Succession rules for CEO in Japanese firms: Institutions and Agency

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Abstract

The succession of the Chief Executive Officer (CEO) has attracted growing attention from social scientists and management researchers. CEO succession provides a context in which individual decisions and agency, stakeholder interests and conflict, and the organizational needs for legitimacy and acceptance in the large environment come together. Most of these researches, however, have been conducted in the U.S., where the board of directors has the legal and actual responsibility for appointing and replacing the CEO. CEO succession still remains unexplored terrain in countries such as Japan in which the corporation system differs significantly from the U.S. For example, the board of directors in Japan is composed primarily of executives and non-executive members of the firm and overwhelmingly represents the interests of the employees. Also, a Japanese CEO enjoys considerable autonomy from stakeholder influence, where he is usually the sole authority in deciding the timing of his own retirement as well as his successor. Although main banks provide a limit to CEO power, they tend to refrain from intervening in CEO succession until the firm is in a dire condition.

In this thesis, I apply the model of CEO succession based on U.S. firms to the study of Japanese CEO succession. I address three questions: 1) what are the rules in the *shacho* (Japanese equivalent of CEO) succession process; 2) how are the rules framed and what does this linguistic framing suggest about *shacho* succession in Japan; and 3) how do the rules affect the various succession processes, such as the timing of change as well as the relationship between performance and rules. The theoretical framework I use is based on the institutional theory of action by March (1994) and March & Olsen (1989), and I rely on both qualitative and quantitative methods to answer the research questions.

I use a qualitative study to identify succession rules in large Japanese firms. Through CEO succession stories from popular business journals, I identify the two guiding spirits of CEO succession in Japan: the spirit of rejuvenation, in which the CEO

succession's main function is to bring younger executives to the leadership position, and the principle of *hanamichi* (translated as 'flower way'), in which the CEO succession celebrates good performance by the exiting leader. In addition, tenure rules, such as four-year rules, six-year rules, and sometimes ten-year rules, are widely used for guiding the CEO succession process in Japan.

I then turn to a large sample longitudinal study to test the implication of one of the succession rules—the tenure rules—identified in the qualitative analysis. I capture the various tenure rules by suggesting the concept of tenure milestone set by the predecessor's tenure. A CEO's life cycle can be divided into three distinctive periods based on tenure milestone—before the milestone, milestone, and over-the milestone—presenting different mandates for the incumbent CEO. Specifically, I hypothesize that (1) CEO succession is more likely during the tenure milestone period, (2) the effect of performance is different across the three periods, and (3) organizational and political factors moderate the tenure milestone effect on CEO change. I test the hypotheses in a sample of the 200 largest industrial companies in Japan over the period 1955-1995 using event history analysis. The empirical results show that the hazard rate is higher during the tenure milestone period and that the negative effect of performance is stronger in the over-the-milestone period than in the other two periods. Finally, organizational and political factors, such as the existence of a large internal talent pool and subunit rivalry resulting from merger, also facilitate CEO change during the tenure milestone period.

The thesis shows that organizational rules are an important addition in understanding the phenomenon of CEO succession.

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I remember a scene from a movie where a preschool-aged boy watches in awe as the sculptor carves a woman out of a mass of stone. The boy asks the artist, "How did you know that the woman was hiding in the stone?" While I was working on my thesis, I thought of the scene quite a lot, because I myself have watched my advisers in awe—in their offices, at a Chinese restaurant in Chicago, in a school lobby in Toronto, at a café in Tokyo, and at all committee meetings—as they taught me that something interesting is hiding in my data and in the topic. As my dissertation reached the final stage, I had have another wonder in them. How did my advisers make 'me' see what they see? Of course they taught me and shaped me. But, to me it is a wonder, because teaching is one thing and learning is another. How did they make me learn? This dissertation would not have been possible without my three wonderful advisers, who taught me what it means to be a scholar and teacher through examples and gave both moral and intellectual support throughout my time at MIT.

First, I would like to thank Prof. D. Eleanor Westney, who kindly agreed to be the chair of my dissertation committee. In some sense, Eleanor changed my academic career and also my life completely, because it was through her course on Japanese business system that I became interested in studying Japanese firms. Her breadth of knowledge and perceptive insights on Japanese society and on organization theories have been an invaluable guidance throughout my dissertation project. She recognized the potential of my study long before I realized it myself. Conversations with her engaged me more and more deeply with my own topic, because she would describe so beautifully what my contributions could be in our field. I am also grateful for her time in far away places such as Toronto and Tokyo, amidst her own busy schedule. I would never forget her help in the final four weeks before my defense. I also thank her for her final heavy-handed editorial help. It was a Midas' touch.

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D. Eleanor Westney, Lotte Bailyn, and Willie Ocasio. They are the co-authors of this dissertation whose names should come before mine. Needless to say, all the remaining errors are mine.

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I dedicate my thesis to our parents.

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Chapter 1. CEO succession as a focus of research

The succession of a Chief Executive Officer (CEO) is a potentially traumatic event for the retiring CEO. Sonnenfeld (1988) has discussed in detail how the heroic self-image of leaders makes it difficult for them to exit. "Heroes believe that they have earned their stature through their deeds and sacrifice. Thus they do not realize until their retirement that their position is, in part, a social creation. The hero's personal identity is so intertwined with his or her role that retirement represents a personal void" (Sonnenfeld, 1988, p.284). Sonnenfeld provides several examples where political heroes—for example, Winston Churchill, Woodrow Wilson, and Franklin Delano Roosevelt—refused to retire, some of them even reneging on their prior commitment to retire upon reaching a certain time or age.

Business leaders, especially CEOs, face a similar set of challenges as they approach retirement. Like political leaders, they face the loss of power and status. They also often face higher economic costs. So, it is not difficult to imagine why many top executives cling to their position, some even to death. Such reluctance is quite common and examples are abundant (Sonnenfeld, 1988; Kets de Vries, 1995).

There are two major ways the problem of reluctant heroes is addressed: the power dynamics among actors, and the establishment of formal rules. In the past, political leaders who tried to hold on to power too long were in danger of invasion from powerful foreign enemies. The analogy for CEOs is the hostile takeover. Second, both political and business leaders face threats to their power from below, as impatient followers form coalitions to replace ailing leaders. Third, powerful forces outside the political elite, such as People Power in the

Philippines, or outside the management system, such as external shareholders, can take action to force out a leader who stays too long.

Such political action takes a toll on the system. Therefore, in order to avoid such struggles, both political systems and corporations develop formal rules to guide succession processes. Societies and organizations also make formal rules that limit the term or tenure of the top leaders. For example, the office of President in the U.S. is limited to 4 years, after which the President may campaign for reelection for a maximum of one term. Most political offices are subject to such specific rules, where the terms and the qualification for being in the office are specified. Similarly, firms may have a retirement age for their top executives. Through these formalized bureaucratic rules, the succession process is routinized and the leadership is institutionalized (Weber, 1978).

Although rules tend to be taken for granted when they have been established, how rules emerge in the first place is never simple or easy. Multiple actors with different interests engage in bitter political struggles in order to set up rules that are beneficial to themselves. Even when rules are taken for granted, the dissatisfied party may engage in various political behaviors to change the rules of the game. The rule process is dynamic and political. Framing the issues in a way that would legitimize the change of rules is quite important in the battle (Hirsch, 1986).

CEO succession has some of the drama and many of the challenges of changes in political leadership, and has attracted growing attention from social scientists and management researchers. Most of this research has been conducted in the U.S., where the board of directors has the legal and actual responsibility for appointing and replacing the CEO. The board of directors represents the shareholders of the corporation, in whose interests they are required to act. The American model of corporate governance has been held up as a model to other business systems around the world.

In the 1980s, Japanese corporations presented an alternative model of corporate governance in which the board of directors is composed primarily of executives and non-executive members of the firm and overwhelmingly represents the interests of the employees (Abegglen and Stalk, 1985; Aoki, 1988; Lazonick 1991). Given this difference in corporate governance, we would expect to see a great difference in the process of CEO succession. However, although Japanese corporate governance has been criticized, especially recently (see for example Nakatani, 1997; Tezuka, 1997), there have been very few empirical studies that looked at the actual process of CEO succession in Japan. What we do know is that there are very few public contests or struggles over CEO succession in Japan. And yet in most Japanese companies, CEOs do not have unusually long tenure. Indeed, the tenure of the *shacho* (which is the Japanese term most usually used to translate CEO, and which means, literally, "the leader of the company") in large industrial firms has become shorter and shorter over the last few decades (Itami, 1995). This shortening of *shacho* tenure in the absence of a strong and independent board and without strong external stakeholder influence suggests that organizational rules may play a bigger role in limiting the power and tenure of the *shacho* in Japan. I argue that the study of succession rules is the first step in understanding the succession process in Japanese firms, and in this dissertation I carry out such a study of succession rules in Japanese large industrial firms.

Why is the operation of succession rules an important venue for research? The rise of the new institutionalism in the study of organizations focused attention on the constraints on individual and collective action imposed by socially constructed rules and the taken-for-granted nature of routines (see the papers collected in Powell and DiMaggio, 1991). This perspective has been criticized for neglecting the role of individual agency (DiMaggio, 1988) and more importantly the role of power and conflict in organizations (Oliver, 1991). CEO succession provides a context in which individual decisions and agency, stakeholder interests and conflict, and the organizational needs for legitimacy and acceptance in the large environment come together. This research context provides us with an opportunity to deepen our understanding of the complex interplay between agency and power on the one hand and social constraint and legitimacy on the other.

This study follows Ocasio (1999)'s lead in analyzing the CEO succession process and the corporate governance issue from the perspective of rules and in applying an institutional perspective at the level of 'action'. Applying the institutional theory of action enunciated by March and Olsen (1989) and March (1994) to the study of CEO succession, Ocasio (1999) argues that rules provide actors with the scripts for action, function as a political truce among multiple actors, and thus provide reliability and accountability in the system. While Ocasio (1999) examined the role of formal and informal rules on the issue of insider vs. outsider succession, I examine the role of tenure rules in the timing of Japanese CEO succession. Moreover, I further elaborate the key proposition of institutionalized action theory—that the rules are attached to identity. The actors analyze the situation and match the rules with identity and situation. By bringing the level of analysis to that of organizational action, we can observe the interplay between power and agency on the one hand and institutional pressure on the other hand.

Specifically, the thesis asks: 1) what are the succession rules in the *shacho* succession process; 2) how are the rules framed and what does this linguistic framing suggest about *shacho* succession in Japan; and 3) how do the rules affect the various succession processes, such as the timing of change as well as the relationship between performance and rules.

In order to answer these questions, I use both qualitative and quantitative methods. Qualitative and quantitative methods complement each other as they provide insights into different aspects of organizational rule processes. In order to answer the first two questions, I undertake a qualitative study in which popular business articles provide the material for developing insights into succession processes, and into what is considered "normal" and what is considered "unusual" or "rule-breaking" in CEO succession. There are several reasons why a qualitative study is more appropriate in answering the two questions. First, organizational rules often vary significantly across firms and may be hard to quantify for a large sample study. For example, some firms may have a 4 year tenure rule, while some may have 6 or even 10. Second, the rule process is dynamic, where rules are frequently broken and reestablished. Thus, some organizational rules are not so evident to outside observers. For example, some firms may have a rule for the *shacho* to retire as a chairman, yet some may choose not to become chairman upon retirement for a variety of reasons. The absence of a rule is quite different from a rule that is broken. A quantitative study is not appropriate for capturing such dynamics. Finally, the change in the rules of the game often accompanies an ideological battle, which is captured only through qualitative study. Linguistic framing affects organizational behavior by providing a script for the participants (Hirsch, 1986). It specifies not only the role for individual actors but also how they should feel about the course of action. The qualitative chapter could be thought of as developing a grounded theory in which the main purpose is to develop the hypotheses rather than to test the hypotheses.

