Transformation of the Japanese Corporate System and Possibilities of the "New J-type Firm" Re-examined

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Abstract

This paper presents some stylized facts about the transformation of the Japanese corporate system since the 1990s and discusses the resulting emergence of new hybrid organizational forms. To begin, we outline two major findings. One is that changes have not proceeded uniformly but unevenly across different groups of firms; consequently, the Japanese corporate system now shows a far greater heterogeneity than it ever has. The other finding is of the emergence of a hybrid firm called the "new J-type firm," which combines shareholder-oriented management styles and long-term employment practices. We then discuss whether this new J-type firm can be sustained over the long term from both theoretical and conceptual perspectives.

Keywords: Japanese corporate system, institutional complementarity, heterogeneity of firms, New J-type firms, gradual institutional change, new segmentalization

JEL Classification: B52, D21, L22, P51

1 Introduction

More than two decades have gone by since the bursting of Japan's bubble economy. Though the "lost decade" was a term popularly used to describe the Japanese economy of the 1990s following that event, this decade imperceptibly turned into the "lost decade and a half" and eventually passed the torch to the "two lost decades." During this period, the core features of the Japanese corporate system, such as the main bank system, the stakeholder-oriented model of corporate governance, the lifetime employment system, and the trust-based supplier network, faced strong pressures to change and did, in fact, change significantly. As a number of studies have pointed out, the institutions constituting the Japanese corporate system tended to enforce homogeneity in their practices and in high-level performance. By the late 1990s, however, diverse organizing patterns became evident. A diversity of firm organizations has now become internalized, taking preeminence away from cross-national forms of diversity, as emphasized by the "variety of capitalism" literature (Aoki et al. 2007; Aoki 2010).

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The purpose of this paper is to provide an overview of the transformation that has occurred in Japan's corporate system over more than two decades, using the terms "diversity," "heterogeneity," and "hybridization" as keywords, and then clarify the important implications and issues concerning the future of this transformation. We investigate whether the hybrid organizational form called the "new J-type firm" that emerged as a consequence of the transformations in the Japanese corporate system can be sustained over the long term.

The remainder of this paper is organized as follows. We begin by sketching out the stylized features of the Japanese corporate system in Section 2. In Section 3, we provide empirical findings demonstrating that the core elements of the Japanese corporate system changed significantly after the 1997 banking crisis and then examine the specific changes in the domains of finance and employment. We emphasize that these changes have not proceeded uniformly but have occurred unevenly among firms and industries and even within industries. In Section 4, we discuss the new hybrid organizational form, the new J-type firm, produced by the transformations under discussion. We raise two questions concerning the sustainability of this firm type and about the future of Japanese employment systems. Section 5 investigates the potential of the new J-type firms from the theoretical and conceptual perspectives. Finally, we summarize our findings and their implications and suggest further research agendas.

2 Stylized Features of the Japanese Corporate System

As many scholars have pointed out, Japanese firms maintained long-term and continuous relationships on the basis of labor, product, and monetary transactions. Before the bubble economy, Japanese firms had long-term and growth-oriented management targets and featured structural traits such as continuity in employment, trading, and ownership relations. This continuity enabled behavioral traits that allowed Japanese firms to accumulate management resources over long periods and, in turn, grow using these accumulated resources. The above three traits were mutually reinforced in the Japanese corporate system within which firms entered into their relationships. These corporate characteristics are thus strongly linked to the more expansive Japanese model of capitalism, characterized by a high degree of firm-specific investment supported by complementary institutions.

Therefore, the post-war Japanese firm has long been noted for its unique organizational features or attributes, which are vastly different from those of Anglo-American firms. The stylized features of the Japanese corporate system can be summarized as seen in Table 1.

Table 1 Stylized Features of the Japanse Corporate System

Behavioral Attributes	Functions	Institutional Features
Maximizing Market Shares	・Risk-sharing	Corporate Grouping
		Cross Shareholding and Stable Shareholding
Growth-oriented	・Mitigation of Short-term Pressures from the Stock Market ・Maintaining the Continuity of Business Management	Correspondence of Operating Officers to Directors in the Board
Long-run Horizons	・Internalization of External Ecomies or Social Costs	Long-term Employment Practice
	・Mitigation of Asymetric Information	*Keiretsu*
	・Preventing Over-liquidation of Corporate Business	Main Bank System

(Source) Miyajima (2002) p. 10.

As Table 1 implies, corporate grouping, cross-shareholding, and stable shareholding provided an institutional foundation for growth-oriented firm behavior. Cross-shareholding and stable shareholding precluded the hostile takeovers that would have threatened management stability, which mitigated short-term stock market pressures on corporate management. Cross-shareholding among firms lowered transaction costs such as marketing costs to economize ex post facto and contributed to the stable, long-term, and continuous relationships between firms. Meanwhile, the formation of corporate grouping based on cross-shareholding performed an ex-post risk sharing function. In this sense, corporate grouping was an "insurance mechanism" peculiar to the post-war Japanese economy, making it possible for the group-affiliated firms to remain insulated from the imperatives of market forces.

Moreover, the main bank system provided the institutional foundation for corporate growth. Fund lenders and borrowers possess asymmetric information, as lenders have a great deal of information concerning the future revenues of investment projects. The main bank played an important role in mitigating this asymmetry and promoting corporate capital investment. According to Aoki's concept of "contingent governance" in a critical corporate-value state, the main bank had to decide whether to bail out and restructure counterparty firms at its own cost or liquidate them. This method of dealing with underperforming firms, which contrasted strongly to the U.S. method, prevented the over-liquidation of corporate businesses.

In Japanese firms, employees were important stakeholders in corporate governance, reflected in larger firms' long-term orientation and implicit norm of lifetime employment. Large firms have been trying to hoard as much excess labor within their own organizations as possible, even during the recent severe recession. This labor hoarding could be regarded as a mechanism for the internalization of the social costs induced by mass unemployment, which would otherwise need to be borne by society as a whole.

The institutional features illustrated above in Table 1 were gradually consolidated from the late 1950s to the early 1980s.

3 Transformation of the Japanese Corporate System

In the 1980s, the Japanese model of capitalism was deeply admired for its economic success, and the features of Japanese firms with a strong growth orientation and high economic efficiencies attracted a great deal of attention both inside and outside Japan. However, in retrospect, it could be said that the conversion of the functions of the Japanese corporate system began as soon as they had gained a strong reputation.[1] Thereafter, the long recession after the bubble burst caused a substantial change in the growth-oriented strategies of Japanese firms. In this section, we present some stylized facts about the transformation of the Japanese corporate system and discuss the new hybrid firm organizations that emerged as a consequence of various institutional reforms.

3.1 Simultaneous Changes in Labor, Product, and Monetary Transactions

An urgent issue that demanded Japanese firms' immediate attention in the 1990s was the restoration of corporate profitability. As Figure 3 below shows, the net profit ratio reached its peak around 1990 and then repeatedly and rapidly decreased; corporate profitability plunged, eventually falling into the "crisis of profitability" of 2001, causing the bankruptcies of many banks and large firms.

