

**The Irresponsible Japanese Top Management  
Under the Cross-Shareholding Arrangement**

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## **Introduction**

Japanese Capitalism is very much different from American Capitalism. Worldwide surveys conducted between 1986 and 1993 differentiated the Seven Cultures of Capitalism and showed large differences between American style capitalism and Japanese style capitalism, with the two invariably at opposite poles. The report stated :

All [the United States, the United Kingdom, Sweden, France, Japan, the Netherlands, and Germany] call themselves capitalist and free enterprise nations and subscribe generally to the same philosophy, but there the resemblance ends. When we look at the day-to-day details, the meaning found in work, the attitude toward stakeholders, the styles of managing employees, the various negotiation tactics, the differences are wide, as any American who has negotiated a contract with a Japanese will tell you. <sup>1</sup>

As for proper goals of a company, they gave us an example. Forty percent of Americans consider the only real goal of a company is making profits, while only 8 % of Japanese agree with this view.<sup>2</sup>

The principles of Japanese social structure can be seen clearly portrayed in the household structure, and the internal structure of the various groups in Japan is vertical.<sup>3</sup> *Kaisha* (a company or a corporation) is not an exception. Key characteristics of corporate governance in Japan are the lifetime employment mores for larger corporations with the seniority system, company-wide labor organizations and the cross-shareholding arrangements among corporations that center around main-banks. The Japanese corporate governance promoted economic growth but lacks an effective brake, because of the cross-shareholding arrangements. This is the big defect of Japanese-style capitalism.

The main purpose of this paper is to analyze the behavior and the consciousness of the directors, managers and employees of the six big banks and their clients under these arrangements after World War? , and show how these banks and their clients were able to

execute what they wanted to do (to get bigger shares in the markets rather than their profits) without any restraints. It is certain that their behaviors promoted the Japanese economy and made Japan the biggest economy next to the U.S. However, the Japanese economy, has not been able to recover from the burst of the bubble on October 1, 1990. To our great regret, the two brakes to this practice were *Gaiatsu* (foreign pressure, chiefly from the U.S.) to amend this arrangement and to a larger extent the *Sokaiya* scandals that had some connections with the *Yakuza*.

The cross-shareholding arrangements between big banks and their clients is contrary to the principle of the law of the Joint-Stock Companies, but they only came to be regulated in the 1981 revision of the Commercial Code. This revision, however, was far from enough. Chapter 1 deals with the transition from the dissolution of *Zaibatsu* (financial cliques) to the Cross-Shareholding Arrangement. Chapter 2 discusses the main characteristics of the Japanese management. Chapter 3 clarifies unique characteristics of the enterprise union. Chapter 4 states the authority, the privilege and career of management. Chapter 5 shows that irresponsibility among the Japanese management is deeply rooted in Japanese culture and history and there are few mechanisms to check responsibilities of the management. In conclusion, I argue that reforms should aim at realizing the principle expressed in the law governing joint-stock companies. Such reforms must involve : (1) the prohibition of shareholding of the corporation by banks ; (2) the prohibition of the voting right of the corporation ; (3) an enhancement of the public disclosure of important information on the corporation.

## Chapter 1

### The Transition from the Dissolution of *Zaibatsu* to the Cross-Shareholding

#### Arrangement

##### 1.1 Iron-quadrangle

To begin with, the structure of control in contemporary Japan is usually called an Iron-triangle that consists of politicians, bureaucrats, and businessmen who rule Japan. Here, bureaucrats are weak against politicians because politicians give the orders or directives to bureaucrats. Bureaucrats are strong against businessmen, because bureaucrats give *Gyoseishido* (administrative guidance) to businessmen and place retired officials in strategic positions in the industries they used to regulate (This practice is called *Amakudari*, literally “descent from heaven”). Politicians are strong against bureaucrats, but weak against businessmen because businessmen contribute money to have their will reflected in government policy. Hence, these three groups are in a mutually dependent relationship. Among them, businessmen will produce wealth and powerful businessmen constitute the *Zaikai* (the business community). By the business community is meant “a group from a power elite in the economic world which consists of large corporations and their managers. Through its organizations it reflects its interests in the formation of government policy, and it exerts influence over Japanese society as the core of a composite made up of politicians, bureaucrats and businessmen.”<sup>4</sup>

In reality, the *Zaikai* was taken to refer to groups such as Keidanren (the Federation of Economic Organizations), Nihon Shoko Kaigisho (the Japan Chamber of Commerce and Industry), Nikkeiren (the Japan Federation of Employers’ Associations) and Keizai Doyukai (Japan Association of Corporate Executives). On May 28, 2002, Keidanren and Nikkeiren merged into Nippon Keidanren (the Japan Business Federation) and Mr. Hiroshi Okuda, chairman of Nikkeiren and of Toyota Motor Corporation, was elected as the new chairman.

He seems to be the most qualified businessman to head the JBF at this time because he was not only an apostle of the Japanese management philosophy, but he also is a passionate reformer with a global perspective.<sup>5</sup>

As everyone knows, the *Zaikai* has come to exert a powerful influence over government as the representative of the will of total capital. The role of the *Zaikai* is to exert its influence on politics. It participates in the formation of government policy in a variety of forms and wields its power in this process. It influences the political parties, and in particular Jimin-to (the Liberal Democratic Party, LDP). One important thing to note here is the fact that when the LDP was established in 1955 and Nobusuke Kishi (1896-1987) became Secretary-General and Prime Minister in 1957, his cellmate at the Sugamo Prison, Yoshio Kodama<sup>6</sup> (1911-84), helped him in every possible way. ‘From that point on over the next decades, Kodama was perhaps the most powerful single individual within the LDP.’<sup>7</sup> The LDP has been ruling so many years except for a few (Hosokawa, Hata and Murayama’s Administration) since then. Acton’s dictum about unmonitored power is entirely true.

The interests of individual large corporations as well as those of the whole of large corporations are reflected in the political process. In return for this, large sums of money in the form of *Seiji Kenkin* (political donations) are paid. Companies donated a total of ¥3 billion to political parties in 2000, down from nearly ¥10 billion in annual political donations before 1993 when Keidanren stopped arranging them<sup>8</sup> which resulted in lesser influence upon politicians. In the United States, political contributions by corporations are prohibited because it is only electors – that is, natural persons who can participate in political activity. Furthermore, the *Zaikai* is coordinating and adjusting interests among large corporations, or between large corporations and small and medium-sized companies. Thus, the fact that the *Zaikai* performs the role of resolving conflicts of interest among corporations means that the power structure of the business community reflects exactly the power relationships among corporations. Strong corporations and the groups to which they belong exert power as

mainstream factions within the *Zaikai*. It is the large corporations who wield the greatest power within the modern system in Japan.

Here, I want to add the media as the fourth power, making an Iron-quadrangle, because the media is expected to be critical about the state of politicians, bureaucrats and businessmen from the standpoint of the people. Their criticism, however, has not been enough. In the world of the media, editorship is said to be independent from business that usually depends heavily on the revenues from advertisements from corporations. In fact, the independence of editorship is not always fully realized. In the *Sokaiya* scandal, (details of which will be stated later), Inoue, chairman, the Dai-Ichi Bank utilized the power of the *Sokaiya*, Rikiya Kijima (1926-1993) who had been close with Kodama in order to be against the merger plan with Mitsubishi Bank in 1969, but no media did report this fact.<sup>9</sup> Consequently, the most influential are businessmen, especially main bankers. Though a collusive relationship among the LDP, bureaucrats, businessmen and the media still exists, this system is being weakened in many scandals involving politicians, bureaucrats, businessmen-bankers and the media after the bubble burst in 1990.

Among large corporations it was the six large groups of Mitsubishi, Mitsui, Sumitomo, Fuyo, Sanwa and Dai-Ichi Kangyo who were in a dominant position, together with large independent corporations such as Shin Nittetsu (the Nippon Steel Corporation), nine Electric Powers Corporations, Toyota Motor Corporation and the Industrial Bank of Japan. The managers of the corporations in these six large groups and those of a small number of large independent corporations made up the mainstream factions within the *Zaikai*. Mainstream factions within the *Zaikai* were therefore made up of managers of its giant corporations.

In 2000 companies of the Big Six held about a quarter of the outstanding shares of the 1892 firms listed on the Tokyo and Osaka stock exchange (Table 1). Moreover, 41.9 % of the money lent to these companies came from the financial institutions of the Big Six. In addition, of the 5,891 board members who came from outside the respective firms among the listed

companies, as many as 52.63% were sent by Big Six group corporations (mostly by their financial institutions). Therefore, the six corporate groups combined held significant weight among the big businesses in Japan.

## **1.2 From private capitalism to corporate capitalism**

As corporations got bigger in the post-war period, continuation of family control over them became unsustainable. This had not been the case with corporations before the war. The primary reason why this changed so much in the post-war period was because of the dissolution of the *Zaibatsu*. Under the direction of the Supreme Commander for the Allied Powers (SCAP), the Japanese government designated 83 enterprises as holding companies (i.e., companies that hold stocks of other companies) between August 1946 and August 1947. In June 1946, ten families designated as *Zaibatsu* families gained control of these holding companies.<sup>10</sup> Although *Shiteki Dokusen no Kinshi oyobi Torihiki no Kakuho ni kansuru Horitsu*<sup>11</sup> (the Law concerning the Prohibition of Private Monopolies and Maintenance of Fair Trade Practices) prohibited holding companies, each city bank was allowed to hold 5% of the stock of any company. Most of the shares of the holding companies and *Zaibatsu* families were transferred to Mochikabukaisha Seiri Iinkai (the Holding Company Liquidation Commission). These shares were sold to employees of the respective companies and then to the residents of localities where the companies operated. No individual was allowed to acquire more than 1% of the stock of any company in this liquidation operation. As a result of this policy, holdings by individuals reached 69.1% of all shares outstanding at the end of 1949.