As for the third question, quantitative methods are more appropriate. For one thing, some organizational rules could be institutionalized across organizational fields. Quantitative analysis may be better suited to trace the diffusion process as well as to test larger social, organizational, and political factors that affect the establishment of institutionalized rules. Moreover, there are rules that exist only as rhetoric. A quantitative study also will distinguish the rules that have lesser social impact from those that have stronger impact on the actual behavior of participants. In other words, we would like to know when and how rules affect actual economic and political behavior, in this case, CEO succession.

Getting to the research questions

The biggest challenge in writing a dissertation is not answering the questions, but formulating questions that are both interesting and answerable. In fact, alternative questions were considered in the course of this research, and it may be worth describing the process by which the final questions were arrived at.

The choice of Japanese CEO succession as a topic of research grew out of work with Professor William Ocasio on CEO succession in the U.S. Initially, the work consisted of studying the change in the functional backgrounds of CEOs (Ocasio & Kim, 1999) and the role of institutional shareholding on CEO succession (Kim & Ocasio, 1995). Next, through discussions with

Professor Eleanor Westney, it became clear that the process of CEO succession in Japan was quite different from the U.S. and appeared to be a fruitful domain of research.

The first approach I adopted was grounded on the widely recognized differences between the corporate governance systems in Japan and the U.S. and the strong influence in Japan of the view of the enterprise as a community whose principal stakeholders are the employees rather than the shareholders (Dore, 1973 and 1987; Imai and Komiya, 1994; Whitley, 1992). The first questions generated from this approach were 1) Is the relationship between performance and CEO succession different in Japan vs. the U.S.? 2) How do the differences in corporate governance systems moderate the relationship between performance and CEO succession? 3) What was the role of three external shocks—oil shocks, the rise of the yen, and the end of the bubble economy—in shaping the CEO succession process? The initial exploration of these questions indicated that they were not the right ones to be asking but they did lead to an understanding of what kind of data I needed to collect.

In building a data base on CEO succession in Japan, I quickly discovered that Japanese CEO succession had something quite unique: a routinized pattern of CEO succession, which had been explored quite extensively, although descriptively, by Itami (1995). What was interesting from Itami's study was his conclusion that routinization is a cause for concern, because it symbolizes the lack of charismatic leaders in Japanese business firms. This was curious, because, from a U.S. point of view, the major problem in CEO succession was managerial entrenchment. Japanese firms, however, have apparently overcome this problem, without the independent boards and active takeover markets that were the primary means of controlling managerial entrenchment in the U.S. There were many other reasons beside the routinization of

CEO succession that made Itami worry about Japanese firms—such as the increasing age of top executives in general at the time of their appointment and the inflexibility in the preferred age of the CEO and so on—and someone who had not studied CEO succession in the U.S. could easily agree with his diagnosis that at least one cause of these problems was the routinization of CEO succession But the difference between the Japanese and U.S. patterns naturally led to the next focus of research, "Is routinization actually bad, and what conditions lead to it?"

Initially, I undertook categorical approach. Routinization of CEO change was loosely defined as having implicit or explicit rules about the tenure of a CEO within the company. Criteria were needed to decide which firms had "routinized" CEO tenure. Two criteria were developed: the number of CEO change events in a given period, and the central tendency of CEOs' length of tenure in the given period. First, there should be more than 3 CEO change events in each period. Second, the lengths of tenure should fall between the 25th and 75th percentile of all tenure lengths in the periods of interest. I evaluated these criteria for 200 firms in two time periods, 1955 to 1975 and 1975 to 1995. Using the two criteria, 17 firms in the early period and 73 firms in the following period were categorized as having routinized the CEO change pattern.

Given that not all firms had the routinized CEO change pattern, I furthered asked what were the characteristics of firms that showed routinization. The difference between Itami's findings and mine provided one explanation, having to do with the sample size and the distribution of size of firms. The Itami study looked at 50 mostly large firms, whereas my study looked at 200 firms, including many that were smaller. If the routinization criteria were applied only to the larger firms, Itami's conclusions appeared to be confirmed. This exposure to the data led to the hypotheses that routinization was related to having no dominant owner, the existence of a competitive internal labor market (as indicated by the number of elite university graduates in the board), prior merger experience, and affiliation with the leading *keiretsu* (industry groups in Japan).

Although the initial analysis was quite useful in giving some idea why routinization happened in large Japanese firms, it had many problems. First, the operationalization of routinization was arbitrary. Second, the operationalization of routinization did not allow any observation of the dynamics of the routinization process. Third, the concept did not have any clear link with theory. A new idea was needed.

The new idea came from my advisers who encouraged thinking about the phenomenon in terms of 'rules' rather than in terms of 'routinization'. Actually, it was obvious that the routinization was a result of having multiple rules regarding the timing of CEO's exit, such as retirement age rules and tenure limit rules. However, it seemed that there are too many varieties in 'rules' across firms—there were 4 year rules, 6 year rules and 10 year rules—and it was not clear how to incorporate the diversity in the large sample quantitative study.

This impasse was broken when, under firm guidance by advisers, the level of analysis was changed from firms to succession events. This led to the concept of the tenure milestone, in which a predecessor's tenure works as an informal tenure rule. Through the concept of the tenure milestone, it was possible not only to deal with the diversity in tenure rules but also to elaborate on how tenure rules may shape the actors' expectations in the course of CEO succession.

Changing the focus from routinization to rules also expanded the scope of the study significantly. First, it became possible to link the study to the rich theoretical traditions that emphasized the role of rules in organizational life (Burns and Flam, 1987; March and Olsen, 1989; March 1994; and Ocasio, 1999). On trying to apply these rule theories to Japanese CEO succession, it became clear that there are other important rules, other than tenure rules, that make Japanese CEO succession different from the U.S. For example, rules specify who participates (and who is excluded), who does what, when, where, and how, and in relationship to whom (Burns & Flam, 1987), and it became clear that implicit norms of the Japanese succession process, such as a CEO taking charge of his own retirement, or a CEO retiring as a chairman were important rules even though organizational actors themselves do not refer to them as 'rules'. Thus, the question 'what are the implicit and explicit rules of Japanese CEO succession?' became an important first step that needed to be addressed through qualitative analysis of CEO succession stories published in popular business magazines. The importance of linguistic framing also became evident while accumulating the collection of stories of Japanese CEO succession.

Outline of Chapters

Chapter 2 suggests a model of CEO succession based on the institutional theory of action developed principally by James March (March and Olsen, 1989; March 1994). The institutional theory of action provides the concept of organizational identity and rules to link the political process and the institutional logic that shape the CEO succession process and outcome. I also review some of the prior studies on CEO succession and organizational rules to illustrate the relationships among institutional logic, power dynamics among stakeholders, and organizational identity and rules. As indicated in my discussion of the process of formulating my research questions, the institutionalized action theory is not the theory that guided my study from the beginning. Rather, it is a theory that I 'discovered' in the later stage of my dissertation. Nevertheless, I present it as a theory in this chapter, because I believe it provides the best introduction, as well as the best summary, for the subject of CEO succession both in the U.S. and in Japan.

Chapter 3 reviews the corporate governance system in Japan by exploring the nature of the boards of directors, dominant institutional logic, and four types of dominant stakeholders that shape organizational identity and succession rules in Japanese firms.

Chapter 4 takes on a qualitative study to identify succession rules in large Japanese firms. The chapter identifies succession rules by adopting the journalist's lens on what it takes to make CEO succession processes usual or unusual in the Japanese business world.

Chapter 5 applies a large sample longitudinal study to test the implication of one set of the succession rules—the tenure rules—identified in Chapter 4. The chapter takes the predecessor's tenure as an informal and formal rule that regulates the timing of CEO change in Japanese firms. It tests how tenure rules moderate the relationship between performance and the timing of CEO succession.

Chapter 6 concludes with a discussion on the role of organizational rules on CEO succession. In that section, I also identify further research questions.

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Chapter 2. Power dynamics among stakeholders, institutional logic, and CEO succession rules

The phenomenon of CEO succession has been the focus of a significant body of research, particularly in the United States. The dominant approach has been to see CEO succession as a political process in which various stakeholders contend for influence in the process (March, 1962; Pfeffer & Salancik, 1978). The succession process both reflects and shapes CEO and stakeholder power. These studies focused on identifying conditions that will increase the power of the CEO and the characteristics of stakeholders that would limit the power of the CEO. An alternative perspective draws on institutional theory, and explores the role of the institutional logic of society and of organizational fields in shaping CEO succession process and outcomes (Fligstein, 1990; Thornton & Ocasio, 1999).

Despite the large and growing volume of succession studies, the literature on CEO succession remains somewhat unsatisfactory, and the two theoretical frameworks are not effectively integrated. Most CEO succession studies based on power theory give little attention to the larger institutional context; on the other hand, the specific processes through which institutional logic shapes CEO succession are not fully understood. Oliver (1991)'s challenge to link institutional theory and the power perspective is a significant one for CEO succession studies.

The institutionalized action perspective (March & Olsen, 1989; March, 1994; Ocasio, 1999) explicitly recognizes the role of political process in shaping rules and thus attempts to integrate political perspective and institutional theory on organizational decision making. As Ocasio

(1999) puts it, "reliance on rules does not imply a lack of political action and behavior; instead, rules establish the parameters by which the political game is played. ... What distinguishes an institutional theory of action from interest-based approaches is that according to this view, while rules shape and are shaped by political processes, they are not merely the reflection of the interests of decision makers but are shaped by history and experience and are not easily changed in response to the immediate interests of organizational decision makers (p. 386)."

This chapter presents a brief overview of the political perspective in CEO succession in the U.S. and then provides the alternative institutional perspective. Next, I develop a general model of organizational process and outcome following the institutional theory of action enunciated by James March (March, 1994; March & Olsen, 1989). Following March (1994) and Ocasio (1999), I propose that the way these two constructs—institutions and power—affect organizational process and outcomes could be understood more cogently if we take the concept of organizational identities and rules more seriously. Next, I apply the general model of institutional theory of action to CEO succession and review the prior studies on CEO succession and on organizational rules in light of the model. Finally, I consider some methodological considerations in the study of CEO succession rules.

Political perspective in CEO succession literature

The office of CEO is unique in being the top position in the organizational hierarchy, as well as the hub linking various stakeholders. CEOs may use their strategic position to extend their stay amidst poor performance and may uncouple the usual link between poor performance and their exit. Although many studies have found that poor performance is generally related to

CEO succession (Puffer & Weintrop, 1991), other studies also found that the relationship was rather weak (Weisbach, 1988; Fredrickson, Hambrick, and Baumrin, 1988), and in some cases CEO succession was actually preceded by abnormally good performance, not bad performance (Morck, Shleifer, and Vishny, 1989).