In this period, the "selection and concentration" of business areas—the reorganization of firms' vertical and horizontal boundaries—became an urgent issue. Selection and concentration in a vertical direction shortens the vertical boundaries of firms. This can result from a decrease in in-house production benefits, possibly caused not only by a decrease in coordination cost through the development of information communication technology but also by an increase in the availability of outside specialized companies.[2] Meanwhile, selection and concentration in a horizontal direction leads firms to focus on their main businesses areas while withdrawing from more remote businesses or disposing of them. We can easily imagine that a comprehensive implementation of selection and concentration will lessen the validity of *keiretsu,* which is characterized by long-term and continuous product transactions. In fact, this situation has occurred in the past. A typical example is the selection of parts suppliers by Nissan, which had reduced its number of suppliers from 1145 companies in 2000 to 595 companies in 2002. Studying the patterns of the transactions made by small- and medium-sized manufacturing firms since the late 1990s, we can see that client volume grew more rapidly than sales. This fact suggests that the number of business with few large-volume clients has declined and that their transactions have become more dispersed. In short, focus has shifted to business relations, which requires business to be conducted with a wider clientele. This situation is reflected in the "increasing fluidity of the subcontracting

[1] On this point, Isogai (2012) took up the problems of the over-accumulation and changes in corporate finance that have occurred in the period between the bubble of the late 1980s and the post-bubble era of the early 1990s.

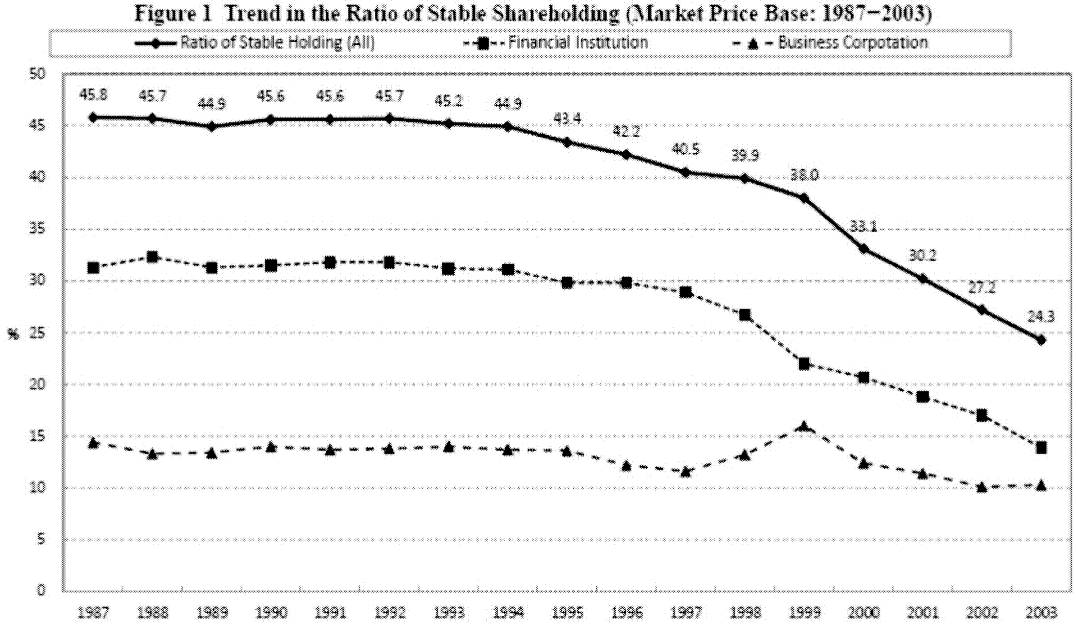
[2] What lies behind this is, of course, the dramatic development of the global supply chain in the East Asia region.

transaction structure."[3] Simultaneously, assembly and processing operations began to be moved overseas, especially to East Asia. This movement, led by large firms, triggered a chain reaction, as the small- and medium-sized firms involved in related processes followed in their wake, creating gaps in the division of labor in the manufacturing operations within Japan. This process occurred because an increasing number of small- and medium-sized firms have been aiming to optimize their production systems, both in Japan and abroad, in the pursuit of survival and growth, as well as the limited benefits accruing from reduced labor costs, since the late 1990s.

Furthermore, the long-term and continuous relationship between firms and financial backers such as the main bank system and cross-shareholding has also significantly changed. In fact, the decay of the main bank system became obvious after the bursting bubble caused a "hiatus" in the governance of the Japanese corporate system as a whole. The structure of shareholding in Japan also underwent an immense change in around 1995. As Figure 1 shows, the proportion of stable shareholding, defined as the ratio of the sum of cross-shareholdings plus the shareholdings of financial institutions and financial institutions by business corporations and of listed parent companies to the total issued shares of the listed corporations, showed a definite decline in 1995 and continued to decline after 1999. In particular, the stable shareholdings of banks declined dramatically from 15% in the early 1990s to 6% in 2003. Correspondingly, the internal attributes of Japanese firms, such as lifetime employment practices, seniority-based pay systems, a board of directors comprising only insiders, and remuneration systems that are non-sensitive to corporate performances, changed significantly. Thus, the banking crisis of October 1997 was a turning point during which each of the long-term and continuous relationships concerning labor, product, and monetary transactions that had characterized the Japanese corporate system faced strong pressures to change and did in fact undergo significant changes.

[3] *The 2006 White Paper on Small and Medium Enterprises in Japan* shows manufacturing SMEs becoming less intimately dependent on a small number of customers and developing thinner, broader, and more multifaceted transactions with a larger number of clientele, with a "meshing" of the subcontracting transaction structure. However, this idea of meshing appears to be somewhat controversial. It would be more accurate to see, at the domestic level, a shift away from a dependence on certain enterprises, while traditional subcontracting relations are being maintained. An upsurge in the activity of SMEs entering local manufacturing networks in East Asia can be regarded as an extension of the subcontracting system at the East Asian level, creating divisions of labor in manufacturing that integrate the entire East Asian region.

Figure 1 Trend in the Ratio of Stable Shareholding (Market Price Base: 1987–2003)



Source: Nissei Life I nsurance Research Institute, *Survey on Cross Shareholding*, 2003.

In what follows, we emphasize that such changes have not proceeded uniformly but have been occurring unevenly among firms and industries and even within industries, a fact that concerns the "heterogeneity" of firms (Boyer 2004; Lechevalier 2007, 2012). Therefore, deregulation and liberalization under economic globalization and the rapid development of information communication technology will never lead to the *flat world* phenomenon, as the producing impacts of those processes are diversified by firms and industries, and the resulting changes proceed unevenly.