At the same time, a substantial number of shares were purchased by securities companies and eventually resold to city banks and other companies that belonged to each corporate group. SCAP dissolved the major *Zaibatsu* families including Mitsui, Iwasaki (Mitsubishi), Sumitomo, and Yasuda. *Zaibatsu* resolution and a series of other measures brought about a number of outstanding achievements (female suffrage was granted: labor

unions and radical political parties were rapidly gathering support). But the campaign to democratize the Japanese economy came under harsh attack in the American Press.<sup>12</sup> The core of this group was the American Council on Japan (ACJ)<sup>13</sup>. On July 3, 1949, SCAP ordered Mitsui Bussan and Mitsubishi Shoji to be dissolved. The important thing to note here is that it did not dissolve the city banks<sup>14</sup> (namely Teikoku Bank<sup>15</sup>, Mitsubishi Bank, Sumitomo Bank and Yasuda Bank) that existed within each *Zaibatsu* group, because each bank became a main bank around which the cross-shareholding arrangement among corporations arose.

The members of ACJ became in alliance with the old guards<sup>16</sup> in Japan and the campaign to democratize the Japanese economy was reversal. A later study notes, “Eventually, the former *Zaibatsu* enterprises in even-closer alliance with American and multinational corporations, not only re-established their pre-war strength but actually augmented their shares of both the national and international economies.”<sup>17</sup>

In 1953, a 5% ceiling on the holdings of city banks was raised to 10%. In a return to the pre-war situation, a substantial portion of the new stocks issued by major companies were mutually subscribed by companies related to each other, especially by old *Zaibatsu* connections. As a result, cross-shareholdings more than doubled in six years from 5.6% in 1949 to 13.2% in 1955.

On July 1, 1967, the Japanese government decided to liberalize its capital market. Japan had become an Article Eight Country of the International Monetary Fund (IMF) on April 1, 1964, and a member of the organization for Economic Cooperation and Development (OECD) on April 28. The Article Eight stipulated that a member country cannot restrict current account transactions, and OECD Codes required the liberalization of capital markets. Companies that feared hostile takeovers by foreign investors sought to prevent this through mutual holdings. In what was called *Kabushiki Antei Kosaku* (Stockholding Stabilization Operation), shares that had been purchased by the *Shoken Hoyu Kumiai* (Securities Holding



Union)<sup>18</sup> were repurchased by the companies that had issued them and utilized for cross-shareholdings. This was done at the insistence of Mr. T. Ishida, chairman of Toyota Motor Corporation, whose motto was, “Jibun no shiro wa jibun de mamore (One should defend one’s own castle).”<sup>19</sup> As a result, holdings by financial institutions reached 30.9% of all stocks by the end of 1970. Stockholdings by other business corporations reached 23.1% at this time. The management of large Japanese companies thus became insulated from outside takeovers. A 10% ceiling on each city bank’s holdings of the stock of any single company was lowered to 5% in 1977.

Consequently, the ties of the *Zaibatsu* organizations remained between the related firms, and organizational principles rooted in ethnic tradition remained. The post-war six business groups, especially the former *Zaibatsu*, had the following common characteristics : First of all, in principle each group tries to maintain one and only one company in any type of business (so called the “one set principle”). Second, there are *Shacho-Kai*<sup>20</sup> (President’s clubs) at the core of each group where periodic exchange of information and, occasionally, decision making among member businesses occurred. Third, member firms maintained a considerable level of mutual long-term inter-corporate holdings of stocks (stable cross-shareholdings) to prevent hostile takeover bids by both foreign and domestic outsiders. Fourth, there was a large city bank (Mitsubishi, Sumitomo, Mitsui, Fuji, Sanwa and DKB) which was called a main bank operated at the center of each group, providing short-and long-term loans for member firms under slightly advantageous conditions, and in many cases was involved in the selection of companies’ directors and auditors. Fifth, *Sogo Shosha* (a general trading company : Mitsubishi Shoji, Sumitomo Shoji, Mitsui Bussan, Marubeni, Nissho-Iwai and C. Itoh respectively) at the core of each group engaged in information exchange between both buyers and sellers.

The concentration of the cross-shareholding arrangement among six business groups is shown in Table 2. Mitsubishi has the highest ratio of interlocking shares. In other words,

about 30% of the total shares of an average Mitsubishi firm are owned by other Mitsubishi firms. Recently however, in confronting with foreign competitors, Mitsui and Sumitomo merged into MSBC on April 1, 2001. Tokyo Mitsubishi, Mitsubishi Trust and Nippon Trust established Mitsubishi Financial Group and Sanwa, Tokai and Chuo Trust established UFJ Holdings on April 2, 2001 respectively. Dai-Ichi Kangyo, Fuji and the Industrial Bank of Japan established Mizuho Holdings on April 1, 2002. Big changes have occurred that was unthinkable a decade ago.

## **Chapter 2**

### **Managers and Shareholders**

#### **2.1 The main characteristics of the top management in Japan**

According to Akihiro Okumura's *Nippon No Top Management*, based upon the survey between Matsushita Denki Sangyo (Matsushita Electric Industrial Co., Ltd.) and RCA, he noted the following characteristics:

- (1) The proportion of outside directorships in the U.S. is substantial, whereas in Japan it is few.
- (2) In the U.S., policymaking decisions are made in the boardroom, while operations are made by the executive officers. The two roles are fully separated. In Japan, the directors usually have management functions in addition to their policymaking positions [general manager of a specific division] and the two roles are not fully separated.
- (3) In Japan, directors hold their own positions within the company whereas in the U.S. they seldom hold any.
- (4) The size of the board of directors [by numbers of members] is larger in Japan.
- (5) In Japan, the board of directors evolves into the following hierarchy – chairman, president, managing directors, executive directors, general directors. In the U.S., on the other hand, the director (chairman of the board) is the only member of the board with a distinct rank while the others are at least nominally equal. On the management side, though, the ranking follows from the chairman of the board, the president (CEO), chief operations vice president, vice presidents, and so on.<sup>21</sup>

In short, in Japan, first, policymaking and operations are inseparable, and second,

directors do double roles (a policymaking role as well as an operating role) as managers. These two reasons make outside directors rare in Japan. Whereas in the U.S., directors take charge of a trusteeship management function and decide overall corporations management policies by being entrusted by shareholders. The execution of these policies is the responsibility of the executive officer or the chief executive officer. In this the performance of the executive and the directorship can be evaluated separately.

In 1950 Commercial Law reforms separated between decision-making bodies and executives bodies to be more like those in US. Under this reform, the board of directors was made the supreme decision-making body with regard to corporate policy, whereas executives were named to represent the board in the daily operations of the corporation; however, this was not the case in reality. In truth, the provisions of the Commercial Code stipulated that representative directors were to execute corporation policy in accordance with the decisions of the board. As representative directors, doubling as executives, assumed the highest positions on the board, it is impossible for the board to direct and control them. Boards in Japanese companies have vertical, hierarchical orders based on the seniority system so the representative directors who are the highest, are also the oldest.

In this way, the policymaking directors and executives in Japan are not separated from each other. Professor Hiroshi Okumura states:

Matters that concern day-to-day operations find their way into the boardroom. This ultimately precludes the consideration of issues pertaining to corporate strategy and keeps the board from taking an industry-wide viewpoint in policy-making, preferring instead to direct the corporation with a narrow, inward-looking viewpoint. In the end, this system puts policy-making and execution on the shoulders of the same people, so that when a decision is made it can be implemented immediately for the utmost effectiveness.<sup>22</sup>

## **2.2 Relationship with shareholders**

In the United States, executive and policymaking functions are separated from each other and many of the policymakers on the board of directors are appointed from the outside. We can assume that the board has been entrusted by shareholders to manage the company, which is called trustee management. The aim of U.S. corporations is known to increase Return On Investment (ROI) and Price Earning Ratio (P/E Ratio) because the shareholders have power over management. Those executives who have not been successful in realizing this aim are often fired by the decisions of the outside directors.

In Japan, the fact that the management is not influenced by outside shareholders implies that: (1) the cross-shareholding arrangement exists between main banks and their clients corporations, details of which will be described later; (2) almost all of the corporate shareholders prefer a stable relationship to return or profitably on their holdings. Large corporate shareholders issue each other blank letters of attorney for each of their shareholders' meetings. If a corporation does not issue such a letter, the shareholder meeting cannot proceed; when this happens, corporation cannot manage. Without a majority decision from the shareholders' meeting, the directors must resign. But in fact this does not happen and the shareholders' meeting is held every settlement term. And the proposals of the corporation nearly always pass because the corporation possesses the letter of attorney, or if present, hand in an agreement on the corporation's proposals. In this way the corporate shareholders build mutual trust and create the Japanese style of top management structure. It is certain that the historical relationship with management cannot be ignored, but the mutual trust built among large corporate shareholders has become a very important factor.