The literature on CEO succession could be characterized as identifying the factors and conditions that uncouple the expected link between performance and the succession process and outcome. Many analyses focused on the problem of CEOs' staying on even though their company was performing poorly, and attributed this to the power of the CEO. Researchers differ in their analysis of political processes that limit the power of the CEO. While resource dependence theory (Pfeffer & Salancik, 1978) and agency theory (Fama & Jensen, 1983)[1] emphasize the role of external stakeholders and the power contests among them as important in bringing checks and balances to the executive power, strategic contingency theory (Hickson et al., 1971; Fligstein, 1985, 1990), the theory of the circulation of power (Ocasio, 1994; Ocasio & Kim, 1999), the theory of the institutionalization of power (Boeker, 1992), and socio political theory (Frederickson et al, 1988) all emphasize the internal political dynamics that shape the CEO succession process and outcome.

The two outcomes that have been studied most in the external view of CEO succession are the timing of change (or tenure) and the choice of successor (for example, between an insider and an outsider). The board is emphasized as the place where the interests of shareholders and

[1] Resource dependence theory argues that firms rely on external stakeholders for critical resources. The external stakeholders can control the firm to the degree that the firm is dependent on the resources supplied by the stakeholders. Agency theory could be thought of as a variant of resource dependence theory, in which the power and the stake of shareholders has been particularly highlighted. In fact, the two theories have a lot in common and make similar predictions regarding CEO succession.

other stakeholders are contested and adjusted. It was hypothesized that poor performance will hasten the timing of CEO change, and thus reduce the CEO tenure. It was also hypothesized that the board is likely to prefer an outsider as a new CEO under conditions of poor performance, since outsiders are more likely to bring changes in firm strategy and structure. The power and stake of the shareholders and other stakeholders, such as the degree of concentration of ownership, and the nature and characteristics of the board, such as the proportion of outsiders and the separation of the roles of Chairman and CEO, have been suggested as moderating the relationship between poor performance and CEO succession. As predicted, poor performance was more likely to result in CEO succession and to result in the selection of an outsider as the new CEO, when ownership was concentrated in the hands of outsiders (Allen and Panian, 1981), when the board had a larger proportion of outside directors (Weisbach, 1988; Cannella & Lubatkin, 1993), and when the positions of chairman and CEO were held by separate persons (Cannella & Lubatkin, 1993).

Theories that emphasized internal coalitions within the firm were interested in different outcomes and processes of CEO succession, such as the functional background of the CEO, in addition to the timing of the change and outsider succession, because these outcomes revealed the various power bases of the CEO. Organizational actors rise to the top position by claiming superior ability to shape the strategy and structure (Fligstein, 1985). The power of the CEO is contingent upon the fit between the strategy and structure that he or she has created and the external environment. The functional subunit is also considered an important source of the CEO's power base.

The institutionalization of power highlights the ability of CEOs to entrench themselves in formal positions of authority (Salancik & Pfeffer, 1977; Pfeffer 1981; Boeker, 1989). For example, a CEO's power increases with tenure and he may become more difficult to get rid of over time. Also, power could be institutionalized in a functional unit, which affects the choice of successor (Boeker, 1989). The circulation of power, however, highlights the conditions that increase the political contests within the firm. For example, a larger number of insiders in the board was more likely to result in CEO succession under conditions of poor performance (Ocasio, 1994). Also, CEOs with financial backgrounds, who gained prominence during the 1960s and 1970s (Hayes & Abernathy, 1980; Fligstein, 1987), were less likely to be succeeded by CEOs from the same background in the 1980s and early 1990s, as the financial conception of control was challenged by increased foreign competition and was criticized by management intellectuals for its short-term orientation (Ocasio & Kim, 1999). The socio-political model of CEO succession also emphasized the role of board expectations and allegiances in the dynamics of the CEO succession process.

It should be noted, however, that political theories about internal dynamics have not been clear about the locus of political struggle. The problem of successor choice centered on the political contest among the candidates. It was assumed that a CEO's natural choice for a successor was an insider from a similar functional background. But, it is not clear how these internal political dynamics could challenge the CEO who has the formal authority.

Institutional theory and the challenge of integrating political perspective

Institutional approaches suggest a different focus for studies of leadership power in organizations—that interests, power, and politics in organizations are shaped by institutional logics prevailing in wider environments (Fligstein, 1990; Friedland and Alford, 1991; Powell 1991; Davis and Greve, 1997; Thornton and Ocasio, 1999). Institutional logic, which could be defined as the socially constructed, historical pattern of material practices, assumptions, values, beliefs, and rules by which individuals produce and reproduce their material subsistence, provide meaning to their social reality and shape the sources of power, its meaning, and its consequences (Friedland and Alford, 1991; Thornton and Ocasio, 1999).

Compared to the political process, the role of the institutional environment in shaping the process and the outcome of CEO succession has been relatively unexplored. Some exceptions are Fligstein (1985, 1990) and Thornton and Ocasio (1999), which I will review in a later section. The lack of studies that examine the influence of institutional logic on CEO succession is related to the fact that institutional logic and rules tend to stay in the background, as they are taken for granted by organizational actors as well as by academics. There are two situations where the study of institutional logic becomes important: when there is a change in the dominant institutional logic over time, and when we attempt to apply theories developed in one national context to another. In the current study, the need to take institutional logic into account was generated at least in part when I tried to apply the theories and findings from the U.S. CEO succession studies to the succession processes of Japanese CEOs. Through the process, however, I also found out that the shift in institutional logic that has been documented by other scholars has also changed the rules of CEO succession in the U.S. over time.

In applying institutional theory to the study of CEO succession, we need to incorporate the political perspective that has been adopted by most CEO succession studies in the U.S. One of the main criticisms of institutional theory is its neglect of the power and agency of the organizational actors in shaping institutional logic (Oliver, 1991).

Institutionalized action theory integrates the power and agency of organizational actors and the institutional context by examining institutional effect at the level of 'action' as opposed to describing the institutional logic at the higher level. By focusing on 'action,' we are able to observe the diversity in individual and organizational actions, which reflects the power and agency of the actors. In addition, the concept of organizational identity, to which organizational rules are closely matched, provides a useful way to integrate power and agency. Organizational identity is both shaped by the organizational actors and is imposed upon them. CEO succession is an example of such action where individual level and organizational level identity formation becomes an important factor in guiding the succession process and outcome.

In the following section, I summarize the institutionalized action theory, which was first formulated by March & Olsen (1989) and by March (1994) and later extended by Ocasio (1999), and present a general model of organizational action that could be applied to the study of CEO succession.

<u>Institutionalized action theory: the role of organizational identities and rules</u>

The institutionalized action theory portrays individuals, groups, and organizations as following rules and routines based on the logic of appropriateness in everyday decision (March

& Olsen, 1989; March, 1994; Ocasio, 1999). As opposed to a decision maker in the rational choice theory whose primary task is to analyze his preferences and the expectations of future consequences, a decision maker in institutional theory of action is required to analyze the situation, to establish his identity, and to match rules to recognized situation. Since the interpretation of identity, rules and situation inevitably involves ambiguity, the decision maker in rule-based decision making theory is far from being a cultural dope blindly following the culturally defined norms.

Institutional logic provides an important source for organizational identity, although the relationship between institutional logic and organizational identity is fundamentally recursive (Haveman & Rao, 1997; Ruef & Scott, 1998; Thornton & Ocasio, 1999). As one type of institutional logic gains legitimacy among major players within an organizational field, the boards of directors are more likely to accept that institutional logic. When an institutional logic is internalized, it becomes the organizational identity. Through various processes, organizations can also shape institutional logic. A shift in dominant institutional logic may start with a few firms, probably those in the margin rather than in the center (Hirsch, 1986), adopting new organizational identities and practices creating a diversity in the organizational identity pool. Other firms may or may not start to mimic the new identity. As the number of such firms increases, the identity emerges as a new institutional logic.

Organizational stakeholders could also shape organizational identity through various political processes. For example, when the firm borrows money from banks, it assumes a role as a borrower. The identity as a borrower will be evoked in the contract. Similarly, when the top management is negotiating with unions on employees' salary and working conditions, the identity as the employer for the employees is evoked and top management will follow certain rules of conduct in its action. Large shareholders may also demand a seat on the board of directors and influence the organizational identity. Thus, the demands and expectations from multiple stakeholders are an important part of defining organizational identity. In a sense organizational identity is the board's solution for the conflicting demands from multiple stakeholders. The board may prioritize the demands of one stakeholder, or create an organizational identity that integrates the interests of many stakeholders.

Varying sources of organizational identity suggest that a firm may have multiple identities with conflicting behavioral rules for the organizational decision maker. An organizational decision maker could minimize the role conflicts by bracketing the situations, allowing only one organizational identity to dominate in a given situation (Jackall, 1988). In other words, the recognition of the situation provides a cue for evoking one organizational identity, but not others, and the behavioral rules attached to the identity. Differentiating the situation as normal vs. crisis is also an important cue for evoking one organizational identity over other. Some organizational stakeholders may find it easier to impose their own identity under a crisis situation, while the board of directors may find it easier to refuse such pressure when things are normal.

The board of directors is central in organizational identity formation. The board constructs organizational identities by asking the question of what kind of firm it is. Just as an individual asks the question of "Who am I?" when searching for one's own identity, an organization also asks the question of "What are we as an organization?" (March, 1994). Although the question seems quite generic and universal in defining organizational identity, the question could be raised in various ways which would lead to different answers. For example, if we ask 'What is a firm?' in terms of the activities, the answer inevitably leads to emphasize the role of employee in all those activities. If we ask 'who owns the firm' the answer has to address the property ownership and will lead us to emphasize the shareholder. In the latter question, there is no place for employee or even other stakeholders.

Although many studies have looked at the boards of directors as the locus where the powers of stakeholders are adjusted, a closer look at board composition suggests why U.S. boards may be more susceptible to institutional logic than those in other economies. Basically, most stakeholders are not represented in the board, with an exception of large shareholders. Outside directors are considered to provide an independent monitoring function, but they usually do not represent any particular stakeholder. Interlocking directorates have been an especially effective way of disseminating dominant institutional logics, be they capitalist values or new merger and acquisition techniques (Useem, 1984; Haunschild, 1993).

Although we could say that rules follow from organizational identity conceptually, we often infer organizational identity by observing the kind of rules individuals and organizations follow, because identity is not always easily observable. Some identities are relatively easy to identify, such as, gender, religion, and profession for individual identities and industry and business groups for organizational identities, because these identities are based on explicit membership. Other identities are difficult to identify, such as being a vegetarian or being a liberal/conservative, because these identities are not based on explicit membership. Nevertheless we could infer these unobservable identities, when we observe how individuals and organizations act and what kinds of rules they follow. Thus, organizational rules and identity are like the two sides of one coin.

We need to be aware of the complex relationship between identity and rules, however. First of all, rules may be also decoupled from organizational identities. For one thing, it takes a while to learn the rules of identities. We go through extensive socialization. Take religion for example. A person may acquire a new identity instantly as he or she accepts the basic tenets of the religious teaching, but it may take time to learn the rules that will make him or her look like a true member of the particular religion. Second, individual and organizational rules could vary considerably, even when people have the same identity, reflecting the style and agency of the person and the organization. Finally, individuals and organizations have multiple identities and some of the rules learned from one identity may be spilled over to other identities.

These difficulties, however, reveal the complexity of how identity plays out in our everyday life, rather than a problem with the theoretical construct. One of the important benefits of having the concept of identities is that it allows us to understand why certain rules develop within the organization. It allows us to see the commonalities behind the seemingly idiosyncratic organizational rules.

