the results of synthesizing the skills of diverse human resources will differentiate the company from its competitors, achieving a competitive advantage that raises the company's unique corporate value. Regardless of age, gender, nationality, or whether or not they have disabilities, the company values and emphasizes the differences in the characteristics and skills of individual workers. The company uses WLB as a mechanism for supporting the working styles of a diversity of human resources, and all individual workers are actors, regardless of their age, gender, or nationality</p>	<p>Company D (Information and Telecommunications)</p> <ul style="list-style-type: none"> WLB making work and life indivisible <p>Company D emphasizes that work is a part of everyday life, and that it is impossible to draw a line between work and life. This attitude is based on the belief that, not only does "work" mean to (1) live and (2) work at a company, but also includes child-raising, housework, and undertaking social contribution activities. An important concept is that work is indivisible from everyday life, that it is living and life itself, 100% committed to all their activities, be they work or life activities</p>
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<p>History of WLB Efforts</p>	<p>Following the revision of the Equal Employment Act in April 1998 (enforced in relation to motherhood protection), the company undertook positive action. The five main points in the history of these efforts were (1) Compliance with the Equal Employment Act (1998–), (2) Changing awareness/corporate climate (2001–), (3) Compliance with the Act for Measures to Support the Development of the Next Generation (2003–), (4) Improvement of the employment environment (e-Work, etc.), and (5) Labor movement</p>	<p>The company focused on reorganizing human resources between 2000 and 2005 (efforts centered on system changes: performance-based evaluation and treatment) and between 2006 and 2007 (efforts centered on human resource training). In particular, since 2006 the company has been implementing WLB measures targeting all employees and aimed at “harmony with society”. Points include countermeasures against long working hours and the promotion of mental health care</p>	<p>In 1992, the company introduced a childcare leave/childrearing work system. In 2001, in addition to abolishing the distinction between main career track and general employees, the company created a plan for positive action from four angles: “equal opportunity”, “re-forming awareness”, “securing human resources”, and “support for balance”. The company promotes an environment in which each employee, regardless of gender, can fully display their skills. Since 2003, the company has been actively improving both hard (system) and soft aspects of WLB</p>	<p>Of the company’s 117 employees, women comprise a high percentage in each division: Strategic Planning Division (20 %), Technology Marketing and Development Division (30 %), and Business Planning Division (40 %). The company is aware of the limitations of seeking a balance between work and childrearing/housework through the independent efforts of women alone. Therefore, they are concentrating on creating a system that supports work-life balance for all employees as well as the realizing a workplace in which it is easy for women to work</p>
<p>Concrete Efforts Related to WLB</p>	<ul style="list-style-type: none"> • Compliance with the Equal Opportunity Act (childcare leave, nursing care leave, child-plan leave, family support leave, work and life support duties) • Changing awareness/corporate climate • Compliance with the Act for Measures to Support the Development of the Next Generation (“First Action Plan” in 2005; “Second Action Plan” in 2007) 	<ul style="list-style-type: none"> • Choosing lifestyle/work style: career track selection system; change-of-track support system; re-employment system for workers aged 60 years • “<i>Kirameki</i> (Sparkling) Life Promotion Office” (2007): supporting a place where women can play an active role within business activities (childcare support system, etc.) • Career plan training: providing opportunities for individual employees to consider their 	<ul style="list-style-type: none"> • Efforts to eliminate long working hours • Efforts based on an awareness of “work restructuring” • Establishment of flexible work schedules • Promotion of planned paid leave • Improvement of measures to support work-childrearing balance • Establishment of a “Website to Support Work-Childrearing Balance”: workers taking 	<ul style="list-style-type: none"> • Shorter working hour systems in addition to legally prescribed systems • Half-day paid holiday system • Earlier/later times for starting/finishing work • Re-employment system • Hiring of workers seeking re-employment • Equality of work duties/division areas • Proactive gender equality education and training; guaranteed advancement

(continued)

Table 13.1 (continued)

	Company A (Manufacturer)	Company B (Manufacturer)	Company C (Manufacturer)	Company D (Information and Telecommunications)
	<ul style="list-style-type: none"> Improvement of the employment environment (establishment of an E-Work Promotion Office) Labor movement 	<ul style="list-style-type: none"> own careers and life plans Mental health measures Countermeasures against long working hours 	<p>childcare leave are provided with information about the company's activities and the workplace during their leave of absence to support their smooth return to the workplace. Efforts to raise awareness amongst supervisors are also implemented</p> <ul style="list-style-type: none"> Action plans are implemented in accordance with the Act for Measures to Support the Development of the Next Generation 	<ul style="list-style-type: none"> Career path system based on individuals' skills, regardless of gender Compulsory creation of opportunities for worker exchange during working hours (once per month)
<p>Outcome of Efforts</p> <p>(1) Quantitative aspects (shortening of work hours, etc.)</p> <p>(2) Qualitative aspects (enhancing work content, etc.)</p> <p>(3) Diversity viewpoint</p>	<ul style="list-style-type: none"> Quantitative aspects: Although the company has been improving numerous supportive measures for work-life balance, they are conscious of problems related to employees' awareness and use of the system, the workplace environment, and corporate climate due to an insufficient understanding of the system Qualitative aspects and diversity viewpoint: Through promotion of the e-Work@home 	<p>Quantitative aspects: Surveying and analysis of working hours through work-hour management</p> <ul style="list-style-type: none"> Qualitative aspects: As part of career plan training, each age-group is set a theme and provided with opportunities to consider their future life plans and career plans. Employees participate actively, achieving communication beyond the bounds of divisions and occupations. The effectiveness of these efforts as a forum for 	<p>Quantitative aspects: In an effort to eliminate long working hours, the company monitors the working-hour situation uniformly for the entire company</p> <ul style="list-style-type: none"> Qualitative aspects: In addition to efforts to eliminate long working hours, the company has increased work efficiency due to work restructuring Diversity viewpoint: As a supportive measure for work-life balance, the company not only provides hard (system) 	<ul style="list-style-type: none"> Quantitative aspects: For each measure implemented, there is a history of workers having used these measures and an observed improvement in employees' awareness and understanding of WLB measures Qualitative aspects and diversity viewpoint: Opportunities for exchange between employees within working hours and after work in "After-six Seminars"