### **2.3 Managers and share prices**

It is commonly known that in terms of long term planning the Japanese management is better than U.S. management because the latter tends to place too much emphasis on the short-term indicators such as ROI and P/E Ratio above -mentioned. For example, in 1981, *the*

*Economic White Paper* stated the following: Japanese firms use such long term growth indicators as market share and development of new product output.<sup>23</sup> This statement is correct but omitted a very important fact. The Japanese management usually thinks highly of the share prices of their own as well as those they have as collateral for their financing and the common stocks issuing at the current market prices.

Previously, companies had issued common stock at its par value. In 1969, however, Yamaha Corporation, then known as Nihon Gakki, followed the U.S. practice and issued common stock at the current market price. Other corporations soon followed suit so that they, too, could raise more money. Because of the prevalence of cross-shareholding, few floating shares (shares not held by stable shareholders) are traded in the stock market in Japan. Cross-shareholdings among corporations listed on the stock market have accounted for between 52.2 and 60% of the value of the stock of Japanese corporations since the start of the 1980's.<sup>24</sup> Moreover, the stock market was dominated by Big Four<sup>25</sup> securities houses: Nomura, Nikko, Daiwa, and Yamaichi. The power of Nomura was particularly great, so when Nomura buys shares of a corporation in collaboration with Nomura's Keiretsu securities houses, the price of that stock invaluablely rose.

Under these circumstances, it was common practice for Nomura to persuade a corporation to issue common stock at its current market price or convertible bonds (CB) overseas. It also urged its *Keiretsu* corporations to hold shares in the corporation so that every party would benefit from the higher price of the stock. This practice contributed further to cross-shareholdings, especially among financial *Keiretsu* during the late 1980s resulted in the booming economy in Japan. The capital-adequacy requirements for banks doing international business that introduced at the Basle Committee on July 15, 1988<sup>26</sup> under which the Japanese banks are allowed to count up to 45% of *fukumi* (the unrealized gain) on securities and other equities as part of base capital in calculating 8% ratio was also of help to the Japanese banks to extend loans overseas so long as the stock market prices are on the upward

trend.

During the stock and urban real-estate bubbles of the late 1980s, many banks except Mitsubishi Bank approached the real estate companies that were often related with the Yakuza and lent them money to acquire the land upon which they had planned to build gorgeous apartments to sell or to rent. After the bubble burst on October 1, 1990, it became very difficult for banks to be paid back from the Yakuza. Some say that the present recession is the Yakuza recession.<sup>27</sup>

## **Chapter 3**

### **Managers and Employees**

#### **3.1 Unique characteristics of the enterprise union**

As already mentioned in the Introduction, the notion of the corporation, as a form of a vertical, hierarchically-ordered family has its roots deep in Japanese culture and was consciously utilized by Japanese managers to win the loyalty of employees in the volatile labor market of the early period of industrialization (1890-1930). The systems established are *Shushin Koyo* (the life-time employment mores) for larger corporations, which offered employees the security of a job for life, and *Nenko Joretsu* (the seniority system), which linked promotion and fringe benefits to age and length of service. The practice of hiring employees immediately after graduation from school or university, which began before World War? , became particularly entrenched in the post-war period. All these factors tended to restrict labor mobility and encourage the development of closed employment systems. Nearly all Japanese labor unions are organized on a company basis as opposed to on an industry basis. This was chiefly attributable to Takashi Sakurada (1904-85)<sup>28</sup>, president and chairman of Nisshinbo Industries who helped create Nikkeiren and served as its executive director and permanent executive secretary, as well as its chairman from 1974 to 1979. All workers in the

corporation, both white and blue collar, are organized in the same union. All belong to the workplace branch of their union. Collective bargaining negotiations are wide ranging and usually result in a yearly agreement on pay and working conditions that is negotiated as *Shunto* (spring offensive). At *Shunto* management supplies the union with a great deal of information that is passed on to the members. Such collective bargaining negotiations are, in effect, a joint labor-management conference. When a Japanese company is in deep trouble, it can cut its part-time employees, because there are no contracts with the union against reducing this part of labor. The next step is to limit bonus payments. This is followed by an attempt to reduce wages.<sup>29</sup>

The relationship between managers and employees cannot be explained in contractual terms. Managers do not employ only a man's labor itself but really employ the whole man. There are a number of well-known features peculiar to the Japanese employment system.<sup>30</sup> Then, labor unions show concern for the company's needs. Japanese employees have been less prone to strike than U.S. unionists. Professor Lipset states, "American unions have been reluctant to cooperate with executives on management problems or to take responsibility for corporate welfare."<sup>31</sup> Thus in 1980, one million work days were lost to strikes in Japan, as compared to almost 21 million in the United States. By 1991, the Japanese figure had fallen to 96,000, while the American was close to 4.6 million.<sup>32</sup> In Japan, the labor unions are often called *Goyo Kumiai* (unions for companies). Cases where labor union members move up to the board of directors or to the audit committee and from there, eventually reach CEO, are not at all unusual. According to the Nikkeiren report, roughly one in six of all the major posts of the companies have experienced union members assuming top executive positions (as of 1983). In Japan, joining the union can be thought of as a way of getting promoted in the company because the company wants to have managers who can control the union. As already mentioned, a Japanese corporation is of vertical character. Competition was made not between capital and labor but rather between other corporations within the same industries.

These competitions among them are keen and they are trying to get more share of the markets. Thus, within a corporation the management and labor have to be cooperative, because if they were on strike, they would lose in competition.

These systems, however, have recently encountered new challenges. Banks' efforts to clear up their non-performing loans, details of which will be stated later, pushed weak borrowers into bankruptcy, resulting in more job losses. Major companies in the IT industry suffered a sudden slowdown in 2001. For example, Matsushita Electric Company made it clear to change the life-time employment mores and reduce 5,000 employees by paying additional payment to the retirement allowance for the earlier retirees after they had recorded the red in the operating profit in the September term of 2001.<sup>33</sup> The attitude or loyalty of the employees toward the corporations also changed. One survey<sup>34</sup> made in January 2001 by *Nihon Keizai Shimbun* showed that 45% of all employees preferred to change their jobs if possible and its rate among the younger employees was nearly 70%. Employers and labor unions floated the idea of introducing job-sharing programs because the unemployment rate, tracked by the Ministry of Public Management, Home Affairs, Posts and Telecommunications topped 5.2% last year for the first time since 1953, when data-keeping began.

### **3.2 Relative lack of outside directors**

Outside directors were not rare in the pre-war Japan. Viscount Shibusawa (1840-1931), the founder of the Dai-Ichi Kokuritsu Ginko (predecessor of the Dai-Ichi Bank) and one of the founders of Shoho Koshujo (now Hitotsubashi University) was an excellent example.<sup>35</sup> But this tradition had been lost during the war.

The majority of directors in a typical Japanese corporation are current or former employees of the company. One survey<sup>36</sup> of nearly 2,000 large Japanese firms conducted in 1990 found that roughly 91% were company men. Employees of larger corporations traditionally spend their entire career with the company, rising through the ranks to management positions primarily according to the lifetime employment mores and the



seniority system. More talented individuals who are well-liked by the president (details of which will be mentioned later) will be appointed to directorships, while they often retain day-to-day responsibilities for running the company as mentioned in the previous chapter.

So though many directors in Japan come from parent companies or affiliated banks, there is no denying that, in comparison with America, a great number of directors are promoted from within. Independent shareholders - no matter how large a stake they have in the company - are rarely found on the board of directors.

## **Chapter 4**

### **The Authority, the Privilege and Career of Management**

#### **4.1 The ground on which managerial authority relies**

As mentioned already, managers are neither the representatives of shareholders nor the representatives of workers. It is managerial control based on corporate shareholders. It is not simply “ownership control” but control by natural persons due to ownership of corporations. Originally a manager was a company’s representative and served as an agency. This role started when companies gained status as corporations. With corporations, shareholders put up the funds to establish a company. And yet, the company owns the company’s assets.

One attempt to explain this arrangement has been advanced by Professor Okumura. “If the company accumulates a part of profits within it as a reserve fund, the owners of the assets are not shareholders but the company itself.”<sup>37</sup> Thus the notion has gone from the notion that “everything which belongs to the company belongs to the shareholders” to the notion that “the company stands on its own.” With the company owning company shares, the idea of the ownership by the company itself becomes clearer. In the case of a one-way ownership by a company of shares in another company, one can say that the assets of one company are owned by big shareholders of that company. But Professor Okumura explains further: in the

case of mutual ownerships of shares of these companies, it is impossible to determine the ultimate owner of the assets of these companies. If a corporation buys shares in another corporation, the fictitious person theory must search for natural persons as the shareholders of the company. This kind of traceability of ownership to a natural person is not obtained in the case of mutual ownership of shares, as it is not so in Japan.<sup>38</sup> Control is not arisen from the ownership by natural persons but is exercised by managers on the basis of ownership by legal persons. This is a pivotal point.

#### **4.2 Who selects management?**

Managers in most companies in Japan start as employees under the lifetime employment mores and seniority system already mentioned. They are given on-the-job training. They climb the ladder one by one within banks or their client-corporations. Finally they approach the stage where they are either selected as directors or auditors or sent to their affiliated companies. According to the Commercial Law, directors and auditors are appointed at the general shareholders' meeting. But the meeting is done mostly in accordance with letters of proxy passed among the various corporate shareholders, and the candidates favored by the company are the ones who gain the positions. The shareholders' meeting is a ceremony for candidates that the company has pre-selected for the various positions.