It is worth mentioning the commonalities and differences between routines and rules. Both routines and rules specify scripts about who participates, in what way, and how. They both reduce uncertainty and coordinate activities. Organizational decision making processes and outcomes become accountable and reliable as a result. Routines and rules, however, are concerned with different aspects of individual and organizational action. Routines, on the one hand, have the elements of repetition and sequencing. They are a self-contained unit of practices, such as standard operating procedures. The outcome is more or less predictable from routines. Rules, on the other hand, do not need to be a unified system. Instead, rules deal with uncertainty by specifying contingencies. Rules may be flexible. In many cases, routines and rules go together. Rules may result in routinization, especially if the rules regulate the temporal aspects of organizational process. Also, many routines include contingency rules that make the routines reliable in various situations. Yet, routines are primarily used for transmitting knowledge, while rules work as a political truce among multiple actors.

The relationship between institutional logic, power dynamics among actors, and organizational identity make a full circle as they influence each other. Institutional logic and power dynamics among actors shape organizational identities and rules, although organizational identities could also affect institutional logics and power dynamics. Moreover, the relationship between institutional logics and the power dynamics of stakeholders could also shape each other. Figure 2-1 portrays the relationship between institutional logics, power dynamics among actors, organizational identities, and organizational process/outcome. Figure 2-2 shows the model applied to CEO succession.

<u>**Ideal types of organizational identities through the lens of organizational theories**</u>

The board of directors constructs organizational identities in the real world. One way to start a study of organizational identity may be to interview boards of directors at firms of various sizes, locations, and industries. If the purpose of the study is to identify dominant organizational identities, however, we could also use the organizational theories as guidance since some of the organizational theories ask the question of 'What is an organization?' Not only do they ask the same question as the boards of directors who try to construct organizational identities, the answer they provide reflects the ideal type of organizational identities in their own time. Even though most theories are presented in universal/absolute language, these theories reflect the dominant institutional logics of their time about what it means to be an organization. The closer they get to the reality, the more resonant the theory. The classic is born. Some of these theories may get to the boards of directors through various channels and may influence the process of identity formation in the real world.

Therefore, I review three models of the firm in organization theory as reflecting organizational identities in the real world. The three models of the firm are: firm as community/institution (Selznick, 1957), firm as shareholder's property (Jensen & Meckling, 1976; Fama & Jensen, 1983), and firm as a political coalition among dominant stakeholders (March, 1962; Pfeffer & Salancik, 1978). In the following section, I show that the three models of firm differ systematically not only in how they view the firm and the role of CEO, but also in the set of succession rules that firms will establish.

THE FIRM AS A COMMUNITY/INSTITUTION

The community view of the firm maintains that a business firm may develop a life of its own and pursue a self-maintenance goal before a profit-maximization goal (Selznick, 1957; Ouchi, 1981). A key feature of this view is that it recognizes the firm as a social organism consisting of people with needs for self-fulfillment and self-protection. In a community firm, members identify emotionally with their firm and achieve personal satisfaction in it. Efficiency may follow as a result of members' commitment to their organizational success (Ouchi, 1981), although the achievement of efficiency may not be the primary goal of a community firm. Furthermore, intimacy may breed information sharing among organizational participants which may be critical for knowledge creation and innovation within the firm (Nonaka, 1994).

The role of the top manager may be best described as a "leader" in a community firm, who creates a mission and goal for organizational members, protects organizational integrity from external pressure, and transforms organizational members, through educational processes, from neutral, technical units to committed and sensitive participants (Selznick, 1957). Although shareholders' demands are an important concern of a leader, they are treated as one of the external forces that may threaten organizational integrity and stability and, thus, as something the leader should protect against. In contrast, employees gain priority as members of a partnership.

The virtual lack of discussion of control mechanisms for top managers is not surprising, given the assumption that top managers are the most committed persons in the whole organization as a result of their extended service (Selznick, 1957). The internalization of one's own mission and value as well as the need for respect in the community are the strongest constraints preventing the leader from taking advantage of his/her powerful position and acting greedily. CEO succession, thus, does not have a disciplinary connotation in this model. The benign leader, if he is not able to function as an effective leader, will plan for succession and probably select a person from within the organization who knows the firm well enough to protect organizational integrity.

THE SHAREHOLDER VALUE MAXIMIZING FIRM

Most of the discussion of corporate governance in the financial economics literature tends to agree that the firm's primary goal for existence is to maximize the shareholder value. These studies view the firm as the property of its shareholders (Jensen & Meckling, 1976; Fama & Jensen, 1983). We very often come upon such sentences as "The ultimate owners of a firm are its shareholders." The separation of ownership and control in large public companies, however, considerably complicates the reality. That is, managers, as agents of the shareholders, may not have the same incentives as those of shareholders and may behave to maximize their own interests, in what is called an agency problem. Managers' strategic position at the center of the organizational decision making process aggravates the agency problem. Developing several control mechanisms to align the incentive of agents more closely with the interests of principals becomes a central concern for shareholders.

In this model of firm, the term "agent" best describes the role of the top management. Top managers' primary goal is to please shareholders by improving performance, using their specialized knowledge. In addition, a hierarchical structure develops to ensure that upper level managers adequately supervise lower level managers to prevent agency problem at different levels. Thus, organizational members are all agents of shareholders. Aligning the incentives of managers at each level through explicit contracts and control devices is the key to the success of such a system.

CEO succession (or dismissal) has a special disciplinary meaning in this model. In a time of poor performance, top managers are replaced by either the board of directors or the takeover market. Dismissal of managers can happen anytime at lower levels as well. Here, top managers may lay off "excess" labor, without too much blame, true to their role of agents for shareholders. The effectiveness of CEO succession as a disciplinary mechanism may depend on both internal control mechanisms, such as the existence of strong and independent boards of directors or the concentration of ownership, and external control mechanisms, such as the efficient stockmarket and the active takeover market.

THE FIRM AS A POLITICAL COALITION

The firm as a political coalition was first conceptualized by March (1962) and has been reintroduced in terms of resource dependence theory (Pfeffer & Salancik, 1978) in the organizational theory literature and as multiple stakeholder theory in the corporate governance literature (Freeman, 1983). Unlike a shareholder value maximizing firm or a community firm, where either shareholders or employees are represented as having a superior claim over organization's existence, the concept of the firm as a political coalition recognizes that suppliers, customers, governmental agents as well as shareholders and employees have distinctive existing and potential interests in the firm. These different groups supply the firm with critical resources and in exchange each expects its interests to be satisfied. Since the demands of one group may conflict with those of others, the goals of the firm have to be negotiated. Different patterns of coalitions emerge, depending on the consistency or complementarity of demands among participants (March, 1962), as well as the power and the extent of the stake of each participant (Hill & Jones, 1992; Donaldson & Preston, 1995). Hence, analyzing complementarity of goals as well as the power of each participant is important in understanding firm behavior. Furthermore, at any point in time, there may be a number of possible coalitions that are viable. Thus, the model allows dynamic change of coalitions over time.

The role of the executive in the firm is best described by the term "political broker" (March, 1962), meaning someone who has to coordinate demands of different stakeholder groups. The model also acknowledges that top managers may use the organization to maximize their own utility. Because top managers are in the center of such bargaining processes, they can wield enormous power over shaping goals to their own interests. However, they need to form coalitions with other participants who have similar or complementary goals with top management. Otherwise, the cost of maintaining the coalition becomes high enough that it invites the emergence of a newly dominant coalition. In other words, difficulty in coordination and control of stakeholder groups can impose constraints on top managers (Hill & Jones, 1992; Pfeffer & Salancik, 1978).

CEO succession is viewed as reflecting a shift in coalition formation. Shifts in environmental conditions, such as changes in technical, legal, and market conditions, are important for such changes, since the shift may weaken the incumbent manager's ability to maintain the existing coalition. Those who demonstrate their ability to adequately deal with the uncertainties of environments may gain support from stakeholders and take over the top position.

Organizational identity in the firm as political coalition can be quite varied, as various stakeholders may become a dominant coalition partner. Thus, we may be able to identify more than three organizational identities in the real world. However, in the organizational literature, the three models whose identities are summarized in Table 2-1 have been predominant.

Although three models do not explicitly describe the rules that would be proper to each organizational identity, we could nevertheless infer from the literature the general succession rules in each model. The CEO succession rules for three models of firm are summarized in Table 2-2.

Institutional logic, power dynamics among stakeholders, and organizational identities in large U.S. corporations

(1) Institutional logic and organizational identity/rules

Several researchers noted that there has been a shift of dominant institutional logic that accompanied the change in the key question for defining organizational identity. Useem (1993) argues that with the rise of institutional investors since 1970s as well as the rise of hostile takeover market during the 1980s, the nature of American business shifted from managerial capitalism to institutional capitalism. The center of gravity moved from management to a new breed of shareholders: institutional investors. Blair (1995) also makes a similar argument but more explicitly links the change with organizational identity and argues that the conception of the firm has changed from that of a social entity to that of the property of the shareholders. For example, Blair writes "With the separation of ownership and control, the development of a sophisticated securities market, and the emergence of a class of professional managers who thought themselves as the 'trustees' of these great institutions, the social entity conception began to take hold. The corporations assumed more and more responsibilities as social institutions (Blair, 1995)." The equitable balancing of interests replaced the maximizing of profit. By the 1960s, the social entity view dominated the U.S. corporate scene.

During the late 1970s and early 1980s, the conception of firm as community slowly gave way to the conception of firm as shareholder's property in the U.S. Several changes in the environment accompanied the shift in dominant institutional logic: the rise of global competition, internationalization of financial markets, the emergence of the hostile takeover, and the rise in the cost of capital in the early part of 1980s (Blair, 1995). The property concept was strongly backed up by agency theory. The rise of institutional shareholders also had an important role in propagating the property concept of the firm in the 1980s. Donaldson (1994) argues that individual shareholders in the previous decade tended to be loyal to the firm they invested in because of limited expertise and knowledge beyond that industry. The institutional investors and professional money managers had a quite different span of knowledge and expertise, which made them much more willing to sell the shares if they could find a better earning opportunity in other industries. The growth of institutional investors, however, limited their option for swift exit. They were not large enough to monitor individual firms and their boards, but they were too big to exit without incurring loss. Some of the biggest institutional investors, such as CALPERS, chose a strategy to improve the market as a whole and began to press for governance reform based on the logic of shareholder's property (Davis & Thompson, 1994).

The latest shareholder revolution was an important departure from the shareholder logic in the early days when the owner-manager controlled the firm. While the early version of the logic of shareholder's property depended on the power of shareholders who had a large block of shares, the new shareholder logic regarded all shareholders, large or small, as genuine owners of the firm. Unlike the early version where large shareholders may be able to pursue varied interests in the organizations, such as seeking employment opportunity for family members and other perquisites as a special shareholder, if they wish to, the latest version demands that large shareholders be faithful to the role of shareholder focusing only on share performance.

The characteristics of firms that adopt a new organizational identity could also facilitate or hamper the shift in institutional logic. When the large and prestigious firms start to adopt a new organizational identity, the organizational identity will acquire legitimacy and may encourage others to change the identity, which will bring the change in institutional logic. Donaldson (1994) documents that some of the more successful restructuring in the 1970s and 1980s came from firms whose management actively adopted the shareholder rhetoric. Although Donaldson does not discuss the impact of these successful financial restructurings on the larger institutional context and on other firms, it is likely that they had a positive role in the shift to the shareholder logic. Hirsch (1986)'s fascinating analysis of the linguistic framing of hostile takeovers also shows the shift in dominant institutional logic as more and more prestigious firms were involved in hostile takeover activities.