<p>Project, it has become possible for workers to work from home using information technology (IT). This is an experiment in reducing constraints on where work is performed, and expanding and enhancing the selection of working styles</p>	<p>exchange is acknowledged</p> <ul style="list-style-type: none"> Diversity viewpoint: Measures aimed at “creating a workplace in which a diversity of working styles is possible and people can work with a sense of security” are contributing to a decrease in employee turnover and an increase in the securement of human resources 	<p>support, but also soft support for system users, enabling a smooth return for employees on leave. This has also led to improvements in supervisors’ understanding of work-life balance and in the workplace in general</p>	<p>have been established, with employees creating time to come to know each other’s individual backgrounds and deepen mutual understanding. This has contributed to the creation of a workplace environment/climate in which it is easier to work and a decrease in the employee turnover rate</p>
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Source: Osaka Roshikaigi (Osaka Workers and Employers Council), partially changed from the table on page 3

Note: “Work-life balance” has been abbreviated to “WLB”. The hearing with Company A was conducted with labor union representatives; the hearings with Companies B, C, and D were conducted with management representatives

as improving discretionary work and other flexible work systems or bringing forward times for leaving work. There were also companies that proactively introduced and established telecommuting systems (tele-work), companies that undertook work-life balance measures in coordination with various performance-based human resource systems, and companies that emphasized the mental health aspects of employee care. A diverse variety and range of measures were observed to be implemented in accordance with the circumstances of each individual company. Moreover, the companies not only reformed their systems, but also made an effort to increase the level of employee awareness.

13.2.3 Relationship Between Work-Life Balance and Work Performance

There is no data expressly linking work-life balance measures with improvements in performance or profitability for any of the four companies in terms of business operators' and human resource managers' awareness and feeling. However, it can be seen that the companies share the view that, over a medium-to-long-term time span of at least 4 to 5 years, more skilled human resources have become established within the business as the result of work-life measures, ultimately leading to high performance results. The costs of introducing work-life measures impact income and expenditure for that year, but companies are aware that, after this, performance will gradually improve over several years. Likening this to the shape of the letter "J", this phenomenon is known as the "Work-life Balance J-curve Effect".

A report by the Osaka Prefectural Industrial Labor Policy Promotion Council (2007) states that, because of the nature of Osaka people to "focus on money", especially within small- and medium-sized businesses, evidence is needed that promoting "work-life balance" does indeed lead to improvements in performance and profits. Therefore, this point suggests that viewing work-life balance from a medium-to-long-term perspective of at least 4 to 5 years is important when discussing the monetary aspects of work-life balance measures.

13.2.4 Issues for the Future

Since introducing work-life measures, each company has found that awareness amongst their employees about the concept of work-life balance has gradually increased. However, large-scale companies are conscious that the issue of how best to incorporate work-life balance measures into daily work practices needs to be addressed moving forward. By mainly bringing to the fore improvements related to creating an environment in which it is easy to work, work-life balance

measures tend to make light of work and working styles themselves. In particular, overcoming the problem of long working hours is closely related to changing the everyday working styles of employees, and all companies recognized the need to consciously carry out work restructuring in conjunction with work-life balance measures. However, when the companies were asked whether or not they were in fact carrying out work restructuring, the majority responded that that had not yet done so in a concrete manner.

13.3 Towards the Realization of a “Japanese Work-Life Balanced Society”

Recently, work-life balance theory has gained prominence in Japan. For instance, Morita (2003), Wakisaka (2006), Osawa (2006), Arakane et al. (2007), Komuro (2007), Sato (2007) and Nippon Keidanren Publishing (ed.) (2008) have discussed the theme in various contexts. However, discussions examining various policies and measures concerning the enhancement of work-life balance in Japan, rather than carefully considering the context of this country, have tended to copy and conform to those being carried out in Western countries.