Accordingly, the person who selects the members of the board or the auditors is the president and this nomination is automatically approved at the general meeting of shareholders. It is very natural that the president does not recommend those who do not trust him as the members of the board but select only those who support him as the president. In effect, the president elects himself. Frankly speaking, those who curry favor with the president tend to be selected as a candidate for a director or an auditor. Apple polishers will be in a better position to be selected. It often happens that the president will be chairman, honorary chairman and counselor successively and clings to his bank or company until his death as in the case of Kaoru Inoue, a *Tenno* at the DKB, details of which will be stated later.

Then the president seems to be omnipotent but the important point is that with worsening corporate performance, the president could be forced to quit by the main bank or by a large shareholders. It is true that large corporations that have cross-shareholdings in each other reach mutual understandings on performance and have a system of mutual trust and control.

#### **4.3 Who becomes manager?**

Most of the directors of a given company in Japan are recruited from the ranks of that company's employees who climbed up the ladder one by one under the lifetime employment mores and the seniority system already mentioned. After World War<sup>39</sup>, the initial salary is same irrespective of universities they are graduating from. The top management positions, however, are not open to all universities graduates but limited a few prestigious universities. There are usually *Gakubatsu* (school cliques) in each large bank or company. For example, the top management of the Dai-Ichi Bank, the oldest commercial bank in Japan, consisted of mostly graduates of the University of Tokyo, law or economics department and a few graduates of Hitotsubashi University, economics or commerce department.

Dramatic changes happened in both the business and education world after World War<sup>?</sup>. As has been already mentioned, the *Zaibatsu* were dissolved. The education system also changed. The GHQ abolished the system under which imperial universities had been treated differently financially from ordinary state universities. Under the new regulation imperial universities were transferred into ordinary state universities. As military academies had all been closed, universities were the only means of climbing the social ladder in the secular world, so that the rat race for obtaining a place in a state university was intense in post-war Japan because several state universities are old in tradition and prestigious, and yet their tuitions are comparatively cheap with those of private universities. Those who had been unsuccessful in the race were obliged to enter private universities. In fact some such as Keio and Waseda Universities are considered better than some state universities.

Professor Michio Morishima of London School of Economics classifies the universities in contemporary Japan to show which university graduates are most likely to become the top management among the Six Enterprise Groups. He divides universities into the following categories : (1) the University of Tokyo, (2) the University of Kyoto, (3) Hitotsubashi-Tokyo Institute of Technology, (4) major state Universities, (5) other national and municipal universities, (6) Keio and Waseda Universities, and (7) other private universities. (1) and (2) are ex-imperial universities in Tokyo and Kyoto respectively. In (3) Hitotsubashi is the former Tokyo University of Commerce now specializing in economics and other social sciences, while TIT (Tokyo Institute of Technology) is the former college of technology located in Tokyo. Category (4) includes five former imperial universities (Tohoku, Kyushu, Hokkaido, Osaka and Nagoya) and Kobe, this last one being a comprehensive university, established after World War? on the basis of Kobe Commercial High School with other institutions. The universities in category (5) are influential in their respective localities but have not yet established a nation wide reputation. Among private universities most eminent are Keio and Waseda listed in (6): in terms of numbers of students, the latter is much larger, and although Waseda is more powerful in political world and journalism, it is far less influential than Keio as far as the business world is concerned because traditionally, graduates of Waseda tend to go into the world of journalism rather than the business world. Category (7) includes giant private universities such as Nippon, Kinki and Fukuoka, as well as more moderate universities in size such as Meiji, Rikkyo and Doshisha, etc. with some historical reputations. He pointed out educational backgrounds of presidents and chairman of the Six Enterprise Groups in 1992<sup>40</sup>, which is self-evident (Table 3).

The cross-shareholding arrangement has been stable over a long period. One of factors that determine *Shafu* (the color of character) of a bank or a company would be the composition of the universities from which its chairman, its president and executives have graduated. Needless to say, relations developed by having attended the same prestigious

university contribute to the smooth, effective, and informal exchange of information. This factor supports mutual confidence based upon the cross-shareholding arrangement between city banks and other companies that belonged to each group.

## **Chapter 5**

### **Irresponsibility of the Top Management**

#### **5.1 Irresponsibility among the Japanese management**

Irresponsibility among the Japanese management is deeply rooted in Japanese culture and history. The title *Tenno* (Emperor) was first used by Japanese rulers in the 6<sup>th</sup> or 7<sup>th</sup> century and has been used by all subsequent Japanese sovereigns. The Emperor has almost always been regarded as the titular head of the national government. Yet, the most characteristic feature of the office through most of Japanese history has been the tendency to emphasize the Emperor's role as chief priest in *Shinto* (the indigenous Japanese religion) and to delegate most of the effective powers of government to others.

*Kinnoka* (imperial loyalists) stressed the centrality of the imperial house within the Japanese polity in the mid-19<sup>th</sup> century, when Japan encountered with Western pressure to open Japan to foreign trade and diplomacy. This upsurge which was called *Sonno Joi* (revere the Emperor, expel the Barbarians) proved a key factor in the toppling of the Tokugawa Shogunate and the initiation of the Meiji Restoration of 1868. With the promulgation of the constitution of the Empire of Japan on February 11, 1889, the Emperor became a constitutional monarch in a centralized and unitary state that was to exercise greater political power than any previous form of government in Japan's history.

According to the constitution, the Emperor was "sacred and inviolable", and sovereignty rested with him as the head of the Japanese Empire. From the very start of the Asia-Pacific War, Emperor Hirohito had been positive and aggressive. It is very clear that

Emperor Hirohito was responsible for World War<sup>41</sup>, because he declared the War in his name and many Japanese had been drafted and invaded China and Southeast Asian Countries.

After the surrender to the Allied Powers on August 15, 1945, the government of Australia and the USSR tried to accuse Hirohito as a war criminal. The United States, however, had decided not to accuse Hirohito as a war criminal and wanted to make use of Hirohito in controlling Japan and make Japan the ally in the cold war against the USSR. Hirohito and his five associates prepared the documents to protect him from the accusations in collaboration with the SCAP.<sup>42</sup> As a result of their efforts, Hirohito's name was not included among war criminals. On December 16, 1945, Fumimaro Konoe (former Prime Minister, three times) committed suicide before being arrested.<sup>43</sup> Hirohito made a statement in the New Year's rescript of January 1, 1946 in which Hirohito explicitly denied his own divinity upon the request of General MacArthur. He became the symbol of the state and the unity of the people under the new constitution promulgated on November 3, 1946. Hirohito did not acknowledge publicly his own moral, political accountability for the war fought in his name.

Seven Japanese including one civilian were found guilty and sentenced to death by hanging on December 23 (Hirohito's son, Akihito's birthday), 1948. On returning to Tokyo from his first visit to the United States, Hirohito was interviewed on television on October 31, 1975. A Japanese newsman asked an important question: "Does your Majesty feel responsibility for the war itself, including the opening of hostility? Also, what does Your Majesty think about so-called war responsibility?" Hirohito's face stiffened a little, and he answered: "I cannot answer that kind of question because I have not thoroughly studied the literature in this field, and so do not really appreciate the nuances of your words."<sup>44</sup> Hirohito's pretense of ignorance, as if he had been an innocent bystander to the event of his reign, angered professional historians.

The fact that Emperor Hirohito did not admit the crime and made no imperial

repentance until his death on January 7, 1989 and the fact that those second in command were made responsible seems to have pervaded deeply into the consciousness of the Japanese. There is an Emperor in each bank and each company. No one within dares to be critical about him.

In Japan individualism has not developed enough and the Japanese are thinking highly of the groups such as the family and the company to which they belong. Max Weber in his ‘Politics as a Vocation,’ stated that all ethically oriented conduct may be guided by one of two fundamentally different and irreconcilably opposed maxims: conduct can be oriented to an ‘ethic of ultimate ends’ or to an ‘ethic of responsibility’ and points out that ‘there is an abysmal contrast between conduct that follows the maxim of an ethic of ultimate ends – that is, in religious terms, ‘The Christian does rightly and leaves the results with the Lord’ – and conduct that follows the maxim of an ethic of responsibility, in which case one has to give an account of the foreseeable results of one’s action.’<sup>45</sup>

One’s own responsibility comes from the notion of individualism and one’s responsibility toward the society comes from the notion of functions of work. To our great regret, the majority of the Japanese management influenced by the mental climate just mentioned above has neither the notion of individualism nor the notion of functions of work. Accordingly, irresponsible management arises here. Thus there must be some institutional measures to check this trend. To our regret, however, there have not been powerful institutional measures to check except derivative lawsuit recently introduced after the Structural Impediment Initiative talks in 1989-90.

## **5.2 Lack of institutional measures to pursue responsibility of managers**

### **Weak outside directors on the board**

Since October 1992, large firms (those with capital of at least ¥500 million or total liabilities of ¥20 billion) have been required to appoint a three-member audit committee,

including one outside auditor, defined as a person who has not been a director, manager, or employee of the company or one of its subsidiaries for five years prior to his or her appointment. The terms of auditors were also lengthened from two years to three. While there is currently no legal requirement for Japanese corporations to have a minimum number of outside directors, a growing number of companies are increasing the number of outside directors. According to the results of a survey conducted by the *Nihon Keizai Shimbun*<sup>46</sup>, Of the respondents, 42.3% have appointed outside directors, while 10.5% are considering nominating such directors in or after the next fiscal year. However, 48.1% of these companies have only one outside director and 34% have two. This is very much different from the system of corporate governance in the U.S. where outside directors account for a majority of the board.