There is some evidence that succession rules have also changed over the years reflecting the change in dominant institutional logic. For example, Vancil (1987) identified a few succession rules that have been common in the large U.S. corporation in 1985 and before. Some of the rules were: (1) The CEO takes the initiative in the succession process; (2) Successors are groomed through two different organizational rules; and (3) CEOs have a limited tenure, although it may vary by company and by CEO. These rules are highly consistent with the succession rules that follow from the organizational identity of community.

More recent reports on CEO succession shows that more CEOs are forced to early retirement by active boards (Neff & Ogden, 1999). Boards are more willing to take charge of the succession process. A CEO is more likely to be fired when performance is poor. In other words, the succession rules show that organizational identity as shareholder's property has become more popular in the 1990s.

The change in dominant institutional logic and the resulting reconstruction of organizational identity by the board need not bring a complete change in succession rules. As Oliver (1991) has suggested, management can use different strategies, such as avoiding, resisting, and acquiescing. The board could bracket the organizational identity as shareholder's property into confined governance issues, as in the form of executive compensation, and keep the community identity in other areas of decision making, including CEO succession. Moreover, when the succession rules are formalized they are more likely to survive even when a firm accepts a new organizational identity.

(2) Power and organizational identity

Political theories of the firm, such as political coalition theory (March, 1962) and resource dependence theory (Pfeffer and Salancik, 1978), capture the basic process through which dominant stakeholders shape goals. It is through a direct 'relationship' that stakeholders affect organizational identity. The concrete interaction situation is a very powerful way to invoke organizational identity. Having a representative on the board is one of the major ways to impose a particular identity in every major organizational decision, including CEO succession. The size of the stake matters as well.

Two categories of stakeholders that had direct influence in shaping organizational identity through board membership are large shareholders and financial institutions. Since Salancik and Pfeffer (1980) studied the role of ownership in the tenure of the CEO, many studies have confirmed that concentrated ownership made a difference in the succession process and outcomes. In addition to shareholders, financial institutions also had a close relationship with the organizations by sending representatives to the corporate board to represent their interests. Mintz and Schwartz (1985) provided the list of CEO change events that involved bank or other financial institutions. But they caution that banks worked through hegemony rather than direct 'control.'

The power dynamics between top management and dominant stakeholders make the organizational rules more flexible. Dominant stakeholders can define key contingencies. Moreover, rules can be broken if the situation changes—for example, if one of the stakeholders gains more power. Thus, even when the social entity firms prevailed, large shareholders as well as financial institutions were able to take charge, and they may continue to wield a special power over boardroom politics, even as the identity changes.

The most consistent contingency rule has been CEO succession under poor performance. The relationship between dominant stakeholders and organizational identity/rules is also dynamic. Firms with a particular organizational identity can change the power dynamics among stakeholders by carefully selecting their interaction partners. Pfeffer and Salancik (1978) argue that top management actively seeks cooptation of external stakeholders. If such efforts are not successful, top management and the board of directors could also choose who would be their dominant stakeholders. For example, Useem (1996) showed that top management actively recruited shareholders who would be more sympathetic toward the prevailing managerial ideology.

The rise of the institutional investor is interesting because institutional investors differ from earlier dominant stakeholders in their power base and in the strategy for controlling the firm. The influence of institutional investors has been reported as crucial in CEO succession in large firms in the 1990s (Stewart, 1993). The behavior of large institutional investors in the 1990s is rather different from the traditional role of large shareholders, however. For one thing, some of the more powerful institutional shareholders had less then 1% of shares in large firms, but they spread their shareholdings broadly across companies as a result of the practice called indexing. Their power was based on the fact that the total sum of funds organized by them was very large, and on the fact that other investors watched them closely as providing signals of the potential value of companies. In other words, they were powerful not because of the size of their stake in individual firms, but because they were powerful institutions in themselves. Similarly, some of the poorly performing firms were targeted as a warning to all companies, not because they were particularly dependent on institutional shareholders for capital.

(3) Interaction between institution and power.

Stakeholders could make an independent effort to change the rules of the game at the higher institutional level, which will affect organizational identity formation. For example, Davis and Thompson (1994) show that institutional investors acted collectively to change the disclosure rules for CEO compensation. Thus, institutional investors have influenced corporate governance by promoting the logic of maximizing shareholder value, which may have been an effective strategy for sustaining the behavioral change.

One of the reasons why shareholders were able to keep power collectively, if not individually, is the continued existence of the takeover market. Although these takeovers may have been friendly, it nevertheless forced firms to think about the significance of ownership in large public corporations[2].

Institutional logic also shapes the power bases for stakeholders, creating different types of contingencies for CEO succession processes and outcomes. For example, Thornton & Ocasio (1999) found that a shift in logics in the publishing industries—from editorial logic to market logic—led to different determinants of executive succession.

Conclusion

In this chapter, I have suggested the institutional theory of action to understand the complex interplay among institutional logics, the power dynamics among stakeholders, and organizational identity and rules that shape CEO succession process and outcome. The model provides an alternative interpretation of the role of the board of directors in the period prior to the 1980s, when the board was portrayed as basically serving the interests of the CEO. An alternative interpretation is that the boards shared the community logic in which the CEO was

[2]This is quite different from Japan where contest for control has not truly happened for more than 50 years. There were mergers and acquisitions but most of the mergers were 'brotherly' mergers, where the employees of each company are respected. It may be one of the reasons why the logic of shareholder property has been so resisted among Japanese firms, despite the extensive debate on the nature of firms among academics during the 1990s.

considered as the benign leader who has an ability to pick the best person for the firm's future. It is true, however, that when some of the CEOs ignored the appropriate code of conduct (for example, by using the firm to enlarge their personal interests as opposed to serving the firm), the community logic deprived the boards of directors of the power and rhetoric to initiate CEO succession.

The alternative logic, the firm viewed as maximizing shareholder value, took shape as the shareholders gained power through the active takeover market and through the growth of institutional investors in the 1980s. The change explains some of the inconsistencies in portraying the process and outcome of CEO succession. While Vancil (1987) suggested that 90% of the firms had a 'normal' CEO succession where CEOs themselves played a greater role in the process, later CEO succession studies show that boards of directors were more willing to fire under conditions of poor performance.

The model also shows that dominant stakeholders could affect CEO succession indirectly by engaging in the ideological battle to shape a new institutional logic, which has been neglected in the previous CEO succession literature that focused on the direct political process. The efforts of institutional investors to change the disclosure rule for executive compensation is an example.

Institutional logic and the way it shapes organizational identities and rules are important even when there is no shift in the dominant institutional logic. In the next chapter, I flesh out the dominant institutional logic and stakeholders of the Japanese economy and show how these two distinctive sources of organizational identities and rules shape CEO succession processes and outcomes in Japan.

Figure 2-1. General Model of organizational decision making from Institutionalized Action Theory.

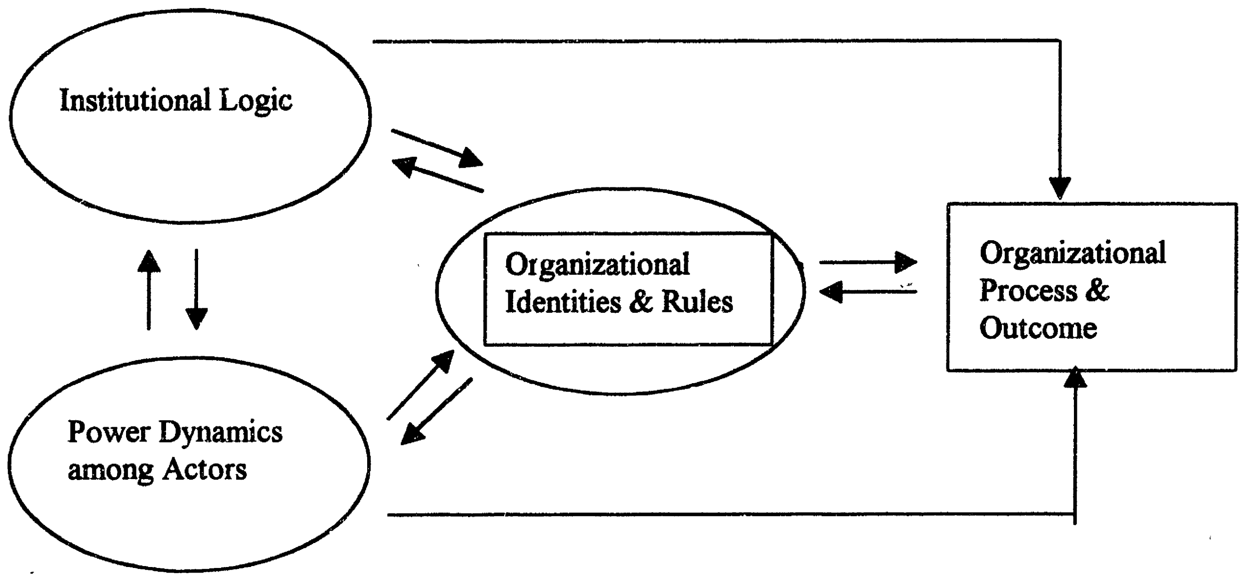

Figure 2-2. Model of CEO succession : Institutionalized action theory

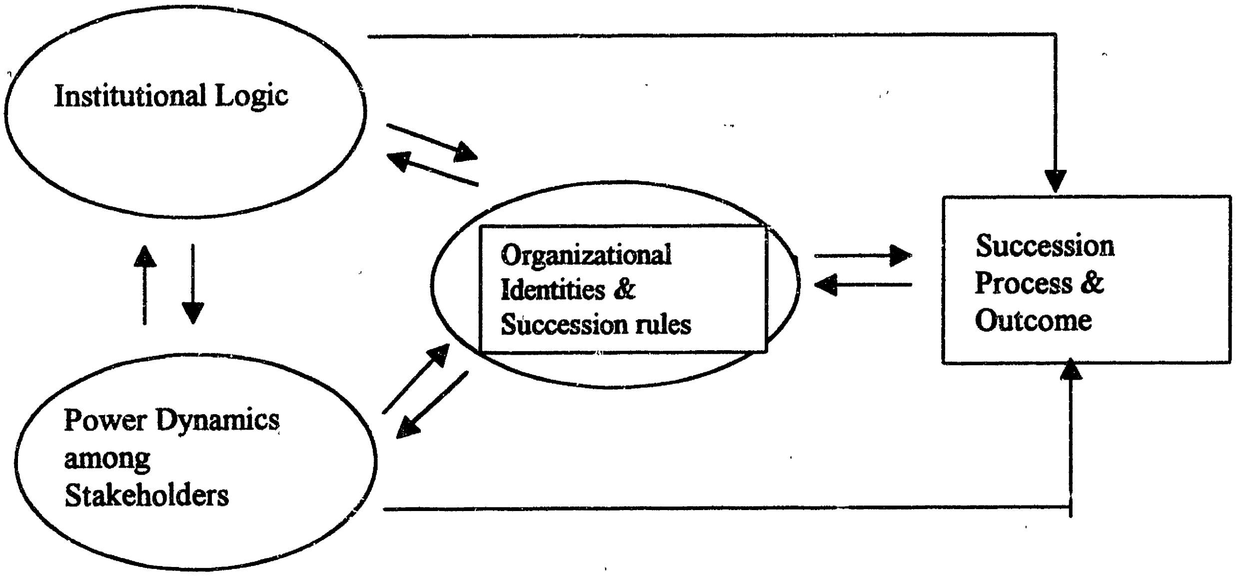

Table 1. Three ideal types of organizational identities and their main characteristics