3.2 Increasing Heterogeneity of Firms and Unevenness of Changes

3.2.1 Decay of the Main Bank System

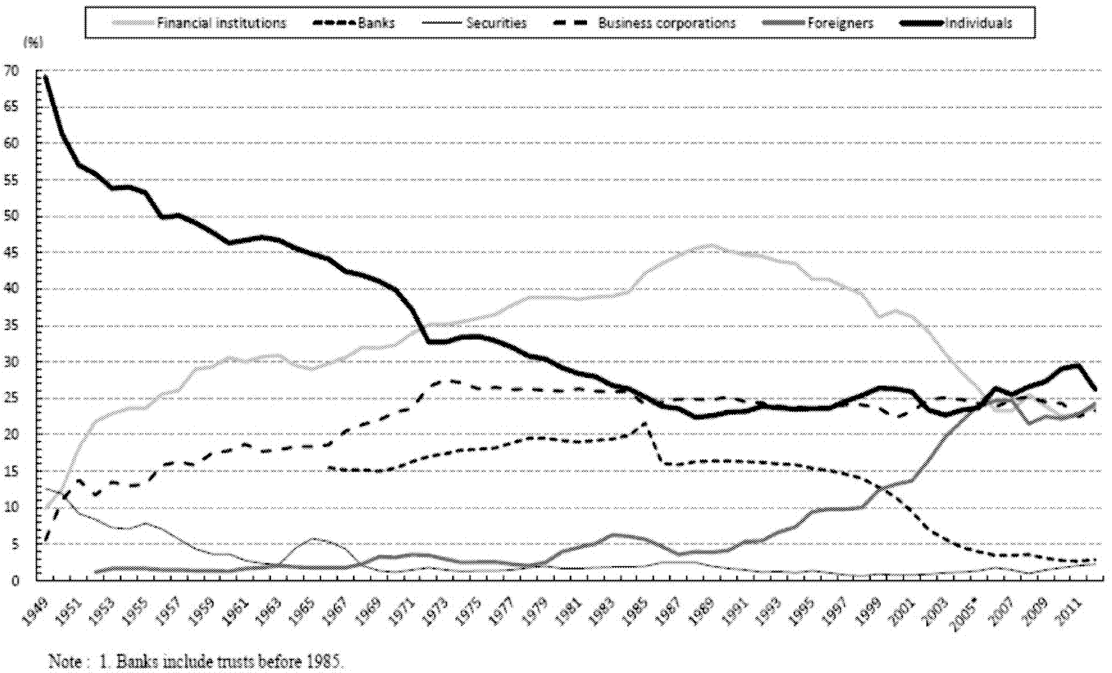
The main bank system played a leading role in corporate governance and information production in corporate finance. Financial deregulation reduced the dependence of Japanese firms on bank borrowing and produced a shift towards bond finance, enabling the substitution of direct financing via banks. By the 1990s, as financial deregulation proceeded, blue-chip firms no longer required the relief insurance of the main bank system, and their dependence on financing through corporate bonds intensified. Banks and firms developed an almost arm's-length relationship, and the weaknesses in the main banks' corporate governance became obvious.

However, it should be noted that the dependence of Japanese firms on the capital market did not proceed in a straightforward manner in the 1990s. From 1997 to 1999, the ratio of bank borrowing in the debt composition of Japanese firms increased again, reflecting the deterioration of corporate profitability and rising risk after the bubble burst. However, this increase in bank dependence does not mean that the positive disciplinary role performed by main banks had been rehabilitated. As many have suggested, two conditions must be satisfied for a main bank's disciplinary function to work effectively. The first is that rents should be secured in the banking sector. The second is that the composition of the bank's finance should be sound and its threats to liquidate their client companies credible. In the 1990s, it was obvious that these two conditions could no longer be maintained. The financial deregulation in process since the 1980s annulled the first prerequisite, and the second was undermined by the worsening problem of the non-performing loans held by Japanese banks. Thus, during the banking crisis of 1997, a main bank could not perform the leading role in corporate finance and corporate governance it had in the past.

3.2.2 Unwinding of Cross-shareholdings

As mentioned, the structure of shareholding in Japan, which had once been extremely stable, showed a definite decline by 1995. As Figure 2 shows, the proportion of shareholding by banks decreased from 16.4 % in 1990 to 2.9 % in 2012, a decrease that accelerated after the banking crisis of 1997. Meanwhile, foreign investors owned 24.7 % of stocks listed on the Tokyo Stock Exchange in 2012, compared to 4.2 % in 1990. The traditional management style of Japanese firms, which had been to limit shareholder pressure on corporate management as much as possible by organizing stable shareholders or cross-shareholdings, has been under pressure to change since the mid-1990s.

Figure 2 Trends in the Distribution of Stock Ownership (1949–2012)



Note : 1. Banks include trusts before 1985.
2. Numbers in 2004 and 2005 do not include those of Livedoor Co., Ltd.

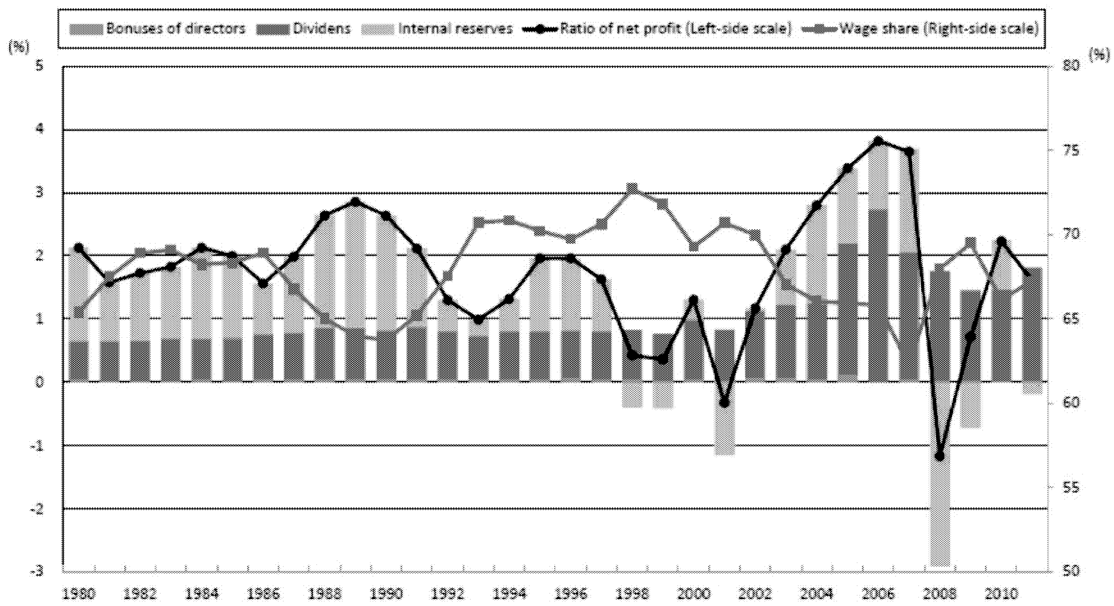
Source: Tokyo Stock Exchange, *Survey on the Situation of Stock Distribution*, 2012.

However, it should be noted that the unwinding of cross-shareholdings also proceeded unevenly. After the 1997 banking crisis began, banks developed a tendency to avoid selling off their shares in client enterprises with which they had close bank borrowing ties; however, they were inclined to sell shares in enterprises whose profitability was expected to be high. A detailed analysis of this phenomenon has been conducted by Miyajima et al. (2003). They found that banks sold off their shares in enterprises whose profitability was extremely low or relatively high and that, as bank borrowings declined, the enterprises sold off their corresponding bank shares. On the contrary, they also found that banks continued to hold shares in enterprises whose profitability was moderately low; the dependence on the bank borrowing of these enterprises was still high, and the enterprises' inclination to sell off their corresponding bank shares was low. Thus, in cases where cross-shareholdings existed between banks and firms, a polarized situation emerged; the unwinding of cross-shareholdings proceeded rapidly among some group of firms while cross-shareholdings were maintained among others.