Very simply put, the major premise of discussions of work-life balance in Western countries are underlain by the semantics of the phrase “work-life balance” itself; that is, the concept of “creating balance between two intrinsically different aspects of life, “working life” (“work”) and “life outside of work” (“life”) and designing a more desirable lifestyle for humans” (Lockwood 2007). The typical Western “logical” way of thinking (a dominant style or form of thinking observed in a particular culture or civilization) is that “working life” and “life outside of work” are intrinsically different. Here, “work” is viewed as “labor (drudgery)”, involving pain and difficulty, while “life outside of work” is “enjoyment and happiness”. According to this concept, the former should be as short as possible and carried out in moderation, while ample time should be taken for the latter so that life can be enjoyed. The point here is that, according to Western thinking, “working life” and “life outside of work” are intrinsically different and the concept of “work-life balance” is underlain by the implicit premise that “working life” and “life outside of work” can be separated completely into two. Mechanisms premised on this Western way of thinking differ in history, culture, and traditions. Accordingly, when introducing ways of thinking that differ from Japanese thinking, a certain amount of care is necessary.

Methods that aim to create balance between “working life” and “life outside of work” also need to be careful at stopping at so-called “quantitative aspects”, such as shortening work hours and increasing leisure time, which cannot be said to raise particularly high expandability of discussions aimed at the future. This is because work-life balance discussions that focus on only quantitative aspects ignore the content of the working life that has been shortened and poses the risk of possibly harming the “multi-capacity”, “intellectual dexterity”, organizational skills, and cooperative skills that Japanese workers have developed, and of which Japan can

boast to the world. Unless discussions of work-life balance do not take the view that shorter working hours means there is no need to question the content of working life, and so the existence of “labor (drudgery)” and “pain (difficulty)” are acceptable, but rather that work is fundamentally an enjoyable activity in which one can experience joy, the discussion will be putting the cart before the horse. Innovations to make working life enjoyable need to be considered based on a principle of sharing under which all labor is shared by all members of society, overcoming the conventional thinking that previously dominated Japan of so-called “division of labor by gender”.

Recent discussions of work-life balance are beginning to acknowledge the basic concept of “making work as enjoyable as life”. By reinterpreting work-life balance from the viewpoint of “diversity in the interpretation of ‘balance’”, we will reconsider methods for realizing “Japanese work-life balance” through the following three steps.

13.3.1 Step 1: Reducing Meaningless Overtime and Excessive Labor

First, Step 1 is to further advance efforts towards shortening working hours and increasing the ratio of workers taking paid annual leave, which in reality is already being pursued. Efforts in Step 1 and work restructuring to reduce meaningless overtime and enhance work efficiency are two sides of the same coin. As mentioned above, companies are already undertaking efforts towards shortening working hours and increasing the ratio of workers taking paid annual leave, but not necessarily in conjunction with improving work processes and how work is carried out. Accordingly, it is essential that these issues be reinterpreted in relation to improvements in how everyday work duties and business are carried out.

Furthermore, an important point that must be considered in Step 1 is that both labor and management must make an effort to decrease meaningless overtime and excess labor as much as possible and increase time for life (such as free time for individuals; life at home, including interaction with family; social life, including active exchange within the community; and time spent by individuals on advancing their skills). For example, introducing a system of shorter working hours for full-time employees is a work style that could be the key to realizing work-life balance in Step 1. In addition, it is important that companies be more aware of increasing the number of days on which workers finish work and leave early, rather than sluggishly continuing with work late into the night. When an employee’s working life is completely devoted to work in the workplace, it inevitably follows that work performed in the home, such as housework and other work necessary for living a human lifestyle, is left up to housewives (or husbands) who are not engaged in “labor” in the form of company work duties. It goes without saying that, with regard to aspects of life such as housework, childrearing, and community life, work-life

balance also needs to be considered from the perspective of everyone—both people working in companies and those not—dividing and sharing labor and participating in these activities. This concept of sharing is the basic spirit and main pillar supporting the implementation of Step 1.

13.3.2 Step 2: Consideration of Methods for Enhancing Work Content

In contrast to the work-life balance measures focusing on “quantitative aspects”, such as shortening working hours and number of days of leave mentioned in Step 1, Step 2 comprises work-balance measures that focus on “qualitative aspects”. That is to say, instead of being based on the major premise of Western society that “working life” and “life outside of work” can be completely separated, work-balance measures need to examine work processes in the workplace to see whether or not elements of “life outside work” that imply happiness or enjoyment in some form can be incorporated into “working life”, which tends to be viewed as “laborious”, “painful”, or “difficult”. Step 2 is a step that should be pursued after sufficient efforts by both labor and management have been made to “correct excess labor” and increase time for life, as pursued in Step 1.