Organizational Identities	*Firm as a community/social entity/institution*	*Firm as shareholder's property*	*Firm as dominant coalition*
Supporting theories	Institutional theory Organizational culture and leadership	Agency theory Portfolio theory	Resource dependence theory Multiple stakeholder theory
Mission	Organizational survival through growth as well as profits	Increase profits in order to create shareholder wealth	Please dominant coalition partners: increase profits, extend business relationship, etc.
The role of CEO	Leader	Agent of shareholders	Political broker
Legitimacy	Rank in hierarchy	Stock performance	Relationship with the dominant coalition partner
Hierarchy at the top	CEO assumes the top leadership for the organization as well as for the boards	CEO at the bottom of the hierarchy of shareholder-board-CEO	CEO as hub among various stakeholders
The structure of the board	CEO at the top of CEO-board-stakeholders hierarchy.	Separation of CEO and chairman Independence of board through higher outsider ratio	Representation of dominant stakeholder in the board The board stands above CEO
The meaning of CEO succession	Symbolic event to celebrate the continuity as a community	Disciplinary tool to align the interests of top managers with owners	Failure in maintaining the dominant coalition.
Ownership characteristics	Dispersed ownership	Institutional ownership	Concentrated ownership

Table 2. Organizational identity and rules of CEO succession

Organizational Identities	Community/Social entity	Shareholder's property	Political coalition
Who initiates the CEO succession process?	CEO initiated	Board initiated	Dominant stakeholder who sits in the board
Preference for successor	Prefer insider	Prefer outsider	Prefer outsiders with close tie to the dominant stakeholder
Selection process	Succession as larger managerial training	Search firm	
Timing of succession	Decoupling with performance Limited tenure	Strong coupling with share performance	Coupling with performance measure that is of interest to the coalition partner

Chapter 3. Stakeholders and the institutional context of CEO/*shacho* succession in Japan

Guided by the model of institutional theory of action developed in Chapter 2, I review Japanese corporate governance in terms of two key aspects: dominant institutional logic and dominant stakeholders that control industrial firms. In the following, I first give a brief summary of the key features of Japanese corporate governance system and compare them with the U.S. corporate governance system. Second, I review the nature of the board and its relationship to organizational identity. Third, I review the logic of community that has been dominant in the Japanese economy in the post WWII period and how the institutional logic affected organizational identities and succession rules in managerial firms. Fourth, I review the nature of dominant stakeholders of large Japanese firms and how they affect organizational identities and succession rules. Finally, I conclude with some of the areas on which I shall focus in the thesis.

Japanese corporate governance in comparative perspective: A summary

A long line of studies on Japanese corporate governance (Aoki, 1984; Porter, 1992; Hoshi, Kashyap, & Sharfstein, 1990; Prowse, 1990; Kester, 1991; Gerlach, 1992; Kaplan, 1994; Kojima, 1997; Dore, 1973, 1987; Dore, Lazonick, & O'Sullivan, 1999) have explicitly contrasted the Japanese system with corporate governance systems of the U.S and U.K. The U.S. corporate governance, which may be characterized as governance through the market, is based on the property view of the firm, where shareholders have the ultimate say. The existence of well-developed security markets allows firms to raise capital through equity. Thus, control is based on equity holding. The shareholders and the management usually hold an arm's length relationship since shareholders find it relatively easy to exit from the firm through market transactions. The dispersed nature of their shareholding makes exit an easier alternative than voicing their concern to management. Although the shareholder revolution in the 1980s was able to better align the interests of managers with the interests of shareholders' by forcing managers to own part of the shares, the basic characteristics of the financial market and the relationship with other shareholders remain more or less the same.

On the other hand, Japanese corporate governance, which is often described as relational governance, is based on the community view of the firm. The institutional background is weak financial markets. Firms mainly rely on debt for their capital and form long-term relationship with principal banks, so-called main banks. The banks maintain control over borrowing firms through dense flows of information. Main banks often complement their relationship with focal firms by holding blocks of shares (up to 5% of the total) or by exchanging personnel.

<u>The board of directors</u>

The board is important in constructing organizational identities and rules. The composition of the board is important because individual board members bring in their own identity in a larger society as they construct organizational identity within the board. One of the dimensions that has been emphasized in the U.S. is the proportion of outsider directors on the board. As outsiders, they are more likely to be independent from the CEO, and thus provide reliable monitoring roles. These outsiders also form an interlocking directorship network that allows new ideas and information to travel across firms, which may have an important implication in the organizational identity formation.

The distinction between inside directors and outside directors is less relevant for the Japanese board, however. There is no "outside" director in the U.S. sense, as most of the directors are either present or former full-time employees in the firm for which they are a director. Then, what are the important dimensions of the Japanese board that influence organizational identity formation? As an illustration, I have summarized the composition and the structure of the board at Sumitomo Metal Industry in 1995 in Table 3-2. One of the largest firms in the steel industry, Sumitomo Metal Industries had sales of $8.25 billion and employed 19, 796 in 1990. It was incorporated in 1935 and is a member of Sumitomo *keiretsu*—one of the six horizontal *keiretsu* in Japan. The structure of the board is typical of the boards in most Japanese firms. In fact, the titles of the rank hierarchy is one of the firmly institutionalized features of top management teams. The composition is also typical among large managerial firms, although it may also include one or two family members in family controlled firms.

Several things could be said from Table 3-2. First, the board is mainly populated by insiders. Twenty-seven out of 33 directors were insiders who have been with the firm for more than 30 years. As for the six outside directors, two are from government bureaucracies—a vice president from the Ministry of International Trade and Industry (MITI) and a director from the Ministry of Construction; two are from Japan Stainless Co. which was merged with Sumitomo Metal Industries in 1991; and two are external auditors who had previously been affiliated with Sumitomo Bank and the Public Prosecutor's Office, respectively. Second, the chairman position is separated from the CEO & President (*shacho*) position. The chairman had previously been the CEO & President of Sumitomo Metals Industries for seven years before assuming the office of chairman. Third, the structure of the board is hierarchical. The hierarchical nature of

Japanese board is closely related to the fact that most board members are insiders. The rank hierarchy of the top management team is applied to the board of directors. Fourth, the seniority principle is well respected in the board. The officers in the same rank hierarchy are from a narrow entry cohort and the average age and average tenure with the company of officers increase linearly with the rank hierarchy. Finally, despite the strict hierarchy in the board, it is interesting to note that the chairman, CEO & President (*shacho*), vice president, and senior executive directors shared the representative rights, indicating the collective decision making process within the Japanese top management team.

The *shacho* is conventionally viewed as the equivalent of CEO in the U.S., although there have been a few cases where the term Chief Executive Officers (CEO) was used to designated chairman (*kaicho*). There are several grounds why it is more appropriate to consider *shacho* as the equivalent of CEO. First, in many firms the office of chairman is an informal position for the retiring *shacho*, which is not specified in the formal company articles. The formal authority of the *shacho* is reflected in the fact that while the office of chairman is often left open when the chairman resigns unexpectedly, the office of *shacho* is never left open. Second, the *shacho* has the power to control the succession process, such as the timing of succession as well as the selection of his successors. Unlike the COO (Chief Operating Officer) of the U.S., the *shacho* is rarely dismissed by the chairman, although they may move on to less prestigious offices than the chairman, such as the vice chairman or advisor, if they showed poor performance as a *shacho*. While using the title of CEO for chairman has become more popular among Japanese firms in the 1990s in Japanese business firms, it would be misleading to think of Japanese chairman/CEO as holding the same power and responsibility as Chairman/CEO in the U.S. In order to avoid the confusion, I will use the term *shacho* instead of CEO in the Japanese context.

What does the composition and structure of the board tell us about the function of the board? First, the board functions as an extension of the career ladder at the top echelon. There is a considerable overlap between the top management team and the board of directors. There is no such thing as an independent board member overlooking the top management team's decisions. Even the dispatched directors (outside directors, as explained below) are expected to contribute substantially as a member of the top management team. Even though Japanese commercial law defines the board of directors as having responsibility for monitoring firm performance, Japanese boards formally endorse decisions made by a subset of their own members, the acting top management team.

The role of monitoring firm performance is often performed instead by the dominant stakeholders, who can gather detailed information through the dispatched directorship network (explained below). As we could see from the six outside directors of Sumitomo Metal Industries, Japanese firms allow a few powerful stakeholders to have direct representation of their interests on the board through a unique system of director exchange, the so called "dispatched directorship". There are three sources from which dispatched directors come—the main bank, government bureaucracies, and other industrial companies. These dispatched directors may be also seen as shareholder representatives, as, with the exception of former government bureaucrats, they are bolstered by the shareholding position of their sending institution. Through the dispatched directorship, information flows more easily between the firm and its stakeholders, allowing stakeholders to influence policy as well as participate in shaping organizational identity.

Interpreting the role of the dispatched directorship requires some caution. Despite the apparent backup of the dispatched directors by the dominant stakeholders, dispatched directors may not be as influential as the insiders on the board because of the board's hierarchical nature. Dispatched directors may help information flow and monitoring, even leading some of the important decision making, but they cannot affect the ground rules of organizational decision making nor the choice of timing and successors. If the dominant stakeholders are truly interested in shaping organizational identities, they must sometimes send a dispatched director as the *shacho,* not as an ordinary director in the lower rank. In other words, who the *shacho* is, where he comes from, and how he was selected are important indicators in the development of organizational identities and rules.

If the interests of creditors, alliance partners, and the government are partially protected through direct representation, the interests of employee groups are protected quite firmly through the normative commitment by the board of directors. As most of the board members are insiders, who have worked for the company for all their adult life, they are likely to be committed to the goal of preserving their firm—their lifetime community. The lack of an external labor market for top executives, combined with getting the second job through their organization, also makes their interest keenly related to the long term survival of the firm. And the primary beneficiary of this long term commitment is the employee.

<u>The community logic, managerial firm and succession rules</u>

The logic of community in Japan shares many common features with the social entity conception of firm that developed in the U.S. during 1950s and 1960s. The logic is closely related to the managerial revolution where ownership and control was separated and ownership dispersed among many anonymous shareholders. The employee was the most important stakeholder in the community conception and long-term employment was encouraged. The CEO and shacho acted as the leader of the community rather than the agent of external stakeholders. In fact, such commonalities are not surprising because many Japanese firms in the 1950s were trying quite consciously to model American firms, most of which were following the community logic (Saito, 1995). In fact, long-term employment and the formation of internal labor market based on the seniority principle have been quite common in large firms in most advanced economies (Milgrom & Roberts, 1992).

Yet, there are subtle differences that make Japanese community logic quite distinctive. Just for convenience, and following the notation used by Aoki (1988), I will refer to J-type community firm for the community logic developed in Japan, and A-type community firm for the community logic developed in the U.S.