3.2.3 Incremental Changes of Employment Systems

Several factors, such as the change from main bank-based indirect finance to capital market-based direct finance, the unwinding of stable shareholders and cross-shareholdings, and the sharp increase in foreign investors, pressured Japanese firms to shift into shareholder-oriented corporate governance.

Figure 3 Trends in the Ratio of Net Profit and Wage Share (Manufacturing, One Billion and Over, 1980−2011)



Note: Wage share is defined for all industries and all sizes. (Gross) Wage share = Personell expense / (Personell expense + Operating profit + Depreciation) × 100. Personell expense = Employee salary + Director salary.
Source: The Ministry of Finance, *Statistical Survey of Business Corporations*, for each year.

As is clear from Figure 3, Japanese firms, particularly large firms in the manufacturing sector, accomplished a V-shape restoration of corporate profitability by 2001; however, at the same time, dividends and internal reserves increased sharply. By contrast, the wage share continued to decrease from 2001. Large Japanese firms have seen a steady movement towards the governance of shareholder value. Thus, the pressures of short-term adjustments on wages and employment will intensify if, in the current term, shareholders' returns are prioritized over varying corporate profitability in the governance for shareholder value. As for wages, the necessity of changing the seniority-based wage system or of making wage costs more flexible has been argued. It has also been deemed necessary to make employment adjustments more flexible by expanding non-regular employment or making the dismissal rules more flexible. Adopting these measures would finally terminate Japan's long-term employment practices.

However, such short-term employment adjustments did not spread instantly throughout Japanese firms, nor have long-term employment practices been abandoned (Miyamoto 2007; Jackson 2007). Reports have claimed that more than 80% of Japanese firms are maintaining long-term employment practices; representative examples include Toyota and Canon.

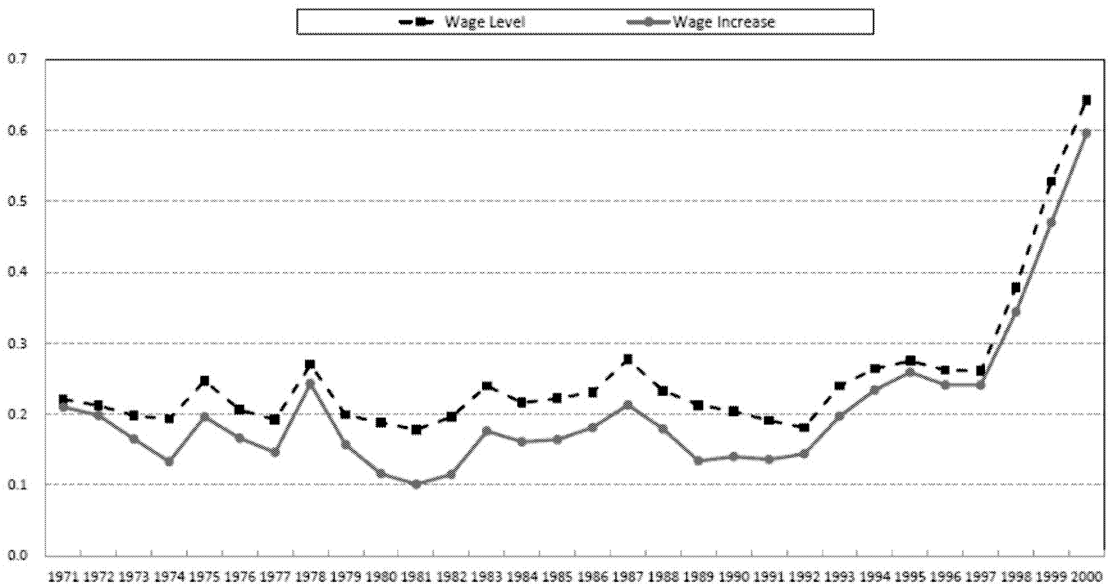
The norm of lifetime employment has remained robust in large firms, although the number of regular workers has gradually decreased since 1998. Meanwhile, the number of non-regular workers has consistently increased beginning in the 1990s. A survey on firms' preference for expanding non-regular employment found that the most popular reason for this preference, among firms in every industry, was wage costs reduction; 80% of the firms in manufacturing, more than 90% in the wholesale, retailing, and restaurant businesses, and more than 90% of firms in the service industry chose this reason. Meanwhile, concerning employment adjustments of regular workers in large firms, large firms have probably been seeking to maintain the employment of these workers by transferring them to group companies. For example, in NEC, which announced a large-scale restructuring in 1999, the number of employees on an unconsolidated basis decreased from 35,000 persons in 2000 to 23,000 in 2004. Meanwhile, the number of employees on a consolidated basis decreased from 150,000 persons in 2000 to 148,000 in 2004. Therefore, it seems that many large firms have maintained long-term employment to the extent possible, utilizing the so-called "quasi internal labor market" among group-affiliated firms in the corporate group; thus, they have incrementally adapted to the changing economic environment.

Unlike this continued commitment to lifetime employment, payment systems have changed significantly. Most firms have adopted the pay-for-performance system, which cuts personnel costs through the use of non-regular workers while attempting to improve workers' performance. Many questionnaire surveys have revealed that the pay-for-performance system has begun to be steadily adopted.[4] Furthermore, a major shift in the wage negotiation system has also been ongoing since the late 1990s. *Shunto*, literally "spring offensive," which had worked quite well as the mechanism for equalizing wage increases on a nationwide and industry-wide scale, significantly changed in the

[4] A 2006 survey conducted by the Ministry of Health, Labor, and Welfare reports that 46% of firms with varying members of employees, 83% of firms with 1000 employees or more, 72% of firms with 300 to 999 employees, and 57% of firms with 100 to 299 employees had already adopted this payment system.

mid-1990s. After 1997, *Shunto* lost its substance, and its dysfunction became obvious, as Figure 4 clearly demonstrates. A gradual increase in the dispersion of wage settlements occurred in the 1990s, with a marked jump in the dispersion index after 1998. In the 2000s, therefore, *Shunto* was transformed into a quiet negotiating table on behalf of labor-management cooperation for wage reduction and the maintenance of employment.

Figure 4 Dispersion in *Shunto* Wage Settlements (1971−2000)



Note: The 4th quartile dispersion index = (The 3rd quartile − The 1st quartile) / (2 × median)
Source: The Ministry of Labour, *Survey on Wage Increase*, various years.