In the past, when the strength of Japanese management practices were much-touted, flexible and unspecific work structuring and duty allocation—rather than completely fixed allocation of individual duties to individual workers—were carried out, enabling workers to acquire a diverse range of skills. This was regarded as the source of Japan’s management strength, and in actuality, it was on this point that the competitive superiority of Japanese management was able to exist. The working style mechanisms utilized by Japanese companies, rather than pursuing efficiency in a narrow sense for individual work units—appearing ambiguous at a glance and even “inefficient” and “illogical” at times (from a Western perspective)—drew the attention of the world as “the secret to Japanese management”. Amidst the prolonged Heisei Era economic downturn, as the performance of Japanese businesses has declined, there has been a trend towards fickle Western companies discontinuing Japanese practices because “Japanese management practices are no good after all; they are nothing more than a relic from the past”. Despite this, however, the magnificent cooperative mechanisms and organizational strength that has been cultivated over many years and is the strength of Japanese businesses is not something that can be easily lost. In discussing work-life balance, too, surely there is a need to again give serious thought to differences in the origins of Western and Japanese philosophy and thinking, as well as differences in the ways of thinking born from these fundamental differences. The Japanese way of doing business includes methods that do not strictly pursue a doctrine of division of labor, such as changing work duties, expanding work duties, enhancing work duties, and working in teams, and working styles themselves in which workers engage in

work tasks while thinking independently. The reason why Japanese management attracted so much attention in the West was that, from an organizational perspective, this was accepted by Western companies as “Japanese wisdom”, so to speak, for generating large profits from a long-term perspective. Looking at Japanese management from a different angle, Japanese businesses have in the past exquisitely incorporated elements of happiness and enjoyment into working life. When one considers things in terms of their “qualitative dimensions” rather than their “quantitative dimensions”, one should also be able to consider these forms as one method of achieving balance. In other words, this is a method for achieving balance between work and life by incorporating elements of happiness and enjoyment into working life without viewing work as “drudgery” and “pain”. Unifying and integrating both “work” and “life”, rather than completely separating the two, is a way of thinking known as “work-life integration”.²

In this context, Company D’s basic attitude to work design, obtained from the hearings, that “working is a part of life; it is difficult to draw a line between work and private life since work is, in other words, a form of play and is synonymous with living” is extremely interesting. Company D holds events called “After Six Seminars” that provide employees with an opportunity to interact with and get to know other employees better, as well as learn what non-work interests and skills they have and are using to enjoy life outside of working hours. Such opportunities give employees a mutual knowledge and awareness of each other’s backgrounds, knowledge that can be very useful for employees in understanding each other’s feelings and perspectives as they perform their work duties. The company is conscious that, rather than dismissing work as a one-off task, viewing it as the fruit of individual workers’ diligent effort, into which they have poured their energy, results in the realization of more personal work and leads to a lower employee turnover rate.

The way of thinking described in Step has not necessarily been sufficiently considered in work-life balance discussions in the past. Step 2 is an important point in leading discussions concerning the enhancement of work-life balance towards a realization of a truly meaningful society, and cannot be overlooked. There are also occupations, such as workers in manufacturing workplaces, for whom it would be difficult to implement Step 2 in its complete form. However, even for such workers, there is a great difference in the meaningfulness of labor between carrying out monotonous routine work requiring little thinking and carrying out work based on even a small amount of free thinking and ingenuity. Considering this from a different angle, work based on free thinking and ingenuity means skillfully incorporating “life-like” elements into monotonous, routine work, and with regard to qualitative aspects, means making work more personal and enjoyable.

² With regard to the concept and definition of work-life integration in Western countries, please refer, for example, to the following works: Blyton et al. (2006) and Lewis and Cooper (2005).

13.3.3 Step 3: Revision from the Viewpoint of Diversity

Based on Steps 1 and 2, Step 3 involves envisioning that “ways of creating balance depend on the individual person and range widely” and providing as many menus as possible for promoting “work-life balance” programs from which individuals can choose. The companies that participated in the hearing surveys have already introduced multiple systems aimed at work-life balance and are expanding and enhancing these measures. However, even in large-scale companies, further enhancing, for example, systems of shorter working hours for full-time employees and telecommuting systems, and expanding their sphere of application could be considered more actively.³ For workers in jobs in which they are often transferred and whose workplace is not necessarily close to their home, the diffusion of telecommuting systems as well as the values and culture of a society that accepts such work practices are extremely important factors in improving their work-life balance.

Alternatively, depending on the individual person, work-life balance measures that cover workers’ entire lifetimes also need to be considered in the future. For example, these might include work-life balance measures that fulfill the individual wishes of workers, such as “In my 30s I want to work actively, but in my 40s I would like to have more time for childrearing and interacting with my family, and in my 50s I want to go back to working actively”. In the sense that workers can freely design their own lifestyles, thinking and mechanisms that make “lifestyle design” a possibility need to be spread throughout Japanese society.

The point here is that work systems should be designed that allow room for independence and discretion for workers to think and make decisions based on their own situations. In the words of the Osaka Prefectural Industrial Labor Policy Promotion Council report, thinking that enables workers to decide matters pertaining to them for themselves. To this end, the more menus that workers have to choose from, the better. In other words, it is necessary to reconsider working styles and work systems from the viewpoint of “diversity”. Although a certain amount of short-term costs may be incurred in terms of management, from a long-term standpoint, the introduction of diversity enables outstanding human resources to establish roots in the company and, by extension, can be expected to ultimately increase productivity and profits.