In the J-type community firm, the interests of core employees were protected firmly. To begin with, the boundary of the core employee group was extended to include blue collar workers as well as white collar workers (Lazonick, 1991)[1]. The relative precedence of employees as a group is also revealed in the diversification strategy. Compared to the U.S. corporations, Japanese firms have eschewed diversification that would take them out of their main line products and core business (Clark, 1979; Kagono et al, 1985). The diversification into unrelated fields and starting a new venture would require that they recruit and provide a costly long-term

[1] Lazonick (1991) argues that the inclusion of the white collar workers within the core management boundary in the U.S. firm was in itself an important departure from the firms in the U.K. where only the top management was acknowledged as the insider.

employment commitment to a new cadre of workers. If the venture were to fail, firms could not lay those employees off as easily as in the U.S. Thus, lifetime employment forces Japanese companies to be cautious about extending themselves into an area where they possess no prior experience, related expertise, or comparative advantage[2]. The commitment to long-term employment also explains the Japanese corporation's preference for networks of subsidiaries instead of expanding through vertical integration. With subsidiaries, parent companies have the leeway of reassigning surplus employees, an important safety valve for the cumulative pressures of permanent employment, without needing to provide the same treatment for the employees of subsidiaries.

The personnel practices were elaborated in order to encourage life-time employment with the J-type community firm. Job-hopping was morally condemned. The seniority principle, as in everyday life in Japan, became much more sophisticated as it was applied to promotion and reward, backed up by centralized personnel practices. It should be noted that the sophistication of the seniority principle does not mean the lack of competition (Hanada, 1989). It was rather that competition was structured in a way that limited the competition to a narrow age cohort. The resulting seniority often does not reveal the intense competition within the narrow age cohort.

While the A-type community firm put more emphasis on social responsibility of the firm, the J-type community firm put more emphasis on the continuity of the firm as an institution. The

[2] The commitment to career-long employment may have opposite effects in diversification strategy in declining industries (Okimoto, 1989). In these industries, companies may actively seek ways to diversify even into unrelated ones, to ensure career-long employment.

social responsibility is narrowly defined in terms of core economic activities, such as manufacturing better products, rather than engaging in corporate philanthropy.

Let me elaborate on the institutionalization of the business firm in Japan. The firm as an institution/community is different from the firm that has the employee group as a dominant stakeholder (Dore, 1973; Itami, 1994). The firm as a community/institution develops a distinct 'identity' that is independent of any stakeholders, including the employees. The legitimacy of stakeholders is evaluated by the commitment they show in preserving the firm. Employees are given priority not by membership, but by the commitment they show to preserve the organizational identity. Such community-centered behavior is also found in pre-modern merchant households (Miyamoto, 1995, 1998). For example, although most merchant households followed the principle of primogeniture in succession if possible, they also explicitly looked for successors who were best for continuing the household name when they did not have an adequate son to take over. Thus, they would adopt a son-in-law and make him continue the household name. In other words, the need to preserve the household name takes priority over the need to create employment opportunities for family members. As Selznick has put it, the firm acquires a life of its own distinct from the technical purpose for which it was created.

Succession rules under the J-type community logic have many similarities with community logic in the U.S. The *shacho* initiates the whole process with close consultation with the personnel department. Basically, the *shacho* determines when he will retire and who his successor will be. The board has virtually no control over the selection process, except that the directors themselves are the candidates for the next *shacho*. There is a strong preference for an insider as the successor *shacho*. Among the two hundred large industrial firms in 1990s, 80 percent of the firms chose an insider as a new *shacho*. Itami's study shows that there are strong industry-wide rules on the appropriate length of *shacho* tenure (4 to 6 years) suggesting the decoupling of performance and *shacho* departure (Itami, 1995). In a sense, the *shacho* in Japanese firms seems to fit quite well with the benign leader portrayed in the institutional theory of leadership, who is most committed to the organizational mission set by himself and by his predecessor.

Several historical developments were influential in making such a difference between the two types of community logic. To begin with, the community identity is a product of concrete interaction between top managers and labor (Gordon, 1985). It is important to understand the characteristics of top managers that shape the process. In Japan, professional managers' access to the top situation was inadvertently made possible by the reforms initiated by the Allied Occupation after the World War II, which Miyajima calls 'a management revolution from above' (Miyajima, 1993). Believing that the key officers of large firms were active proponents of military government, the Allied Occupation ordered an economic purge which required the key executives to resign from their posts and banned them from any further public service. Under the "Law for the Termination of Zaibatsu Family Control" in 1948, the number of companies and company officers designated as the subjects of the Great Purge were 1,681 companies and 3,668 officers. Although the designation was canceled in 1951, the economic purge brought a generational change and a new breed of young managers rose to the top position. For example, the average age of presidents or chairmen of the board in 1951 was 51.8;

at war's end, 60.2 years (Hadley, 1970). Although there was a cancellation of the designation in 1951, it did not bring old timers back to the top executive suite[3].

Several characteristics of newly appointed top managers are worth mentioning, since they are closely related to the development of the Japanese corporate governance system in the following years. Most of the top managers who replaced the purged officers were promoted from inside. They had minimal experience as board members and had almost no connection with the owner family. They were much more sympathetic to labor's demands and were aware of the importance of a stable relationship with labor, while fighting firmly against the leftist unions (Dore, 1973; Gordon, 1985, 1998; Miyajima, 1993; Yonekura, 1993).

The development of a permanent employment system epitomizes the process through which the employee group became a powerful stakeholder in Japanese corporate governance (Marsh & Mannari, 1971; Nakagawa, 1993; Sugayama, 1995). When the war ended, firms were left with excess capacity and hundreds of thousands of employees faced massive layoffs. At the same time, the Occupation allowed labor to organize more easily, as a part of democratization of the economic system, which brought the rapid formation of organized labor unions in this period. With the newly gained power from revised labor law, labor unions fought vehemently against top managers. The labor unions demanded job security as well as wage increases, because instability in the job market threatened the lives of most employees. In the negotiation process, it was the company unions, not the industry based unions, that were more successful in dealing with the top management. The dominance of company unions combined with their

[3] By looking at the ages of top executives in 1953, Miyajima (1993) makes it clear that most of the purged executives, despite the later political events which cleared their name, did not come back to run the company again.

demand for job security set the ground for the establishment of the permanent employment system in the following years. The chronic labor shortage during the high-growth period was a significant factor promoting lifetime employment.

What was the reaction of the dominant stakeholders? For one thing, the bank has been the biggest supporter of the J-type community firm, although the support is limited to the firms that are not in significant trouble. It may be related to the fact that the bank itself also accepted the community logic. An ethnographic study of a Japanese bank by Rohlen (1974) revealed that Japanese banks were organized to secure a common livelihood and way of life for their employees, even more so than industrial firms. The bank in Rohlen's study shares the features of J-firm described by Aoki (1984, 1994): low turnover rate among male employees, life-time employment, the ideology of the firm as a big family, and hierarchical structure of the top management. Main banks may have provided the industrial firms a model for running an organization. The prestige of banks as an ideal workplace among college graduates may have encouraged industrial firms to adopt some, if not all, of the personnel practices that guarantee job security.

Community logics have been challenged as Japanese firms experienced several economic crises during the post World War II period, yet have shown remarkable resiliency. For example, the two oil shocks were a test of employee centered community logic. Although firms had to trim down quite a bit, the community logic was still kept since the large firms were relatively successful in keeping the rules of community logic. Thus, employee centered characteristics were tied with prestige and made it more ideologically correct for Japanese business society. In other words, the diversification strategy that reflected the employee-centered nature of

Japanese firms was able to keep the myth amidst the economic crisis. Also, top management showed good will toward protecting the organizational identity as a community and its core employees through various actions, such as the *shacho* and the chairman resigning voluntarily after major downsizing. Mroczkowski and Hanaoka (1997) show that the tradition of putting employee interests first has also continued, where cutting the workforce was taken as a last resort, not a first resort. In a sense, the J-type community logic is a community logic that puts "community" or "firm" even before the interests of employees.

Dominant stakeholders and variations in organizational identities

Japanese firms are more diverse than most literature on Japanese corporate governance may suggest. The diversity within the Japanese business could be best revealed if we understand the role of dominant stakeholders in shaping organization identity and rules. It is important to bear in mind that the general categories of stakeholders that are the focus of discussion in the U.S. case do not fit well for Japan. In the Japanese context, specific social actors, rather than sets of actors, dominate the political structures of firms. These are discussed in more detail below, but they include the main bank, family owners, and specific government departments or ministries. In certain corporations, specific organizations not only have a large stake, often symbolized by some shareholding, but they are also powerful institutional actors in their own right. They acquire legitimacy not only from their interaction with the firm in which they have a stake, but also from their status within the larger business system and within the Japanese society. These dominant stakeholders left distinctive footprints in organizational identity and rules.

(1) A note on shareholders: the multiplexity of relationships

Shareholders in Japan are often described as not having any superior claim over the firm (e.g. Aoki, 1988). Although shareholders' rights are also protected by law, as in the U.S., the concept of the firm as maximizing shareholder value has been foreign to both management and shareholders themselves. This point was illustrated quite vividly in the 1980s, when top managers were asked to rank their priorities in company policy decision. Share price and shareholders' interest took almost last place in the top managers' priority lists (Abbeglen & Stalk, 1985; Itami, 1994).

It would be wrong, however, to conclude that Japanese shareholders are completely ignored by management. Japanese shareholders can be divided into two different types, or classes: 1) long-term stable shareholders, accounting for about 70 percent of the whole equity market; and 2) short-term shareholders, usually individual shareholders, accounting for the remaining 30 percent.

Table 3-3 shows the types of shareholders in the publicly traded firms in Japan. The table indicates that various stakeholders—banks, government, individual, and other industrial firms—hold shares for different reasons.

The unique feature of Japanese corporate governance lies in the fact that share ownership is deeply embedded in the on-going business activities and that share ownership is used as a token of stable long-term relationship rather than as a means to maximize profit or as a means of control. When we examine the composition of the largest, say top 10, shareholders in large industrial firms, we notice that shares are owned by various stakeholders: creditors, alliance partners, government supported funds, and the founding family. Share ownership by stakeholders shows the most distinctive feature of Japanese corporate governance—the multiplexity of relationships. Relationship takes precedence over the narrow stakeholder interests.

In conclusion, management's low priority given to share price is, in a sense, a recognition of the long-term needs of shareholders rather than a neglect of shareholders' needs. Moreover, some of the long-term shareholders achieve what they want in the business transaction with firms in which they hold shares. It is smaller shareholders who are treated with little respect.

(2) Main bank and the change of identity

The role of main banks has been discussed extensively in Japanese corporate governance literature. An important feature of the Japanese main bank system is the role differentiation between the main bank and other creditors. The main bank alone does not hold a large enough equity stake to control the company, but its power is significant as other creditors delegate the monitoring role to the main bank (Aoki, 1994; Sheard, 1994; Teranishi, 1994). The additional monitoring costs are often compensated through the privilege of having business transactions with the firm. The monitoring role is reciprocal among the main banks as the 10 largest city banks, who usually assume the role of main bank, also own blocks of shares (up to 5%) in firms even where they are not the main bank. Main banks also have distinct behavioral norms expected of them. The requirements for being a main bank include the willingness to supply capital and to support restructuring of the interested firms in times of financial difficulties, and to take the final credit risk. In order to fulfill these roles, main banks actively put effort into training personnel to have management capabilities.

Monitoring by a main bank is mainly achieved by dispatching directors to the lending firm. Table 3-4 shows a list of the 10 largest main banks and the number of directors they dispatch to industrial firms. It is useful to distinguish between the regular flow of dispatched directors and the emergency flow of dispatched directors. In the regular flow, only one or two directors are dispatched as external auditors. In emergency flow, the number of the dispatched may increase significantly, and dispatched directors assume the higher rank within the top executive hierarchy, such as senior managing directors, vice president, and even *shacho*. The hierarchical nature of the Japanese board and the special role expectations for the *shacho* make this high level intervention necessary.