### **Access to corporate information**

Under the Commercial Code, the Securities and Exchange Law, and other statutes, Japanese corporations are requested to regularly and publicly disclose basic financial information, including the company balance sheet and profit and loss statement. These rules have been less burdensome, and less revealing of actual corporate performance, than those of the United States. In particular, disclosure of segmented information of sales and earnings and disclosure of related-party transactions have been limited. But recent annual reports by leading Japanese companies have begun to show the information above mentioned shown by the annual report of Teijin Ltd. that won the best prize among the 53 listed companies on the 4<sup>th</sup> Nikkei Annual Report Awards (*Nihon Keizai Shimbun*, February 5, 2002). Under revisions to the Commercial Code implemented in October 1993, the stock ownership threshold enabling a shareholder to have unrestricted access to the company books was lowered from 10% to 3%. Yet this still excludes most individual shareholders.

### **Derivative lawsuits**

Under revisions to the Commercial Code implemented in October 1993, the cost of



filing derivative lawsuits were substantially reduced through a lowering of the stamp duty to a uniform ¥8,200 and introduction of a requirement that the company pay most legal fees if the shareholders win the suit. Prior to 1993 the Ministry of Justice estimates<sup>47</sup> that an average of about ten new derivative lawsuits were filed annually. For calendar year 1993, the Ministry puts the figure at 30, of which 23 were filed in the last quarter of year. Judging from the sharp increase in the number of derivative lawsuits since October 1993, the amendments in this area appear to have already had an impact on shareholders' exercise of their rights.

An annual survey<sup>48</sup> by Nissei Kiso Kenkyujo shows that cross-shareholdings among six enterprise groups which had accounted for 12.10% from 1987 to 7.47% in 2000 (Unit: amounts of the value of stock). Within each group, Mitsubishi group of firms that belong to *Kinyokai*, the ratio from 14.79% to 11.27%, Sumitomo group of firms (*Hakusuikai*), from 13.36% to 8.87%, DKB group of firms (*Sankinkai*), from 9.14% to 6.24%, Mitsui group of firms (*Nimokukai*), from 10.16% to 5.09%, Fuji group of firms (*Fuyokai*), from 11.16% to 4.60% and Sanwa group of firms (*Sansuikai*) from 9.35% to 4.90% respectively (Unit: amounts of the value of stock). There is certainly a declining trend. Furthermore, since Japanese banks have been requested to restrict bank shareholdings to the level which is equal to their Tier one capital by September, 2004. Consequently, unwinding of cross-shareholdings will be accelerated further. But cross-shareholdings will remain. According to one survey,<sup>49</sup> only 2.3% of the subjects answered that they wanted to dissolve cross-shareholdings and 40.9% of the subjects answered that their object of cross-shareholdings was the stability of their stocks. This is the cross-shareholding arrangement characteristic of Japan and is a defect of Japanese style capitalism.

### **5.3 Cross-shareholding in theory**

As early as 1961, Professor Kenichiro Osumi claimed the fact that cross-shareholdings were against the principle of the Joint-stock Company.<sup>50</sup> The ownership of shares in a company by another company renders possible what is known as *Shoken daii* (securities

subrogation). Take the following: there is a company A with a capital of one hundred million yen. If we also suppose that company B owns 51% of the equity capital of company A and further suppose that company C owns 51% of the equity of company B, the majority shareholder of the equity shares of company C can, by virtue of this fact, control both company A and company B. The rights as shareholders of those who own shares in company A and B are thus impaired. Through the owning of the shares of a company by another company, the rights of the shareholders who were the original investors in the company are invaded. This is a pivotal point, but this view has not been given serious considerations. Professor Osumi notes that when he wrote his paper he had no intention of proposing the revision of the Commercial Code because the ratio of cross-shareholding among the total shares issued was considered to be relatively low. But as we already mentioned, after World War? the cross-shareholding arrangement among the big six enterprise groups has begun and enhanced, especially after 1970 (Table 2). This is the situation of which Professor Osumi was afraid. In fact, the Commercial Code Article 241.3 amended by Law No. 74 on June 9, 1981 stipulates:

In the case where a company, a parental company and affiliated company, or an affiliated company is in possession of the shares exceeding one-fourth of the whole number of the issued shares of another Kabushiki- Kaisha, or the Units of contribution exceeding one-fourth of the capital of another private company, the said Kabushiki- Kaisha or the said private company does not have the voting right in respect of the shares of the company of or the parental company thus in possession.

But the case of the possession of the share exceeding one -fourth of the whole number of the issued shares of another Kabushiki-Kaisha is rare, so in effect this law has no force.

Accordingly, the rationale of allowing corporations to have voting rights in other corporations of which they own shares should be questioned. Professor F. A. Hayek states in his *The Corporation in a Democratic Society: In Whose Interest Ought It To and Will It Be Run?*, ‘I

have never quite understood the rationale or justification of allowing corporations to have voting rights in other corporations of which they own shares.”<sup>51</sup> In fact, he notes, “This was never deliberately decided upon in full awareness of all its applications, but came about simply as a result of the conception that, if legal personality was conferred upon the corporation, it was natural to confer upon it all powers which natural persons possessed.”<sup>52</sup> According to him:

a group which directly owns assets amount only to a small fraction of those of the corporation, may, through a pyramiding of holdings, acquire control of assets amounting to a multiple of what they own themselves. By owning a controlling interest in a corporation which owns a controlling interest in another corporation and so on, a comparatively small amount owned by a person or group may control a very much bigger aggregation of capital. --- such stock so long as it [stock] is owned by another corporation, should cease to confer a right to vote.<sup>53</sup>

It seems to me that the view expressed by F. A. Hayek is adequate and this should apply to the present situation of the cross-shareholding arrangement. To our great regret, almost all Japanese scholars except Professor Hiroshi Okumura<sup>54</sup> pay no attention to this. On the contrary, the government revised the Anti-Monopoly Law of 1947 and the ban was lifted in 1997 to make Japanese companies more competitive globally. Daiei Inc. became the first firm to set up a holding company. Recently, large city banks that had been in trouble from the burst of the bubble created companies such as Mizuho Holdings and UFJ to merge beyond the *Keiretsu*. Such being the case, it is only *Sokaiya* (a kind of racketeers) who scare the corporation by revealing information that is unwelcome and dangerous to the management of the corporation.

#### **5.4 *Sokaiya* and the DKB**

*Sokaiya* means literally “shareholders’ meeting men” but the *Sokaiya* gangs have been described in English as “financial racketeers,” “general meeting mongers,” and “extortionists.” David Kaplan and Alec Dubro explain about their activities by saying:

Typically, the groups operate by buying several shares of a company's stock, digging up scandalous information, and then demanding hush money. They ferret out embarrassing facts about the company's top management : high-ranking officials who cheat on their income tax, ignore safety rules in their plants, or keep mistresses. If the corporation refuses to pay up, at its next general meeting the *Sokaiya* will appear armed with these unpleasant revelations and loudly berate the company management. The executives, highly concerned over losing face before their employees and the public, have traditionally anted up.<sup>55</sup>

Yoshio Kodama, a powerful behind-the-scenes manipulator is said to have systematically advanced into *Sokaiya* circle after 1965 and had remained the leading boss of the *Sokaiya* world until his death in 1984. The *Sokaiya* is less popular than *Yakuza*. His victims are the large and respected corporations. The emergence of these extortionists was possible because of the gap between the formal reality and the substantial reality in the business world. Since Japanese corporations officially have shareholders, shareholders' meetings are necessary so as not to disrupt this formal reality. In actual reality, as already mentioned, the joint-stock companies which belong to big six enterprise groups hold shares of other companies within the groups and have never had any intention of giving shareholders outside the directorates of their own corporate groups a voice of any kind. At their peak in 1981, a police survey revealed 6,800 *Sokaiya* in 500 separate groups extorting as much as \$400 million annually.<sup>56</sup> At the end of 1996, a police survey showed there were 35 groups of *Sokaiya*, amounting to about 1,000 including operators.<sup>57</sup>

As mentioned already, the president of a large Japanese bank and a company lord it over like an emperor, so many large firms created a specialized staff within their general affairs department for *Sokaiya* affairs and almost always ended by paying up. If they failed to pay enough, presidents were grilled for hours at their annual stockholders' meetings. If adequately paid, however, they would follow the unwritten rule of *iginashi* (no objections) at

these ritual meetings. A 1982 amendment to the Commercial Code made *Sokaiya* practices illegal in theory, but this was no consolation for the majority of victims. This parasitic phenomenon is not without benefit because the *Sokaiya* refrain from exploiting the more vulnerable segments of society, and the corporations try to reduce the amount of dirt that the *Sokaiya* dig up by keeping their practices more honest.