3.2.4 Varieties of Corporate Governance Reforms

Beginning in the late 1990s, when the decay of the main bank system had become obvious, Japanese firms started to voluntarily reform their business organizations. At the same time, corporate law reforms were implemented in rapid succession. The first was the lifting of the holding company ban through the 1997 amendment to the Antimonopoly Act. The government has since implemented staged amendments to the Commercial Code. The 2002 amendment introduced an American-style board of directors, called the “board with committees,” as an alternative to the traditional Japanese-style board with statutory auditors. Few firms have adopted this alternative. In the manufacturing industry, firms in the electric machinery and electronics sectors with a larger share of overseas operations and many foreign shareholders have selected the board with committees; in other industries, firms in the finance, securities, distribution service, leasing, and software development sectors have also selected this type. In contrast, most other firms in the manufacturing industry have selected the traditional board with statutory auditors and are proceeding with a shareholder-oriented corporate governance reform. However, what both these boards had in common was the aim of separating day-to-day management from monitoring, which made the board of directors a real seat of decision-making and simultaneously promoted the acceleration of the decision-making process by limiting the number of board members. This type of reform, called the "executive officer system," has been introduced by many publicly held companies. Thus, the malfunctioning of corporate governance did not force Japanese firms to immediately shift to an American style of corporate governance, nor was the situation viewed as inevitable. Rather, a diversity of systems coexisted within industries, as did a diversity of firms within single industries.

Table 2 summarizes the above discussions regarding the transformation of the Japanese corporate system after the 1997 banking crisis.

Table 2 Transformation of the Japanese Corporate System: Summing-Up

	Traditional Japanese Corporate System	Transformation after 1997
Employment	· Combination of seniority wage system and internal promotion system	Introduction of pay-for-performance, but, various variants
Employment	· Long-term Employment Practice (Mutual Complementarity Relations)	Maintenance of long-term employment by incremental adaptation, but, development of non-regularization of employment
Employment (Institutional Complementarity)	· Formation of Firm-specific Skill by In-house Training System	Prospect to formation of industry-specific skill is indeterminate
Employment (Institutional Complementarity)	· *Shunto* as the Mechanism of Equalizing Wage Increases on a Nationwide and Industry-wide Scale	Functional deterioration of *Shunto* After the latter half of 90s: Debacle of wage coordination mechanism among industries and firms
Finance	· Main bank system	Decay
Finance	· Cross-shareholding and stable shareholding	Unwinding, but, unequal development among firms

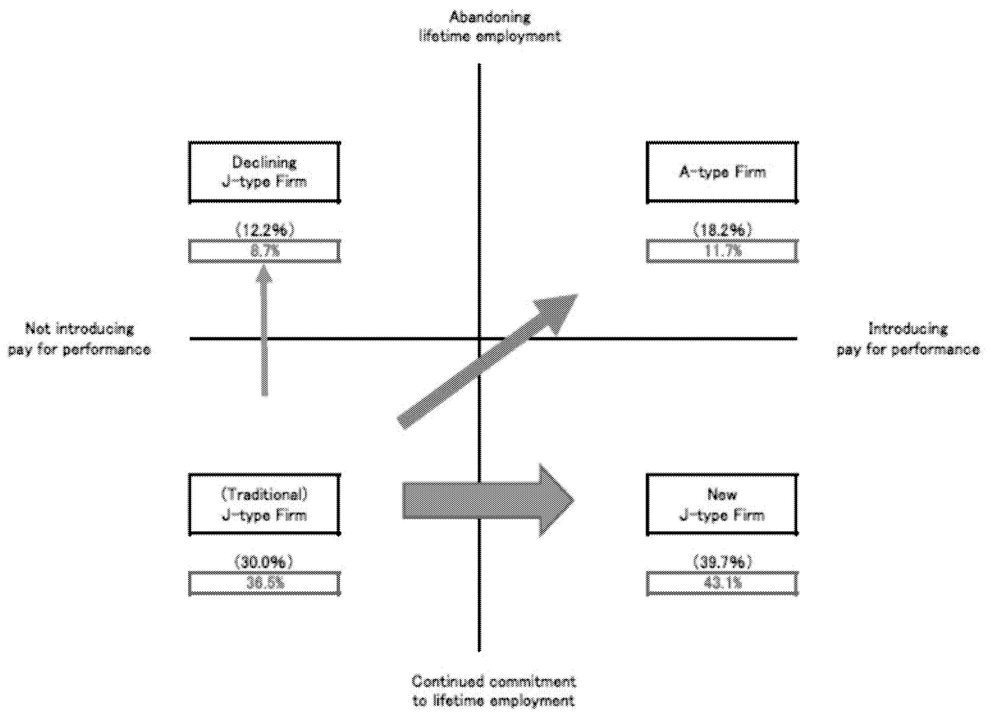
4 Hybridization between Finance and Employment

4.1 Emergence of the Hybrid Firm Organizations

The driving force behind the transformation of the Japanese corporate system was the significant changes in the domain of finance. Corporate governance reforms began from here and reflected pressures toward the pursuit of shareholder values and shareholder-oriented management. Such reforms, however, had not radically shifted Japanese firms towards an American style of corporate governance through the introduction of directors and stock options from outside the firm because changes to the internal aspects of the corporate governance of Japanese firms had been partial and selective, depending on the firms' organizational factors. Similarly, the impacts of corporate governance reforms on employment were also diverse.

During the "lost decade" of the 1990s, corporate governance in Japan moved to a market-oriented style in the form of a pursuit of shareholder value or shareholder-oriented management. Meanwhile, employment systems did not radically change to a market-oriented style in the form of an increasing fluidity of employment. At least for core employees, the organization-oriented style based on long-term employment has been maintained, though its coverage has gradually narrowed. Meanwhile, the pay-for-performance system has been grafted onto the traditional organization-oriented base. Thus, leading Japanese firms are reorganizing themselves into “dual” hybrid organizational forms, which combine not only the market-oriented style of corporate governance and the organization-style of employment but also the norm of lifetime employment and the pay-for-performance system, as discussed by informative studies such as Aoki et al. (2007), Jackson (2010), Miyajima (2011), and Miyamoto (2007, 2011). We will pay special attention to Miyamoto (2007, 2011), which finds four patterns in the impacts of corporate governance reforms on employment based on two questionnaire surveys conducted by the Japan Institute for Labor Policy and Training (JILPT) in 2004 and 2008. Those findings are illustrated in Figure 5.

Figure 5 Four Patterns of HRMs



Note: Numbers in parentheses are the proportion of all answering firms (1280 firms) to questionnairing conducted by JILPT in 2004. Numbers in rectangles are the propotion of all answering firms (923 firms) to questionnairing conducted by JILPTin 2008.
Source: Author's own adaptation from Miyamoto (2007; 2011).

Firms in the third quadrant of Figure 5 are traditional Japanese-type firms. These J-type firms are bifurcating into the “new J-type firm” in the fourth quadrant and the A-type firms in the first. New J-type firms are mainly large-sized and blue-chip firms. Their business performances are relatively good. They are distinguished from existing J-type firms in their strengthening of shareholder-oriented management. However, this shareholder-oriented management does not necessarily entail the abandonment of long-term employment practices. Rather, the new J-type firms use the pay-for-performance system in order to maintain long-term employment for core employees. The A-type firms also strengthen shareholder-oriented management but are, by contrast, distinguished from the traditional J-type firms in being forced to abandon long-term employment practices.[5]

It could be said that the new J-type firms' processes have carried incremental changes into the traditional Japanese corporate system. These changes involve the processes of "institutional layering" (Mahoney and Thelen 2010, Thelen 2009, 2010), which works within the existing system by adding new rules on top of, or alongside, the old ones. In this sense, the emerging J-type firms are hybrid organizational forms consisting of a combination of new and old elements.