In pursuing these three steps, a point to note is that constant monitoring is required for the situation in which the vast majority of workers want to choose a single working style, even if many options are available. Currently, many companies are providing multiple options of working styles, but in many cases, workers do not necessarily make sufficient use of these options. From the standpoint of management, whichever of the working styles a worker selects, management must not neglect to inform him or her about the merits and demerits of that

³For a detailed perspective on the potential for the working style of telecommuting systems using information technology to promote work-life balance, see Shimozaki and Kojima (2007).

particular working style with sufficient transparency. Moreover, from the standpoint of workers, there may be a need to consider maintaining an attitude of proactively trying out and utilizing various systems that are provided by the company, rather than taking as a given the uniform working style that was the natural premise under previous “Japanese management”. In moving towards the realization of “a society in which a diversity of work styles and lifestyles can be selected”, aimed at through improvements in work-life balance, further continuous efforts by both labor and management are needed, as well as a long-term outlook and vision aimed at improving the current situation.

13.4 Towards the Sustainable Development of Individuals, Businesses, and Society

Recently, Japanese businesses have tended to focus to an excessive degree on trends in Western (especially American) companies as models for human resource system reform. There are many points for which the business management systems of other countries may serve as a useful reference, and there is no problem with Japanese companies intending to introduce such systems in Japan, as long as the intention and potential outcome of that introduction is thoroughly scrutinized beforehand. However, could it be that, as a result of this trend, companies’ eyes are focusing to excess on short-term income-expenditure balance? A “system” is ultimately something that is used by humans, and “human resource systems” in particular are important systems that profoundly define people’s everyday working styles and long-term careers. Simply because the system has changed does not mean that the feelings and working styles of workers can easily change. Today, in an era when only those companies that have a long-term business vision and strive to secure excellent human resources survive, management that view workers as merely a cost are doomed to eventually collapse. Companies must be conscious that workers are the most important management resource they have in achieving competitive supremacy. This basic concept enables companies to discover potentially capable workers and introduce employment systems that also fulfill the various human needs of these workers, firmly establishing them within the company. With regard to work-life balance, which has been the subject of increasingly lively debate in recent years, it can be said that we are now about to enter a period during which we return to the original Japanese point of view. We need to seriously rethink what work-life balance measures are appropriate in the context of Japan, and what needs to be done from the perspective of Japanese businesses and the people who work for them (Kambayashi 2008).

As mentioned at the beginning of this paper, in the past few years there has been noisy debate in Japan about the improvement of work-life balance. The reason

that issues related to work-life balance have become so pertinent is that, when considering the direction of future development of Japanese society over the long-term, it is imperative to extend the discussion to include issues that touch on the foundation of social structure. This is the framework that prescribes the relationship between businesses, which are the basis for productivity, and the people who work for them. In other words, improving work-life balance is vital to achieving sustainability for the three actors, namely individuals, businesses, and society.

For individuals, work-life balance is essential for achieving a sense of purpose in life as well as gradually improving their work skills to achieve better-quality work. For businesses, as mentioned above, work-life balance is essential for securing outstanding human resources and establishing them within the company, drawing out and developing workers' skills, and raising productivity. In addition, for Japanese society, work-life balance is essential for promoting better family environments and communities based on good relations between individuals and businesses, as well as promoting the development and expansion of healthy local communities in which the children of the future are born and raised. In this way, the idea that the enhancement of work-life balance is necessary for the development of society as a whole can be said to be so self-evident as to leave no room for doubt from the long-term perspective of the sustainability of all of these actors.

However, we must also recognize the point that realizing "Japanese work-life balance" through the three steps mentioned above incurs costs that must be borne by the three actors of government, workers, and companies. Keeping in mind the above-mentioned "J-curve effect", which expresses how a company's productivity changes following the introduction of work-life measures, companies need to prepare themselves for the possibility that their productivity may drop temporarily, and individual workers may need to be aware of the possibility that there may temporarily be economical costs, such as a decrease in income. With its duty to lead society as a whole in a better direction based on the interests of workers and employers, the government also needs to introduce various regulations, undertake various legal reforms, and set numerical targets.

However, it must be kept in mind that the concept of "costs" that each actor should bear is a way of thinking that appears only in a relatively short-term perspective. While it is important to be aware of the point that all actors incur costs, it is even more important that society as a whole seriously consider the true fruits of work-life balance from a more long-term perspective rather than focusing only on the aspect of short-term costs. In other words, it is vital to consider designs after the "equilibrium point" on the "J-curve", where productivity and profits begin to cover the costs.

For example, when the government attempts to strengthen across-the-board requirements from an extremely short-term perspective, even if they achieve Step 1 (the quantitative dimension), achieving Step 2 (the qualitative dimension) and Step 3 (diversity) is still extremely difficult. The reason for this is that Steps 2 and 3, which are aimed at the realization of a Japanese work-life balance, are not targets

that should be aimed for under so-called “forced” conditions. While a minimum degree of regulation is necessary, the reason that discussions of work-life balance have a basically difficult nature is because it is not the type of thing that can or should be “forced” on people or society through regulations. In order for newly introduced systems and measures to truly take root in people’s (business managers’, workers’) consciousness and transform society as a whole, a lengthy ripple period is required, and even if complications arise for each of the actors during that time, such systems should be implemented. More than anything, the responsibility of government, who are aiming to improve work-life balance for society as a whole, is not to expect sudden and dramatic changes and set unattainable numerical targets. Instead, they need to take a sustained long-term view and, while considering the interests of both workers and employers, foster awareness and enact laws to this end from the standpoint of “guiding” society towards gradual changes in awareness.