In the case of the Dai-Ichi Bank, Kaoru Inoue (1906-93), chairman was against the plan by Juzaburo Hasegawa (1908-85), president, a son of Eiichi Shibusawa, the founder of the bank, to merge with Mitsubishi Bank. Inoue led the movements against the merger by himself by making use of Rikiya Kijima who was a powerful *Sokaiya* and close with Yoshio Kodama, immediately after *Yomiuri Shimbun* had reported this news on January 1, 1969.<sup>58</sup> Inoue often mentioned that he was for the merger in general. He said, however, that he was against this merger, because Mitsubishi Bank (capital : 36 billion yen, deposits ranking: third) will absorb the smaller Dai-Ichi Bank (capital : 24 billion yen, deposits ranking : sixth). He should not have utilized Kijima's power. This left Inoue obligated to Kijima and later almost brought the DKB into collapse. Chairman Tetsuo Fujimori (1919- ), (University of Tohoku graduate) selected Kuniji Miyazaki (1930-97), (University of Kyushu graduate) instead of Tatsuo Aoki (1928- ), (University of Tokyo graduate) who had been considered to succeed Fujimori. Fujimori explained that Miyazaki was suitable for the merged bank, the DKB. As already mentioned, the top management of the Dai-Ichi Bank consisted of graduates of the University of Tokyo or Hitotsubashi University. Miyazaki and Fujimori would have not been selected as a president and a chairman without the merger with the Nippon Kangyo Bank in 1971. Fujimori thought too much of *Wa* (harmony) and he did not consider other factors necessary for the top management. Konosuke Matsushita, a leading capitalist in Japan once remarked "In selecting the top management in a first-rate company, I believe we should prioritize a man of higher ethic."<sup>59</sup> It was true that Miyazaki was well liked by almost everybody. Miyazaki entered the Osaka branch in 1952 and became a deputy-general manager of Kobe branch,

then the secretary to “Emperor” Inoue. This position catapulted him to presidency. Miyazaki became acquainted with Kijima while he was the secretary.

After Kijima died in 1993, Ryuichi Koike (1943- ), a *Sokaiya*, a disciple of Kijima asked the DKB to lend him money. This was the chance for the DKB to reject the loan. The DKB, however, lent him money without enough collateral. No one was against this loan. The total amount to 46 billion yen which is unbelievable. Miyazaki committed suicide on June 29, 1997 just before being arrested. Shin Sadaka, a social critic who read “Why did the chairman commit suicide?” commented frankly that “Miyazaki’s selflessness was conspicuous. It was a prerequisite for Miyazaki to kill his ego in order to climb up the ladder to presidency. Consequently, he has lost himself.”<sup>60</sup> In fact, Miyazaki was the man second in command.

The founder of the Dai-Ichi Bank, the oldest commercial bank in Japan, was Eiichi Shibusawa who had advocated “the Rongu (the Analects of Confucius) and an abacus which means that Japanese style capitalism should go with the Analects of Confucius.”<sup>61</sup> Inoue himself, however, made use of anti-social force positively and Miyazaki and others in the management made enormous amounts of anti-social loans to the *Sokaiya*. This April the name of the Dai-Ichi Kangyo Bank disappeared because of merging with the Fuji and the Industrial Bank of Japan into Mizuho Financial Group. On April 1, the system errors resulted in 2.5 million cases of delays of withdrawal and cash transfers.<sup>62</sup> The troubles lasted until early May. On June 25, the shareholders’ meeting was held and 1,790 shareholders attended, accusing the malfunctions of the system and the irresponsible attitude of the top management. The meeting was closed unsatisfactorily for the shareholders after one hour fifty six minutes because Terunobu Maeda, President, Mizuho Holding did not express his resignation and there were some shareholders still wishing to question but rejected by “Iginashi (no objections)” voiced by those employees who sat in the front rows of the hall in the Tokyo International Forum.<sup>63</sup> Employees who are shareholders played the role of *Sokaiya*.

## Conclusion

The cross-shareholding arrangement between main banks and their customers was created after the dissolution of the *Zaibatsu*. This arrangement developed further with the liberalization of the capital market in Japan and by issuing common stocks at the current market price. This arrangement together with the lifetime employment mores, seniority system, and cooperative company-wide labor union made Japan the big economy second to US. Without outside criticism, the Japanese management had devoted to increasing investment in equipment and getting a greater share in each market. Main banks and major security firms had been of great help in financing them. If any shareholders had asked them to raise up ROE, the high economic growth of the Japanese economy would have not been realized.

The bubble economy of the 1980's, however, was also the result of the cross-shareholding arrangement because the common stock issuing at the current market price under the prevalence of the cross-shareholding had tended to increase too much. The capital-adequacy requirement for banks doing international business introduced at the Basle Committee on July 15, 1988 was also of help to the Japanese banks to extend loans overseas. After the bubble burst on October 1, 1990, however, the Japanese banks and corporations have been in trouble more than ten years. This is because almost all banks and their clients have been afflicted with "cross-bad shares" holdings.

According to business results released by major banking groups on May 24, the aggregate net losses came to ¥4.1 trillion. The major banking groups wrote off a total of ¥7.8 trillion of bad loans in the last fiscal year, while ¥9.7 trillion worth of loans on their balance sheets turned non-performing in the same period. The major banks still carried a total of about ¥5.9 trillion of bad loans as of the end of March (Table 4). In fact, unwinding of cross-shareholdings happened already. After steady building up their mutual equity holdings between World War? and the end of the 1980s, Japanese corporations began to unwind

some of their cross-shareholdings in the early 1990s. As indicated already, cross-shareholdings among six enterprise groups which had accounted for 12.10% from 1987 to 7.47% (Unit : amounts of the value of stock).

In this respect, on January 29, 2002 the Banks Shareholdings Purchase Corporation<sup>64</sup> was established to purchase banks shareholdings at the current prices of the stock market. This will help because if and when a loss is incurred due to the difference between stock prices bought and stock prices at the time of liquidation, then up to 2 trillion yen in public funds will be spent to make up for it. The government is aiming to restrict bank shareholdings to the level that is equal to their Tier 1 Capital by September 2004. Consequently, major banks are thought to be planning to sell their shareholdings amounting to about 5 trillion yen by March 2003.<sup>65</sup> Moreover, with companies now allowed to buy back their own shares and hold them without a specific purpose,<sup>66</sup> a large number of companies set new ceilings on the practice.<sup>67</sup>

It is difficult and almost impossible to change at once the mental climate in Japan, that is to say, lack of individualism in general and the absence of responsibility among the top in the Japanese management in particular. Hence, it is our pressing need to change the institutional arrangements, the most important one of which is the stable cross-shareholding arrangement should be abolished because the cross-shareholding is against the principle of a joint stock company and make Japanese banks' management dependent on the vicissitudes of the stock market. The above-mentioned recent measures by the government are just of temporary character. Fundamentally, the following measures should be taken so that Japan may avoid the recurrence of the unprecedented boom (the bubble) and the extra-ordinary burst.

First, banks should be prohibited entirely from owning the shares of the corporations. This is because a main bank at the center of each enterprise group holds each other shares of its clients customers, and they exchange their letters of attorney for each of their



shareholders' meetings and consequently neglect the rights of other shareholders who own shares. But the representative of a bank or its customer sometimes does not have a share by himself. This is managerial control based on corporate shareholders.

Furthermore, main bank A is able to own shares of company B up to 5% of B's total outstanding stock (Article 11. Anti-Monopoly Law) and also own shares of company C up to 5% of C's total outstanding stock and so on. As a result, bank A holds enormous amounts of shares of company B, C and so on. And the Japanese banks are allowed to count up to 45% of the unrealized gain on securities and other equities as part of base capital in the Basle Capital-adequacy requirements for banks doing international business. Consequently, Japanese banks' management is dependent on the stock market and it makes Japanese banks' management unstable and shaky.

Second, voting rights of the corporations should not be permitted, because big shareholders exchange their letters of attorney for each of their shareholders' meetings and consequently, neglect the rights of individual shareholders. This view was expressed by F. A. Hayek. By allowing corporations to have voting right in other corporations of which they own shares, F. A. Hayek says :

The corporation thereby becomes, instead of an association of partners with a common interest, an association of groups whose interest may be in strong conflict ; and the possibility appears that a group which directly owns assets amounting only to a small fraction of those of the corporation, may, through a pyramiding of holdings, acquire control of assets amounting to a multiple of what they own themselves. By owning a controlling interest in a corporation which owns a controlling interest in another corporation and so on, a comparatively small amount owned by a person or group may control a very much bigger aggregation of capital. There seems to me to exist no reason why a corporation should not be allowed to own stock of another corporation purely as an investment. But it also seems to me that such stock, so long as it is owned by another corporation, should cease to confer a right to vote.<sup>68</sup>

Third, more adequate disclosure on information of the corporation should be available.

It is a well-known fact that Adam Smith (1723-90), author of *the Wealth of Nations* (1776), was against the establishment of a joint-stock company. But, later John Stuart Mill (1806-73), author of *Principles of Political Economy* (1848), supported the establishment of a joint-stock company. He, however, noted that such laws [relating to the establishment of a joint-stock company] should require from all joint-stock associations with limited responsibilities that the amount of capital on which they profess to carry on business should either be actually paid up or security for it should be given. Such accounts, he argued, should be kept accessible to individuals because it allows one to ascertain at any time the existing state of the company's affairs. Hence, Mill argues, it allows one to learn whether the capital, which is the sole security for many engagements into which they enter, still subsists unimpaired, and also impresses upon one the sense in which the fidelity of these accounts being guarded by sufficient penalties.<sup>69</sup>

From this standpoint, the disclosure by Japanese corporations is not enough. Enhancing transparency of *Keiretsu* relationships through a number of legal amendments to strengthen disclosure requirements were enacted and implemented by April 1991. The Japanese Government also enacted legislation in May 1992 increasing the penalties (up to one year in jail or a ¥1 million fine) for inadequate or fraudulent disclosure. But, for example, the disclosure (126 pages) on September 17, 1997 by the DKB that contains the anti-social loans to Ryuichi Koike, a *Sokaiya* was very unclear.

As a result of unwinding of the cross-shareholdings among banks and their client corporations, individual shareholders and foreign shareholders bought shares and the percentage of shares of publicly traded Japanese companies in the hands of Individuals and foreign investors had swelled to 19.7% and 18.3% respectively as of the end of March 2002.<sup>70</sup> This changing composition of share-ownership has started to alter the scene. Japanese corporations will have to pay more attention to disclosure and investors relations.