4.2 Puzzling Questions on the New J-type Firms

How should we interpret the emergence of the new J-type firms? We can instantly raise two questions about the future and potential of the new J-type firms. The first regards the sustainability of the new J-type firms. Given that they are blue-chip firms with good business performances and include most of Japan's world-class firms, their emergence must have some defining factors. Two different views on the question are possible (Aoki 2010). One sees this new hybrid organizational form as only a transitional stage toward a more complete market-oriented model—the Anglo-American model. Were this the case, the new J-type firms would not likely be sustainable over the long term. The other view argues that new relationships between management and the workers are emerging in the new hybrid organizational forms. Were this case, a shift from the system of new J-type firms to that of the Anglo-American type would be less likely.

The second question is about the future of Japanese employment systems: under the institutional arrangements of the new J-type firms, will the combination of long-term employment and pay-for-performance be sustainable?

5 The Potential of the New J-type Firms: More Fundamental Consideration and Discussion

The financial crisis caused by the subprime mortgage fiasco in the U.S. beginning in the middle of 2007 exposed the limit of the business model driven by maximizing shareholder value. This crisis has caused a worldwide depression, immediately affecting the world economy. The global financial crisis of 2008 has likewise had a severe impact on the Japanese economy, ending the five-year run of economic expansion and causing a steep decline in economic performance beginning in the autumn of 2008. In particular, as Figure 6 shows, the earning structure in the large firms of the manufacturing industry deteriorated rapidly from the end of 2008 to early 2009. In order to improve

[5] Aoki et al. (2007) and Miyajima (2011) consider the "type-I hybrid," a combination of market-oriented corporate governance and long-term employment and pay-for-performance policy, a hybrid organizational form corresponding to the new J-type firm. While these type-I hybrids represented roughly one-quarter of the 723 firms listed on the Tokyo Stock Exchange in 2002, they accounted for 67% of total employment of the sample firms. Considering this point, it could be said that type-I hybrid groups were actually becoming the dominant pattern among Japanese firms in 2000s.

their earning structures, firms have had to curtail fixed costs, reduce variable costs, or increase sales. Meanwhile, the earning structures of the large firms of the manufacturing industry have improved very rapidly between the latter half of 2009 and 2010, which may show the strong resilience of large Japanese large firms, especially the new J-type firms.

Figure 6 Trends in the Ratio of Break-even Points

Note: Ratio of break-even point = {Fixed cost / (1 −Ratio of variable cost)} / Sales × 100
Source: Ministry of Finance, *Statistical Survey of Business Corporations*, various years.

When the current global financial crisis ends, in which direction will the transformation of the Japanese corporate system head? All nations will probably re-adopt the policy of intensifying the regulation of financial markets. As a result, the pressures on corporate governance to prioritize maximization of shareholder values may be weakened. However, the long-term trend of the financialization of the economy since the 1980s will not be reversed. The trend in the proportion of shareholders to owners in Japan will also not reverse to the state prior to the mid-1990s (see Figure 2). It is thus unlikely that there will be no pressures on the corporate management from shareholders, especially foreign investors. Moreover, the stance of Japanese management, which aims to control wage increases, will probably continue or intensify. Basically, the competitive pressures or market forces driving Japanese firms toward diversity are likely strong enough to resist being reversed to the old traditional systems.

In seeking possible answers to the questions posed in Section 4.2, we will deal below with the question of the direction that the transformation of the Japanese corporate system will take. We will approach this question from the theoretical and conceptual perspectives. We will first examine how to understand the institutional changes under institutional arrangements that have caused the emergence of a hybrid organizational form such as the new J-type firm.

According to Deeg (2005, 2009), there are two basic approaches to institutional change: the "equilibrium–functionalist approach" and the "historical–political approach." The former approach regards institutions as self-enforcing equilibria that change as a result of exogenous shocks. This approach views institutional change as occurring through breakdown and replacement (i.e., the "punctuated equilibrium" view). The latter approach regards institutions as continuously evolving in non-trivial ways. Thus, institutional equilibrium is not a normal state but an exception to the rule, a view articulated by the *régulationist* school. This approach posits that smaller or gradual institutional changes often add up to major institutional transformations over time. In this paper, we take the latter approach, paying special attention to the perspectives on institutional change of comparative historical analysis.

Table 3, based on Streeck and Thelen (2005), shows four types of institutional change. The scholars argue that the type of change reflecting current developments in the capitalist economy is a "gradual transformation." Meanwhile, Mahoney and Thelen (2010) propose four types of gradual change, as illustrated in Table 4.

Table 3 Types of Institutional Change

		Result of Change	
		Continuity	Discontinuity
Process of Change	Incremental	Reproduction by Adaptation	**Gradual Transformation**
	Abrupt	Survival and Return	Breakdown and Replacement

Source: Streeck, W. and Thelen, K. (2005), p.9.

Table 4 Types of Gradual Change

	Displacement	Layering	Drift	Conversion
Removal of old rules	○	×	×	×
Neglect of old rules		×	○	×
Changed impact/enactment of old rules		×	○	○
Introduction of new rules	○	○	×	×

Note: ○ indicates 'Yes'. × indicates 'No'.
Source: Mahoney and Thelen (2010) p.16.

The process of "displacement" occurs when existing rules are replaced by new ones, while "layering" occurs when new rules are attached to existing ones, thereby changing the ways in which the original rules structure behavior; this process does not introduce wholly new institutions or rules but rather leads to amendments, revisions, or additions to existing ones. Layering can bring a substantial change if amendments alter the logic of the institution or compromise the stable reproduction of the original "core." Meanwhile, "conversion" occurs when rules remain formally the same but are interpreted and enacted in new ways, while "drift" occurs when rules remain formally the same but have different impacts as a result of shifts in external conditions (Mahoney and Thelen 2010). As we have described, the new J-type firm embodies a combination of elements taken from the old Japanese model and the new and more Anglo-American practices. Japanese firms are adopting more diverse forms of finance but continue to retain a homogeneous employment pattern. Nevertheless, this naturally leads to more diversity between institutional domains: this diversity may persist during the process of hybridization. The degree of this persistence will depend on how the new and old rules or institutions are related. This is equally true of the process of institutional layering. The likelihood of the layering of new and old institutions would depend on the degree to which the institutional diversity within a system could persist over a long period without triggering a displacement of the old by the new.

In the domain of finance, corporate law reforms were implemented in rapid succession after the banking crisis of 1997. The convergence of at least the formal rules regarding corporate governance has progressed substantially. This does not mean, of course, that this formal convergence has resulted in the functional convergence of corporate governance practices. For leading Japanese companies, however, the "displacement" of traditional organization-based or relation-specific systems by market-based ones has occurred in each area of corporate finance, corporate ownership, and corporate governance.

Using the conceptions of "conversion" and "layering," we will now consider Japan's labor market diversity since the late 1990s.[6] As mentioned, the dispersion of *Shunto* wage settlements gradually increased in the 1990s, and the dispersion index has shown a marked increase since 1998 (see Figure 4). Figure 7 summarizes the results of a survey conducted by the Ministry of Health, Labor and Welfare showing that the importance of "corporate performance" (i.e. the ability to pay) has gradually increased since 1992 while that of "social norm" (i.e. setting wages according to the going rate considered socially acceptable) has declined since the early 1990s. A comparison of Figure 4 and Figure 7 suggests a slow "conversion" of *Shunto*. Obviously, *Shunto* has converted its goals and functions from coordinated wage increases into a mechanism for legitimizing wage restraint and dispersion.