The only way to pursue “work-life balance” that is not forced or imposed, but truly satisfactory for all actors is to cast aside discussions that focus entirely on short-term costs and, from the perspective of long-term sustainability, tirelessly build up layer upon layer of serious discussions regarding the roles of workers and employers. The basic focal point in doing this should be to pursue the most appropriate situation for all actors after serious consideration of the most appropriate work-life balance for each actor independently, keeping in mind that both businesses and individuals are independent and internalize diversity. The most important point is to correctly understand that the concept of work-life balance is not a “concession” or “benefit” provided by a company to its employees. It is not something that workers unilaterally “win”, and least of all something that should be introduced by the government through sudden and strict regulations, with only short-term numerical targets. Although at a glance this may seem obvious, awareness that tends to be overlooked will be fostered socially and absorbed.

Figure 13.1 shows simplified outlines and lists the important key words of each of the three steps described earlier. Figure 13.1 does not attempt to show that there is a “direct” progression from the conclusion of Step 1 to Step 2 and then likewise to Step 3. As is also shown in the case examples presented in Fig. 13.1, a large number of companies are in actuality working on Step 1 while aiming at Steps 2 and 3. Accordingly, it should be noted that, rather than being a guide indicating a linear order for these three steps, Fig. 13.1 implies that the development and expansion of work-life balance measures in Japanese companies is meaningful when general and ideological ways of progressing over a long time span for these three items are kept in mind.

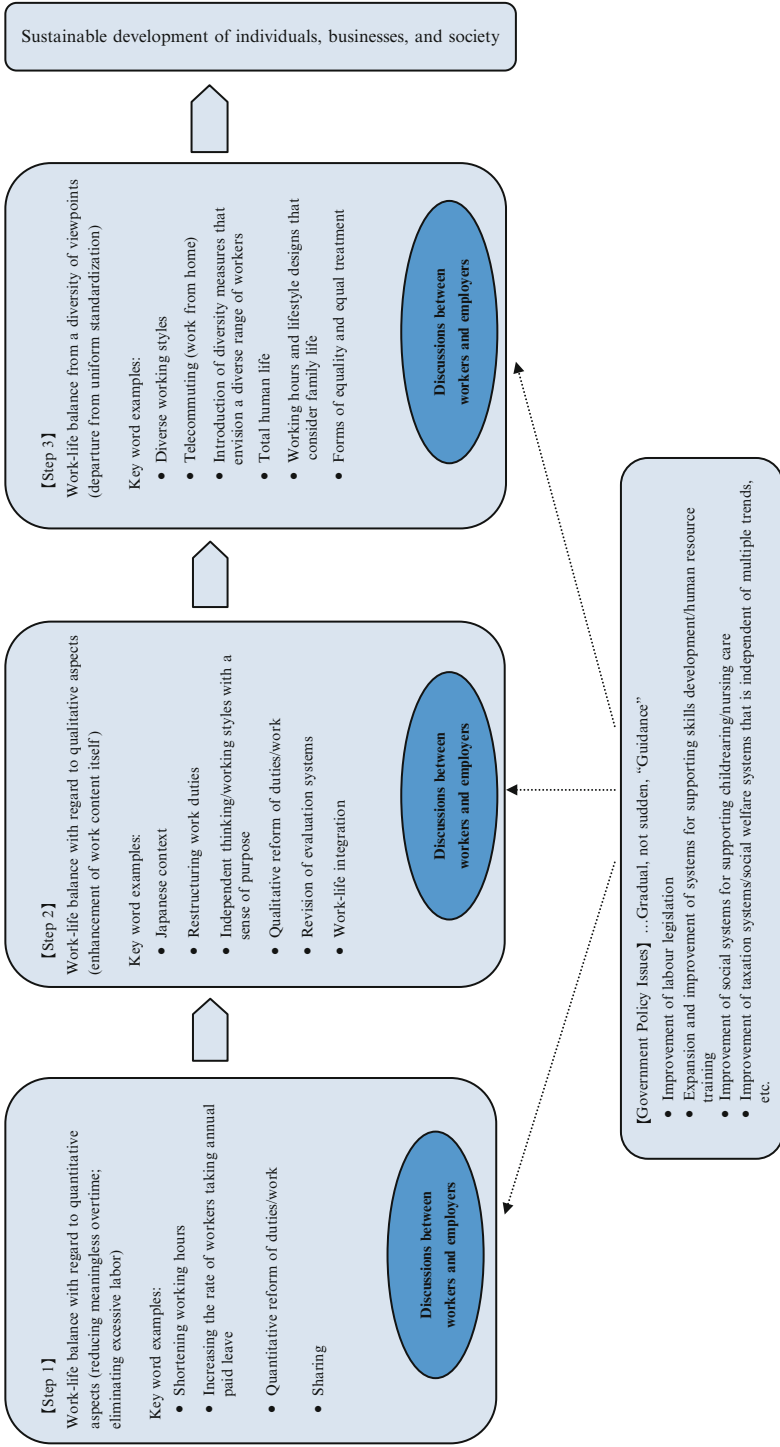


Fig. 13.1 Labor and management issues for the realization of a “Japanese work-life balanced society”. *Source:* Osaka Roshikaigi (Osaka Workers and Employers Council) (2008), p. 15