The revision of the Commercial Code which will be effective in April 2003, may have begun to pave the way for changes in corporate governance at Japanese corporations.<sup>71</sup>

## Notes

- 1 Charles Hampden-Turner and Fons Trompenaars, *The Seven Cultures of Capitalism*. Value systems for creating wealth in the United States, Britain, Japan, Germany, France, Sweden and Netherlands. London : Judy Piatkus (Publishers) Ltd., 1994, 1.
- 2 Ibid., 32.
- 3 Chie Nakane, *Japanese Society*. Berkeley : University of California Press, 1972, 7, 23-25.
- 4 Heiwa Keizai Keikaku Kaigi, *Kokumin No Dokusen Hakusho Zaikai*(1982). Tokyo : Ochano Mizu Shobo, 1982, 10.
- 5 Mr. Okuda is strongly committed to a job-security-first management policy and remains undaunted when criticized by analysts who view lifetime employment mores as an outdated concept. He is interested in the work-sharing. His pledge to make Toyota the world's top carmaker through continuous reform of management realized. Toyota Motor Corp. posted record group pretax profit topping ¥1 trillion in the business ended March, 2002 (*Nikkei Weekly*, June 17, 2002).
- 6 During the war, Kodama had been operating Kodama Kikan that was a civilian arm of the Japanese Navy. At the end of the war, Kodama Kikan had become a financial giant with a working capital of \$175 million in industrial diamonds and platinum, as well as banknotes (David E. Kaplan & Alec Dubro, *Yakuza : The Explosive Account of Japan's Criminal Underworld*, Tokyo : Addison-Wesley Publishing Company Inc., 1986, 65). "Kodama's raremetal treasures --- were partly confiscated by the American military government during the occupation. The remainder was later donated to the cause of forming the Liberal Democratic Party in 1955" (Glenn Davis and John G. Roberts. *An Occupation without Troops*. Tokyo : Yenbooks, 1996, 111).
- 7 Kaplan & Dubro, 67.
- 8 *Nihon Keizai Shimbun*, May 30, 2002.
- 9 *Nikkei Business*, June 16, 1997. Rather some local papers and a noted monthly magazine *Uwasa no Shinso* (Truth about Rumors) usually report the true.
- 10 The ten families were Mitsui, Iwasaki, Sumitomo, Yasuda, Nomura, Okura, Nakajima Furukawa, Asano and Ayukawa.
- 11 This will be referred to as the Anti-Monopoly Law of 1947.
- 12 "Behind the Japanese Purge-American Military Rivalry," *Newsweek*, January 27, 1947. There was "the feud between General Charles Willoughby of G2 (Intelligence) and Brigadier General Courtney Whitney of GS(Government Section). --- although Whitney seems to have followed SCAP's policy loyally, Willoughby was obsessed with the menace of the Russians. He regarded liberal reforms as an invitation to communism, and he appears to have sabotaged them as often as possible" (Glenn Davis, Ibid., 71).
- 13 ACJ was established under the sponsorship of a group of eminent individuals, most of

whom had long acquaintance with Japan. “Joseph C. Grew, who was ambassador to Japan from 1932 until Pearl Harbor, and who served as under-secretary of State in 1944 and William R. Castle, who was ambassador in Japan and then under-secretary of state in the Hoover Administration have agreed to serve as Honorary chairman of the organization” (*The New York Times*, July 19, 1948).

- 14 Dr. Eleanor M. Hadley states, “The contrast in action between trading companies and financial institutions was striking. That the scale of the disparity in treatment was the product of reversing policy makes it no less incongruous though it does become more understandable” (Eleanor M. Hadley. *Antitrust in Japan*. New Jersey : Princeton University Press, 1970. 165).
- 15 The Teikoku Bank was an amalgamation of the Dai-Ichi Bank, the oldest bank, and the Mitsui Bank during the War. After the War, the Dai-Ichi Bank was separated from the Mitsui Bank. This was due to the desire of former Dai-Ichi employees, not because of an order from SCAP.
- 16 On June 22, 1950, John Foster Dulles, then the chief foreign policy adviser of the Republican Party, having accepted Kern’s [Harry F. Kern, Foreign Affairs Editor, Newsweek] invitation was a dinner guest at Pakenham’s [Compton Pakenham, Newsweek’s Tokyo Bureau chief] home in Tokyo. Accompanying Dulles was Undersecretary of State John M. Allison, a keen supporter of Grew’s right-wing clique and future ambassador to Japan. The other Japanese guests were Yasumasa Matsudaira who had been Grand Master of Ceremonies, Renzo Sawada who was ultra-nationalist diplomat, Takeshi Watanabe, a Finance Ministry official handling liaison with SCAP, and Osamu Kaihara, a key figure in forming the National Police Reserve. The topic discussed was Japan’s role in the Cold War structure of Asia according to Takeshi Watanabe, *Senryoka no Nihon Zaisei Oboegaki* (Memorandum of Japanese Finance under the Occupation). Tokyo : Nihon Keizai, 1966, 290ff. It was only three days later that a shooting incident broke out at the 38<sup>th</sup> parallel on the Korean War (1950-53) (Glenn Davis, *ibid.*, 39-41).
- 17 Glenn Davis, *ibid.*, 54.
- 18 This Securities Holding Union was established on January 12, 1965 to purchase excess shares from the open market and securities companies as well as from troubled securities investments trusts after the 1964-65 Stock Market Crash in Japan.
- 19 Takao Sase, *Financial Institutions and Markets : Issues of Access in US-Japan Relations*. USJP occasional paper 93-08 the Program on US-Japan Relations Harvard University, 5.
- 20 The name of each presidents’ club is *Mitsubishi Kinyo Kai* (Mitsubishi), *Hakusui Kai* (Sumitomo), *Nimoku Kai* (Mitsui), *Fuyo Kai* (Fuji), *Sansui Kai* (Sanwa) and *Sankin Kai* (DKB) respectively. The number of firms which belong to each presidents’ club are 28, 20, 25, 28, 44 and 48 respectively (Toyo Keizai. *Keiretsu Kigyō Soran*. 2000, 42-47).

- 21 Akihiro Okumura, *Nippon No Top Management* (Top Management in Japan) Tokyo : Daiamondo-Sha, 1982, 26-28. In Japan, ‘Top Management’ refers to the directorship only and does not include the audit committee, while in US this term includes both directors and officers.
- 22 Hiroshi Okumura, *ibid.*, 147.
- 23 *The Economic White Paper* (1981), 217.
- 24 “A Capital Cost Disadvantage for Japan?” JP Morgan, 6 April 1992, 19.
- 25 Yamaichi became bankrupt in 1997 and Nikko went under the umbrella of City Corp. NY and changed its name to Nikko Cordial in 2001.
- 26 On July 15, 1988, the Basle Committee released its financial version of the Bank Accord on the international convergence of Capital Measurement and Capital Standards. This accord established a two-tier capital framework. Tier one or “core” capital was confined to shareholders’ equity ; Tier two, or “secondary” capital included loan-loss reserves up to 45% of the unrealized gain on marketable securities and hybrid debt-capital instruments after Japanese monetary authorities negotiated successfully. A minimum risk-adjusted capital adequacy standard of 8% was agreed upon and half of that had to be in the form of Tier one capital.

For the Japanese banks it was not difficult to accept at that time because “the Tokyo Stock Exchange was booming in late 1987, making an increase in bank capital relatively painless, especially in light of the provision regarding valuation of hidden reserves” (Ethan B. Kapstein. *Governing the Global Economy*. Cambridge, Mass. : Harvard University Press, 1996, 116).

However, Japan has been in trouble because of the market’s drastic decline after the bubble burst. Recently, there are two problems : Deferred tax assets and the preferred shares.

- (1) Deferred tax assets Bank of Japan Gov. Masaru Hayami said at a congressional testing in October 2001 that major banks’ capital-adequacy ratios would only be around 7% if calculated using the stricter accounting standards employed in the US. Because deferred tax assets are like tax prepayments for future profits, it is very important for banks to strengthen their earnings powers in order to count tax deferred assets as capital. Under the US rules – which allow only up to 10% of Tier one capital or one year of taxable income as capital base compared with Japan’s rules which limit five years of taxable income multiplied by effective tax (about 40%) – the capital adequacy ratios fall to the 6.8% range, according to calculations made by *Nihon Kinyu Shimbun*, May 28, 2002 (See Table 4).
- (2) The Preferred shares Three of the Big Four hold ¥4.65 trillion in preferred shares, which were issued in return for fund injection from the government in their Tier one capital in March 1999. The Preferred shares were injected on condition that they

would repay the public money, but only Mitsubishi Tokyo group has repaid the public funds so far. Because both drastic reductions in lending to Japanese companies and aggressive stock sales would be fairly difficult, the quickest answer would be a withdrawal from overseas operations (*Nikkei Weekly*, June 2, 2002).