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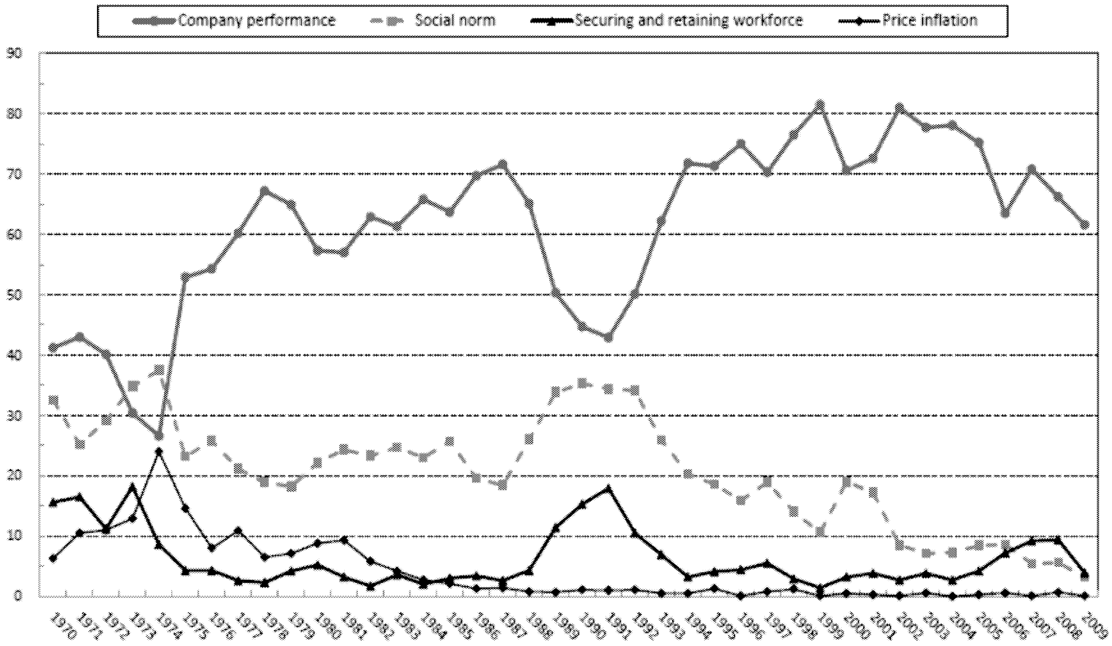
[6] The following discussion owes a great deal to Sako (2007, 2012).

Figure 7 The Most Important Factors in Setting Pay during *Shunto*



Source: The Ministry of Health, Labor and Welfare, *Survey on Wage Increase*, Various years.

By contrast, the use of diverse forms of employment started earlier, from the mid-1980s. In 1986, the Worker Dispatch Law was enacted. After 2004, dispatched work was permitted in manufacturing work. The use of non-regular workers had become layered onto the norm of lifetime employment. While non-regular workers had previously been hired as buffers to cope with cyclical fluctuations in demand, a wider and continuous use of non-regular workers after the mid-1990s was encouraged by individual corporate strategies to reduce personnel costs and turn fixed costs into variable ones. This process reflected significant changes in Japanese firms' management targets since the 1990s. Therefore, contingent or temporary workers can be seen as a case of "institutional layering" onto the norm of lifetime employment in the labor market. However, this layering has not yet eroded the original core features of the Japanese employment system because, even though management's commitment to long-term employment has been relaxed or weakened, it will never be abandoned, especially for core employees in large firms. Unlike in finance, where short-term market pressures encouraged Japanese firms to adopt shareholder-oriented management, two different modes of institutional change—layering and conversion—in the domain of employment will be further drawn out, and these two will coexist in labor markets for a long time. Thus, it seems very difficult to precisely predict the sustainability of the new J-type firm as a viable model of business organization.

However, a number of studies share the view that a shift from the system of new J-type firms to that of the Anglo-American type does not seem likely in the near term (Ahmadjian 2007; Aoki et al. 2007; Aoki 2010; Hirota 2012; Jacoby 2005; Kushida and Shimizu 2013; Jackson 2009; Jackson and Miyajima 2007; Lechevalier 2012; Miyajima 2011; Miyamoto 2011; Olcott 2009; Shishido 2007; Whittaker and Deakin 2009; Yoshimori 1995). Olcott argues that "disinstitutionalisation is not occurring at large Japanese companies and that employee-favoring company has not yet transformed itself into the shareholder-favoring company." (Olcott 2009; 219) While Japanese firms will be further diversified and while the increasing heterogeneity of Japanese firms will become more obvious, the problem of widening disparities of income, wealth, and opportunity across both individuals and firms appears inevitable. It seems obvious that, with the emergence of the new J-type firm, tensions are growing between corporate insiders and outsiders, such as between stable shareholders and institutional investors (including foreign investors), between core and more peripheral groups of employees, and between the more competitive sectors (such as manufacturing) exposed to severe international competition and domestic protected sectors (such as the public and service sectors), which are isolated from international competition. These are the shadows of the evolving diversity. In the domain of employment, while core employees have been retained, the number of employed workers has been substantially reduced through such processes as the provision of early retirement schemes, transfers to affiliate companies, disinvestments in non-core business lines, and an increasing reliance on non-regular employment. Thus, one may argue that a "new segmentalization" has been occurring along with the emergence of the new J-type firms and that Japan can be classified as a "segmentalist CME (Coordinated Market Economy)," a category Thelen (2009) has suggested. However, the speed with which the new institution replaces the old depends on how the new and old are related, how each economic actor behaves in the process of institutional change, and how their behaviors interact. In this regard, a more interesting problem for the new J-type firm is the perception gap about managements' long-term employment policies. A questionnaire survey conducted by the Japan Institute for Labor Policy and Training (JILPT) in 2004 reported that, while 70.1% of firms responded "we will maintain long-term employment practices," only 40.9% of employees acknowledged the continuity of their firms' long-term employment practices. In spite of managements' asserted commitment to long-term employment practices, some of the measures required to maintain those practices have been neglected or weakened over the past couple of decades. An institutional "drift" regarding the long-term employment policy has occurred. As Table 5 shows, this seems to have caused the recent decline in the five-year job retention rate for young, educated workers. Hamaaki et al. (2010) interpret this finding as indicating that owing to the slowdown in wage increases later in their careers, a higher proportion of educated young workers may have an incentive to leave their current tenure-track positions. An intergenerational perception gap thus exists about long-term employment practices, even within companies and workplaces.