13.5 Concluding Remarks

This article has considered specific developments in Japanese companies aimed at promoting work-life balance. In the past few years, the trend of Japanese companies introducing work-life balance measures has progressed rapidly, with companies' main actions being to eliminate excessively long working hours and experimentally introduce human resource systems involving comfortable and relaxed diverse working styles. However, the concept of "balance", which is the basis for the concept of work-life balance, is a way of thinking originally based on a Western concept/value that views "work" (that is, asceticism) and "life" (that is, happiness) dualistically, as two aspects of life that can be completely separated. Thus, attempting to introduce such work-life measures into Japanese companies without question generates concerns that the measures will not function, causing various problems and corporate unraveling. In the past, Japanese corporations have not viewed work as being completely ascetic. Rather, Japan business has been characterized by the skilful incorporation of playful elements into work, and been a strength of Japanese companies.

In the world of business administration, Western countries are "developed countries", and many of the mechanisms and methods used by Western companies appear to be very attractive tools in the eyes of Japan. However, it must not be forgotten that the Western way of thinking has been produced within the context of each of these Western countries. Rather than accepting the institutionalized mechanisms and management methods of other countries without question, Japan needs to introduce and establish mechanisms for Japanese work-life balance that consider the context of the country and the cultural characteristics of Japanese people. It is the author's hope that the three steps presented here can assist in achieving such a balance.

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Names are listed in order of the Japanese syllabary; asterisks indicate members of the Management Committee.

Management Problem 108 Committee

Summary of Meetings 372 to 381

The 372nd Meeting

Day 1: 13:30–15:30 on Thursday, August 5, 2010

Venue: Reception Office, 1st floor, Main Building, Graduate School of Business Administration, Kobe University

Presentation of research results:

Toshimi Okazaki (Committee member): “On the German Bond Market”

Day 2: 13:10–15:50 on Friday, August 6, 2010

Tour: Participants visited Kinki Taxi Corporation (Kobe City, Hyogo Prefecture)

The 373rd Meeting

Day 1: 13:30–16:05 on Friday, November 5, 2010

Tour: Participants visited and inspected the construction site of the JP Tower being constructed by Taisei Corp. (Formerly Tokyo Central Post Office Building in Chiyoda-ku, Tokyo)

Day 2: 9:30–12:00 on Saturday, November 6, 2010

Venue: Hitotsubashi University Graduate School of Commerce and Management Hitotsubashi Collaboration Center (HCC) (10th floor, Marunouchi Building)

Presentation of research results:

- (1) Hiroshi Yoshida (Guest lecturer, Associate Professor at Kyoto Sangyo University): “Strategic Issues Concerning the Disclosure of Managers’ Remuneration in Japan”
- (2) Kazuhiro Tanaka (Committee member): “Profit Responsibility and Social Responsibility of a Company—Concept Organization and Essential Dilemmas”

The 374th Meeting

Day 1: 13:25–16:05 on Wednesday, February 23, 2011

Tour: Participants visited Nippon Fusso Co., Ltd. (Sakai City, Osaka Prefecture)

Day 2: 10:30–12:05 on Thursday, February 24, 2011

Venue: Room 1407, 14th floor, Applause Tower, Umeda Campus of Kansai Gakuin University

Presentation of research results:

Mitsutoshi Hirano (Committee member): “Has the Personnel Department of Japanese Companies Changed?”

The 375th Meeting

Date: 10:00–11:20 on Saturday, July 2, 2011

Venue: HCC (10th floor, Marunouchi Building)

Presentation of research results:

Akio Masuchi (Committee member): “Memories of the 108 Committee—Corporate Management in the Second Half of the 20th Century in Japan and Japanese Management Science”

After the meeting, the ninth open seminar was held.

The 376th Meeting

Day 1: 13:55–16:20 on Monday, August 8, 2011

Tour: Participants visited Shirataki Sake Brewery Co., Ltd. (Yuzawa Machi, Minamiuonuma County, Niigata Prefecture)

Day 2: 9:30–17:00 on Tuesday, August 9, 2011

Venue: Takahan Meeting Room, Yukigunino Yado

Extensive discussions and presentation of research results:

- (1) Akira Komatsu (Committee member): “Corporate Responsibility—Cases in the Great East Japan Earthquake”
- (2) Yoshinobu Sato (Committee member): “Japanese-Style Management—Revisitation”

- (3) Toru Nakai (Committee member): “Research on Business Succession from the Viewpoint of Management Science—From the Viewpoint of the Value Creation Function”
- (4) Shinya Miwa (Committee member): “Corporate Governance and Corporate Results in the Japanese Electric Power Industry”
- (5) Norio Kambayashi (Committee member): “The World of Management Built by Management Science—Management Science as Social Science and Its Crisis”

Day 3: 9:30–11:00 on Wednesday, August 10, 2011

Venue: Takahan Meeting Room, Yukigunino Yado

Discussion of the summaries of three committee members:

- (1) Makoto Ichimura (Committee member): “Corporate Strategy of Publicly Listed Parent/Subsidiary Pairs, Corporate Evaluation, and Corporate Governance”
- (2) Yasunari Takaura (Committee member): “Responsibility of a Company: Research Concept Plan”
- (3) Kazuhiro Tanaka (Committee member): “Organization of the Framework of ‘Company Responsibility’”

The 377th Meeting

Day 1: 13:25–15:30 on Friday, October 21, 2011

Tour: Participants visited Hyogo FM Broadcasting Co., Ltd. (Kobe City, Hyogo Prefecture)

Day 2: 10:30–12:10 on Saturday, October 22, 2011

Venue: Room 1002, 10th floor, Applause Tower, Umeda Campus, Kansai Gakuin University

Presentation of research results:

Makoto Matsuo (Committee member): “Leadership in Developing Human Resources of Administrative Managers”

The 378th Meeting

Day 1: 13:30–16:00 on Friday, February 17, 2012

Tour: Participants visited S. T. Corporation (Shinjuku-ku, Tokyo)

Day 2: 9:50–11:30 on Saturday, February 18, 2012

Venue: HCC, (10th floor, Marunouchi Building)

Presentation of research results:

Hiroshi Yoshida, (Guest lecturer, Associate Professor at Kyoto Sangyo University): “Reconstruction from the Great East Japan Earthquake—Finance Innovation Issues and Strategy”

After the meeting, the 10th open seminar was held.

The 379th Meeting

Day 1: 13:45–17:00 on Friday, May 25, 2012

Tour: Participants visited Yurinsou (formerly the second house of the Ohara family), Hayashi Genjuro Shoten, and the Ohara Museum of Art (Kurashiki City, Okayama Prefecture)

Day 2: 9:30–11:30 on Saturday, May 26, 2012

Venue: Second-floor meeting room, Misono

Presentation of research results:

Takaaki Okamoto (Committee member): “Yamagata Eijyudo Kibidango—Mindset of One-Product Family-Run Stores”

The 380th Meeting

Day 1: 14:00–14:50 on Tuesday, August 21, 2012

Tour: Participants visited Tomioka Silk Mill (Takaoka, Gunma Prefecture)

Day 2: 9:20–16:40 on Wednesday, August 22, 2012

Venue: Meeting Room 380, Inamoto, Echigono Yado

Intensive discussion and presentation of research results:

- (1) Akira Komatsu (Committee member): “Seeking a New Image of a Limited Company”
- (2) Yoshinobu Sato (Committee member): “Formation of New Japanese-Style Management Strategy”
- (3) Mitsutoshi Hirano (Committee member): “Diverse Full-Time Employees and Boundary of Employment—Analysis of the Three-Layer Labor Market Model”
- (4) Kazuhiro Tanaka (Committee member): “Japanese-Style Corporate Governance and Trends of Global Capitalism and Governance Reform—From the Viewpoint of ‘Corporate Governance by Conscience’”
- (5) Sumiko Asai (Committee member): “Responses of Japanese Companies to the File Format of E-books”
- (6) Naoto Fukui (Committee member): “Personnel Evaluation”
- (7) Toru Nakai (Committee member): “IPO Market and Financing of Venture Companies”

Day 3: 9:15–12:20 on Thursday, August 23, 2012

Venue: Meeting Room 380, Inamoto, Echigono Oyado

Presentation of research results:

- (1) Toshimi Okazaki (Committee member): “Globalization of the Financial Capital Market and Its Influence on the Company”
- (2) Norio Kambayashi (Committee member): “Concept of Overture with a Focus on Thoughts about Inagami–Whittaker (2005)”
- (3) Discussion on reports written by three committee members:

1. “Recruitment of Outside Directors in Companies Listed on the Tokyo Stock Exchange and Corporate Results” by Shinya Miwa (Committee member)
2. “Roles of Companies in the New Public: Collaboration with NPOs Observed in Supporting Disaster-Affected Areas in the Great East Japan Earthquake” by Yasunari Takaura (Committee member)
3. “Interorganizational Relation and Strategy: Organization-Set Strategy” by Isao Akaoka (Committee member)

The 381st Meeting

Day 1: 14:10–15:20 on Friday, October 26, 201.

Tour: Participants visited and inspected the Sona Area Tokyo (Tokyo Rinkai Disaster Prevention Park), an area for the study of disaster prevention facilities designated by the Ministry of Land, Infrastructure, Transport, and Tourism

Day 2: 10:00–11:30 on Saturday, October 27, 201.

Venue: 13B Meeting Room, 13th Floor, Building 1, Ariake Campus, Musashino University

Presentation of research results:

Sumiko Asai (Committee member): “Ownership Relationship of the Company and Product Differentiation and Market Performance Achieved by Homogeneous Competition: The Case of the Broadcasting Market”

After the meeting, the 11th open seminar was held.

Note: The above activities were those undertaken after Norio Kambayashi was inaugurated as operating officer. The committee publishes an annual journal, *Management Problems*, which has summarized its activities every year since 2009. Please read this journal for a further understanding of committee members’ research reports and the contents of open seminars.