- 27 This expression was coined by Mr. Raisuke Miyawaki, once a spokesman for Prime Minister Yasuhiro Nakasone, because the majority of outstanding bad-loans would not be repayable due to the fact that politicians, bankers and the Yakuza had been entangled with the original loans made by banks. For example, a Director and a General Manager of Sumitomo Bank, Nagoya branch was killed in 1994 after having tried to be paid back the money he lent. Loans outstanding to three industries – real-estate, construction and non-banking financial industry – were about 114 trillion yen at the end of 1990, immediately after the burst of the bubble and most of these loans became non-performing (*Nikkei Kinyu Shimbun*, July 2, 2002).
- 28 *Nijusseiki Nippon No Keizaijin* 48 *Nihon Keizai Shimbun*, November 29, 1999.
- 29 Professor James C. Abegglen and George Stalk, Jr. of the Boston Consulting Group K. K. explain “at this point the general pattern is for management to announce across-the-board cuts in executive compensation. Having made these cuts, management, then and only then, approaches the union to open discussion of possible wage reductions (James C. Abegglen and George Stalk Jr., *Kaisha : The Japanese Corporation*. Tokyo : Charles E. Tuttle Company, 1996, 197).
- 30 These are *shataku* (company housing), monetary gifts from the company on the occasion of marriage, and marriage counseling company operated within the group of firms such as Diamond family- club (Mitsubishi). In an extreme case a company [Kyocera, Kyoto] has a common grave for its employees, similar to the household grave.
- 31 Seymour Martin Lipset, *American Exceptionalism : A Double-Edged Sword*. New York : Norton & Company, 1997, 225.
- 32 *Japanese Working Life Profile* : Labor Statistics 1993-94. Tokyo : Japan Institute of Labor, 1992.
- 33 *Shukan Gendai*, September 15, 2001,52. *Nikkei Kaisha Joho* 2002-1, 756.
- 34 *Nihon Keizai Shimbun*, April 5, 2001.
- 35 Shibusawa was a director of Tokio Marine & Fire Insurance Co. Ltd. [Mitsubishi group company] then a really globally operated company where Kenkichi Kagami (1868-1939), chairman and Hachisaburo Hirao (1866-1945), managing director, both of whom were graduates of Tokyo Higher Commercial School (now Hitotsubashi University). Peter F. Drucker states in his book that “If Iwasaki’s [the founder of Mitsubishi Zaibatsu] entrepreneurship gave Japan the highest rate of monetary capital ever recorded, Shibusawa’s stress on the human energy gave Japan, within thirty years, the highest rates of human capital formation and of literacy ever recorded. --- And where Iwasaki left

- behind a large and highly profitable business concern, Shibusawa's monument is Hitotsubashi, Tokyo's famous economic university" (Peter F. Drucker, *The Age of Discontinuity Guidelines to our Changing Society*. NY : Harper & Row, 1969, 125).
- 36 *Report to Congress on Japanese Capital Markets and Global Regulation and Liberalization of Japan's Financial System*. Washington, D. C. : The Department of the Treasury, August, 1995, 64.
- 37 Hiroshi Okumura, *ibid.*, 170.
- 38 Hiroshi Okumura, *ibid.*, 171.
- 39 The initial monthly pays for newly university graduates in the case of Mizuho Holdings is ¥174,000. *Nikkei Kaisha Joho* 2002-?, Tokyo : Nihon Keizai Shimbun-sha, 2002, 1148.
- 40 Michio Morishima, "Introduction : Banking and Industry in Japan" to Hiroshi Okumura, trans. Douglas Anthony and Naomi Brown, *Corporate Capitalism in Japan*. Chippenham, Wiltshire : Antony Rowe Ltd., 2000, ? (xl-xlix).
- 41 Kiyoshi Inoue, *Tenno no Senso Sekinin* (Hirohito's responsibility of the War). Tokyo : Iwanami Shoten, 1991, 169-172. Nagasaki Shicho eno 7,300 tsu no tegami (7,300 letters addressed to the Mayor of City of Nagasaki [who said on December 7, 1988 that Hirohito was responsible for the War]). Tokyo : Komichi Shobo, 1990. During December 8, 1988 and March 6, 1989, Mr. Motojima, the Mayor received 7,323 messages, among which 6,942 (94.8%) supported his view and 381 (5.2%) were against his view.
- 42 Makoto Higashino, *Showa Tenno no Futatsu no Dokuhakuroku* (Emperor Showa's two monologues). Tokyo : NHK Shuppan, 1998, 102-126.
- 43 Konoe left notes saying that Hirohito was rather positive toward the War. *Konoe Notes* 11, *Asahi-shimbun*, December 30, 1945.
- 44 Higashino, *ibid.*, 193.
- 45 H. H. Gerth and C. Wright Mills, trans. ed., *From Max Weber Essays in Sociology*. NY : Oxford University Press, 1958, 120.
- 46 *Nihon Keizai Shimbun*, June 20, 2002. A survey was conducted during June 7 and June 14, concerning major 309 firms and 254 firms answered.
- 47 *Report to Congress on Japanese Capital Markets and Global Finance Regulation and Liberalization of Japan's Financial System*. Washington, D. C. : Department of the Treasury, August, 1995, 72.
- 48 Nissei Kiso Kenkyujo. *Kabushikimochiai jokyō chosa 2000-nendo ban* (Survey on the cross-shareholding 2000 edition). September 21, 2001, 9.
- 49 Kosei Torihiki Inkai. *Daikibo Jigyō Gaisha to Gruppu Keisei ni kansuru Jittai Hokokusho* (The report on large-sized non-financial firms and group management) by Fair Trade Commission, May 18, 2001. quoted in the Nissei Kiso Kenkyujo. *Kabushiki Mochiai Kaisho no Jittai*. October, 2001, 20.
- 50 Kenichiro Osumi, *Kabushiki no Sogo Hoyu (Mochiai) ni tsuite* (Reciprocal holding of



- shares between two corporations), *Hogaku Ronso*, vol. 68 5.6, 1961, 187-205.
- 51 F. A. Hayek, *Studies in Philosophy, Politics and Economics*, London : Rutledge & Kegan Paul, 1967, 309.
  - 52 F. A. Hayek, *ibid.*, 309.
  - 53 F. A. Hayek, *ibid.*, 309.
  - 54 Hiroshi Okumura, *Kabunushi Sokai*, Tokyo : Iwanami-Shoten, 1998, 180-184.
  - 55 David E. Kaplan & Alec Dubro, *Yakuza : The Explosive Account of Japan's Criminal Underworld*. Tokyo : Addison-Wesley Publishing Company, 1986, 170.
  - 56 *Ibid.*, 172.
  - 57 Kazuyoshi Hanada and Hiromichi Momose, *Sokaiya kara mita Nihon no Kigyo* (The Japanese company viewed from *Sokaiya*). Tokyo : Kobunsha, 1998, 23.
  - 58 Chairman Tetsuo Fujimori, who was selected later by Inoue, said, "The merger plan was crushed by Inoue's efforts to have made use of Kijima and later the birth of the Dai-Ichi Kangyo Bank (DKB)." YOMIURI SHIMBUNSHAKAIBU. *Kaicho wa Naze Jisatsu shitaka* (Why did the chairman commit suicide?). Tokyo : Shin-cho sha, 1998, 36.
  - 59 Akihiro Okumura, *ibid.*, 36.
  - 60 YOMIURI SHIMBUN SHAKAIBU, *ibid.*, 329.
  - 61 Hideo Shibusawa, *Shibusawa Eiichi*, Tokyo : Jijitsushin-sha, 1965, 144-149.
  - 62 Malfunctions occurred chiefly because three banks insisted strongly on using their own main computer system, that is to say, DKB – Fujitsu, Fuji – IBM and IBJ – Hitachi and they could not succeed in uniting them (*Tokyo Shimbun*, June 20, 2002).
  - 63 *Tokyo Shimbun*, June 26, 2002.  
On June 18 the Financial Services Agency (FSA) concluded that the bank's management failed to grasp the scope of the preparatory work necessary to realize such a major systems integration, and this led to slow decision-making. Following the FSA's actions, Mizuho announced measures aimed at preventing the recurrence of computer malfunctions as well as punitive actions to be taken against 117 directors. But Mizuho Holdings President, Terunobu Maeda did not resign, though he will take a 50% monthly pay cut for six months. *Nihon Keizai Shimbun*, June 20, 2002.
  - 64 *Nikkei Kinyu Shimbun*, February 4, 2002.
  - 65 *Mochiai Kaisho Kasoku* (Accelerating of unwinding the cross-shareholding) *Nikkei Kinyu Shimbun*, June 27, 2002.
  - 66 The Government lifted a ban on holding their own shares as treasury stocks under the revised Commercial Code last October.
  - 67 According to data compiled by NRI, as many as 1,340 companies have announced buyback plans from April to June 13, with upper purchase limits totaling ¥9.3552 trillion. If and when a half of this amount would have realized, this practice could absorb unwinding of cross-shareholdings (my translation) *NRI Global Investment Weekly*, June

25, 2002, 8.

**68** F. A. Hayek, *ibid.*, 309.

**69** John Stuart Mill, *Collected Works of John Stuart Mill Volume? , Principles of Political Economy with some of their applications to Social Philosophy*. Toronto : University of Toronto Press, 1965, Book? ,Chapter ix, 6,898.

**70** *The Nikkei Weekly*, July 1, 2002.

**71** The new code requires companies introducing the new system to set up three committees, which are composed mainly of outside directors charged with auditing, appointing directors and deciding executive directors' compensation. According to the Nikkei survey (*Nihon KeizaiShimbun*, June 20, 2002), however, many companies are cautious about introducing the new system. Of the respondents (254 firms) only 0.8% answered introducing it in the next fiscal year and 66.7% answered "not yet decided" and 12.3% answered "no intention to introduce it." What is important, is not whether companies choose to stick with conventional Japanese Corporate Governance or adopt US approach, but whether or not there are ways to better monitor corporate governance.