Table 5 The Lifetime Employee Share and Five-year Job Retention Rate for University Graduate (All Industries)

1990 Lifetime employee share	1995 Lifetime employee share	Five-year job retention rate (A) 1990-1995	1995 Lifetime employee share	2000 Lifetime employee share	Five-year job retention rate (B) 1995-2000	2000 Lifetime employee share	2005 Lifetime employee share	Five-year job retention rate (C) 2000-2005	2003 Lifetime employee share	2008 Lifetime employee share	Five-year job retention rate (D) 2003-2008	(B)-(A)	(C)-(B)	(D)-(C)
Large-sized Firm														
age 20-24 91.5%	age 25-29 65.8%	71.9%	age 20-24 89.9%	age 25-29 55.9%	62.2%	age 20-24 88.7%	age 25-29 50.8%	57.3%	age 20-24 87.8%	age 25-29 47.5%	54.0%	-9.7%	-4.9%	-3.3%
age 25-29 63.3	age 30-34 56.2	88.8	age 25-29 65.8	age 30-34 59.7	90.7	age 25-29 55.9	age 30-34 47.1	84.2	age 25-29 54.2	age 30-34 40.3	74.3	1.9	-6.5	-10.0
age 30-34 58.1	age 35-39 52.7	90.7	age 30-34 56.2	age 35-39 53.3	94.9	age 30-34 59.7	age 35-39 57.9	97.0	age 30-34 58.6	age 35-39 49.9	85.2	4.3	2.1	-11.8
age 35-39 54.7	age 40-44 54.0	98.7	age 35-39 52.7	age 40-44 53.9	102.4	age 35-39 53.3	age 40-44 50.7	95.1	age 35-39 52.8	age 40-44 51.0	96.6	3.6	-7.2	1.5
age 40-44 58.3	age 45-49 55.9	95.8	age 40-44 54.0	age 45-49 50.7	93.9	age 40-44 53.9	age 45-49 48.4	89.7	age 40-44 53.3	age 45-49 52.5	98.4	-1.9	-4.2	8.7
age 45-49 57.9	age 50-54 52.3	91.0	age 45-49 55.9	age 50-54 55.9	100.0	age 45-49 50.7	age 50-54 47.0	92.7	age 45-49 47.1	age 50-54 43.1	91.4	9.1	-7.3	-1.4
Small and Medium-sized Firm														
age 20-24 90.5%	age 25-29 55.6%	61.4%	age 20-24 89.7%	age 25-29 51.2%	57.0%	age 20-24 89.0%	age 25-29 48.4%	54.4%	age 20-24 89.1%	age 25-29 46.2%	51.9%	-4.4%	-2.6%	-2.5%
age 25-29 55.7	age 30-34 40.7	73.0	age 25-29 55.6	age 30-34 39.8	71.7	age 25-29 51.2	age 30-34 36.8	72.0	age 25-29 51.7	age 30-34 32.6	63.2	-1.3	0.3	-8.8
age 30-34 41.7	age 35-39 35.6	85.4	age 30-34 40.7	age 35-39 35.4	87.1	age 30-34 39.8	age 35-39 34.6	86.8	age 30-34 38.8	age 35-39 32.6	84.1	1.7	-0.3	-2.7
age 35-39 34.1	age 40-44 29.9	87.6	age 35-39 35.6	age 40-44 32.0	90.0	age 35-39 35.4	age 40-44 30.4	85.9	age 35-39 35.9	age 40-44 31.9	88.8	2.4	-4.1	3.0
age 40-44 34.4	age 45-49 32.3	93.5	age 40-44 29.9	age 45-49 29.1	97.6	age 40-44 32.0	age 45-49 31.6	98.6	age 40-44 32.5	age 45-49 32.0	98.4	3.0	1.1	-0.2
age 45-49 31.1	age 50-54 31.3	100.5	age 45-49 32.3	age 50-54 30.2	93.7	age 45-49 29.1	age 50-54 27.8	95.3	age 45-49 29.8	age 50-54 27.4	92.0	-6.9	1.6	-3.4

Note: "Large-sized firm" has more than 1000 indefinite-contract employees. "Small and medium-sized firm" has less than 1000 indefinite-contract employee

The lifetime employee is defined as those who are hired immediately upon graduating from school and continue working in the same firm until survey data. The share of the lifetime employee in age group i is calcurated by dividing the number of lifetime employees by the total number of employees in the same category (age group i and time t).

The five-year job retention rate is calculated by dividing the lifetime employee share in age group i at year t by that in age group $i+1$ at year $t+5$. The right three columns report the change of the retention rate between two neighboring periods. In this Table, some of calculated retention rate slightly exceed 100%, owing to sampling erros

Source: Adaptation from Hamaaki et al. (2010)

6 Conclusion

In this paper, we reexamined the transformation that has occurred in the Japanese corporate system over more than two decades and that transformation's possible future course. Below, we present some of the implications and suggest agendas for future research that should be pursued both theoretically and empirically.

First, the emergence of the new J-type firm as a hybrid model demonstrates that both the "strong" convergence view and the "strong" complementarity view are misleading. The strong convergence view claims that corporate convergence according to a shareholder-oriented model is both desirable and inevitable, while the strong complementarity view claims that systemic transformation is very unlikely. Two possible patterns of institutional change are possible: one is marginal institutional change, and the other is overall systemic change. The process of hybridization rejects both these views.

Second, the emergence of the new J-type firm naturally calls us to reexamine the institutional complementarities between finance and employment theoretically as well as empirically. The mere fact of the new J-type firm seems to show that the institutional complementarities between finance and employment may be less clear than what has been assumed in theoretical models. A part of the complementarity relations among institutions, such as the complementarity between employment and finance, might not necessarily be a fixed relation but may be loose and modest. This reminds us of the significance of the original ideas of the *régulationist* school—that identical reproduction is an exception to the rule and that institutional forms are always in a state of flux, changing sometimes gradually and other times rapidly. Complementarity is always accompanied by tensions, ruling out the notion that institutional configurations exist in static equilibrium. Therefore, in dealing with a dynamic process like institutional change, it is essential for us to reexamine or redefine the conception of institutional complementarity in a dynamic context. Furthermore, from the empirical point of view, the remarkable process of the globalization of financial markets may lessen or ease national constraints on institutional complementarities (Aoki 2010), leading to the emergence of some kinds of organizational hybrid that are unfeasible in a closed economy. The financial and ownership characteristics of Japanese firms have actually moved substantially in the direction of a market-oriented style in the wake of the 1997 banking crisis. By contrast, nation-specificities are still much in evidence in the employment features of Japanese firms because these features appear to be closely related to a number of different factors, including industrial sectors, corporate age, and product architecture, as well as to other path-dependent factors, such as degree of unionization and the prior establishment of a labor-management consultation process.

Last but not least, whether the new J-type firms as a new hybrid organizational form can be sustained over the long term remains an open question. However, as the new J-type firm emerges, tensions steadily grow between corporate insiders and outsiders, such as between stable shareholders and institutional investors (including foreign investors), between core and more peripheral groups of employees, and between more competitive sectors (such as manufacturing) exposed to severe international competition and domestic protected sectors (such as the public and service sectors), which are isolated from international competition. As Table 5 shows, there is also an intergenerational gap concerning the continuity of long-term employment practices between young workers and middle-aged and older workers. The widely-observed dropout of young workers from the lifetime employment system may suggest that the lifetime employment system has started to degenerate. It is very difficult to predict precisely, however, how the conflict of interests and tensions among various economic actors will be settled. This process is likely to be characterized by complexities and non-linearity and will thus be far from mechanical.

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