The changes in governance structure aim at preserving the organizational identity, rather than dismantling the firm. Turnaround is expected. The main bank bears the risk and become more like a manager or a restructuring specialist. The mission for the bank-dispatched *shacho* is to help the firm become independent again, so that the firm could be run by an inside manager again. In a sense, we may even say that it is main banks that change their identity from lender to manager.

The intervention tends to be long because restructuring may take a long time. A main bank may prevent a troubled firm from faltering, but complete revival requires luck and ingenious leadership. One of the successful turnarounds that came after long years of main bank intervention is Asahi Breweries. Since Asahi Breweries first started to accept *shacho* from

Sumitomo Bank in 1971, it took more than a decade and two additional dispatched *shachos* from Sumitomo Bank before it finally made a dramatic increase in sales and profit under the leadership of *shacho* Higuchi. Thus, once the main bank controls the office of *shacho,* it is more likely that the next shacho will also come from the main bank until the firm is ready to go it alone. In other words, the rule of outsider selection is established.

(2) Industrial firm/Parent company and the organizational identity of an offspring

Sizable numbers of publicly traded firms in Japan have other industrial firms as major stockholders. The purpose of ownership is to control the top management and production process and to solidify the relationship between firms rather than to profit from the ownership (Asanuma, 1994; Westney, 1996; Higuchi, 1997). This type of relationship is also called *keiretsu* in Japan, but it is quite different from the six large horizontal *keiretsu* in which the relationship among member firms is less vertical. As an illustration, I show the list of semi-subsidiary firms of Toyota Motors by industry in Table 3-5. The table includes only the publicly traded firms within the Toyota group. Among the 24 firms in Table 3-5, eight firms were ranked within the top 200 manufacturing firms in 1980, which shows that vertical *keiretsu* groupings exist at all levels of firm size. If we include the firms that are not publicly traded, the number of firms that cooperate with Toyota Motors could go up to 187 for the parts companies, 66 for the facility (*setsubi*) related firms. If we count the second and third tiers of the *keiretsu,* the number is virtually impossible to count. Similar vertical *keiretsu* groupings could be found at major large industrial firms.

The organizational identity of partially-owned, spinoff firms could be best described as an 'offspring.' In fact, a Japanese word for subsidiary is '*kogaisha,*' which literally means a 'child company.' Although the term *kogaisha* is usually reserved for the wholly owned subsidiaries in Japan, the spirit of parent-child relationship still holds in the case of spinoff firms. If the relationship between an infant and his parents describes the kind of relationship that *kogaisha* has with its parent company, the relationship between an adolescent and her parent describes the kind of relationship that a spinoff has with its parent company. Although the spinoff company still depends on its parents for important resources, such as capital, management talent, and marketing, it nevertheless tries to maintain its independence. Moreover, when a semi-subsidiary firm does outgrow the parent company, it takes care of the needs of its parent company, just as sons and daughter support their aging parents (Ito & Rose, 1994; Ito, 1995).

The power of top executives in the spin-off firms, including the *shacho,* comes from their ties with the parent company. One of the important succession rules for spinoff companies is that the *shacho* at the spinoff company does not have complete autonomy in choosing his successor. He has to consult the parent company for his successor. Many top executives at spinoff firms have been hired by the parent company at one point. Such a trend is especially strong in the early years of spinoff firms, because the lack of external labor market forces complete dependence on the parent companies for labor. In later years, however, the semi-subsidiary firms may still accept top executives from the parent company in order to facilitate coordination and communication with its parent company. Again, the outsider succession rule is established in the semi-subsidiary firms.

The relation between parent and semi-subsidiary companies may have different origins. First, quite a few firms are created as a division of the parent company and are later spun off. For example, Toyota Motors was a spinoff from Toyoda Automatic Loom, and Fujitsu was a spinoff from Fuji Electric. The two firms are also examples where the semi-subsidiary company outgrew the parent company. Spinoffs are often used as a strategy to participate in emerging markets (Ito, 1995). By creating a separate entity a company could reduce the risk for complete failure. It could reap the benefits of a young organization. Second, some of the smaller firms chose other larger, stronger firms within the same industry as alliance partners, giving them security through increased capital, technological support, and managerial support. Such a trend was especially strong in the automobile industries. For example, Daihatsu and Hino became part of the Toyota groups during the 1960s as a way to ward off foreign companies. Finally, separate firms were established in order to encourage competition within the same group. Firms that were kept separate for the same reason include Japan Victor Company of Matsushita and Tokyo Sanyo of Sanyo Corporation.

(3) Founding family and the identity of family firm (*dozoku kaisha*)

Chandler (1977) asserts that most family firms will in the long run be transformed into managerially controlled firms. In that sense, family firms could be thought of as firms in transition. The path of the transition, however, may vary across firms. The timing of the transition may also vary depending on the unique history of the firm. Until that transition actually happens, family members remain the dominant stakeholders who assume the leadership position or monitor professional managers.

In Japan, the transition from family firm to managerially controlled firm was hastened in some industries with the defeat of Japan in the WWII. The reforms of the Occupation Army severed family ties in several large *zaibatsu*, which dissipated some of the more prominent owner families. Yet, family bases were preserved for firms that had no obvious tie with military activities during the World War II, or for firms that were small. Several pharmaceutical companies are examples. Also there are several firms that grew after the World War II which are still influenced by the founding families. Examples include Sony and Matsushita.

In modern Japan, especially during the post WWII period, family firms represented backwardness and smallness, especially in the light of community logic in the business world (Morikawa, 1996). The word *dozoku-gaisha*, which could be translated as "family firm," is often used in a pejorative way. By limiting the *shacho* succession race to the family members, it is believed, family firms do not attract the most career aspiring professional managers, or face handicaps in boosting employee morale. Moreover, there have been quite a few incidents where the *shacho* succession involved competition among siblings that was quite destructive for the family as well as for the firm.

One interesting aspect of the family firm in Japan is that founding families hold only a small amount of shares in the firm over which they exert control. For example, the Takeda Science Foundation owned 2.13% of total shares at Takeda Pharmaceutical in 1985, while one of the Takeda family was with the firm as a *shacho*. It shows that the founding family is a special type of shareholder, able to wield power beyond the basis of shareholding.

Succession rules in family firms are different from succession rules in non-family firms. Succession rules may indeed differ across family firms, reflecting the family dynamics as well as the style and preference of individual families. First of all, family members are identified as successors very early in their career and receive special training in preparation for future top leadership. When there is more than one eligible family member, there may be a horse race competition among family members. When the incumbent *shacho* in a family has only daughters in the next generation, he may consider a son-in-law as his successor. As a result of early identification, the age of a *shacho* who belongs to a founding family is often quite young compared to that of non-family *shacho*. The young age of the *shacho* also results because it is a succession from father to son, which involves a generational change that spans a thirty-year age gap.

Second, professional managers may assume the position of *shacho* as an interim *shacho*. The role of the interim *shacho* is to educate and prepare the next generation of the founding family rather than to make substantial changes in corporate strategy. In this case, personal loyalty to the founding family may be the important qualification for the professional manager to become a *shacho*. In fact, the practice of having an interim *shacho* is well established in Japanese management history (Morikawa, 1996). As early as Tokugawa era, *zaibatsu* family such as Mitsui and Sumitomo were famous for having talented and loyal head clerks (*banto*) who ran the family estate. Despite the tradition, however, the *shacho* has more power than the head clerk and may seek to remove the family from top management.

In short, family members continue to have access to top executive positions among firms in younger industries, for example, food and electronics industries, and in a traditional industry, such as the pharmaceutical industry where most of the firms could trace their history back to pre-modern Japan. They also develop culture for family firms. They reward commitment and loyalty toward the family. The imprinting of the founding experience seems important in determining the nature of the family reign.

(4) Government

The Japanese government has actively intervened in selected industries with the goal of producing firms that could compete successfully in the world market (Johnson, 1982). The role of MITI, the Ministry of International Trade and Industry, has been especially large in non-financial companies, although it is debatable exactly how much government was instrumental in the phenomenal growth of Japan. Beside regulations, national subsidies, and tax policies, which are commonly used by governments in other countries, the Japanese government has unique ways to influence business: administrative guidance, and personnel flows from government to financial and industrial firms.

The state has a long history in playing a special role in economic development in Japan since the opening of the nation in 1867 (Hirschmeier & Yui, 1981). As is common in late-industrializing societies, state bureaucrats with knowledge and managerial skill provided a pool of scarce management talent. For example, Mitsubishi Mining started as a provincial government project in 1866, until it was finally sold to bureaucrat-turned-businessman Iwasaki Yataro, the founder of the Mitsubishi group. During war-time, the military government intervened directly, coordinating production for the war-time economy.

The role of government in the postwar crisis following the Occupation period was rather indirect because the role of government in the war-time economy was heavily criticized. Instead, the government's role centered on funding through the Bank of Japan. The Bank of Japan had been leading the loan consortium to allocate funds to key industries as part of the Target Production Policy, although it gradually relinquished the role to private banks as early as 1948. The Bank of Japan provided the role model for city banks to follow during the financial crisis throughout the post World War II period (Okazaki, 1994).

Not all industries have an equally close relationship with the government bureaucracy in Japan (Okimoto, 1989). Industries such as steel, petroleum refining, and the electrical power utilities have been dependent on government support, while industries such as the fast-food industry or the general trading companies have maintained quite distant relationships with the government bureaucracy. The electronics industry is somewhere in the middle between adhesion and arm's length autonomy. Although government bureaucracies rarely become a major shareholder in industrial companies, they can support firms enormously through lending and through controlling the legal environments within the industry. The organizational identity for these firms could be thought of as that of public enterprise, as opposed to private enterprise, even though they are traded in the major stock exchange.

Intervention by government has been maintained by the practice of government bureaucrats seeking their second job at private firms after retiring from the government. The practice called '*amakudari*' (translated directly as "descent from heaven") made the government bureaucracy the most attractive career for college graduates. Schaede (1995) argues that the old boy network of government bureaucrats provides an important monitoring mechanism for Japanese corporate governance. However, the role of these *amakudari* directors seem to be limited to channeling information, especially after Japanese government has taken various liberalization policies. With the government having less means for controlling the industrial firms, the influence pattern may go the other way around, in which the industrial firm tries to influence government by providing employment opportunities for retiring bureaucrats.

Just like the main bank, government has a role as providing a source of organizational identity and rules and a role as a dominant stakeholder. Table 3-6 shows the list of *amakudari* directors from MITI to industrial firms. The office title of *amakudari* directors is an indicator of the involvement of government bureaucracies in industry and in individual firms.

Conclusion

In this chapter I reviewed the institutional context of *shacho* succession in Japan, and the cases in which particular stakeholders carry unusually significant weight in the *shacho* succession pattern. Japanese firms shared both a stakeholder environment and an institutionalized community conception of the firm. On the other hand, some firms have a distinctive pattern of dominant stakeholders that shape the organizational identity and influence the pattern of *shacho* succession.

The review of the Japanese corporate governance system through the lens of institutional context and of dominant stakeholders does not give the complete picture of Japanese *shacho* succession, however. In the U.S., a dominant set of stakeholders, the shareholders as represented on the board, has at least in theory the power to force a *shacho* to retire. In Japan, only in a minority of firm is there a counterpart, in terms of a dominant stakeholder. Therefore the puzzle of *shacho* succession in Japan remains. How is the problem of reluctant retirement addressed in the Japanese context? The next chapter tries to answer the question by examining succession rules for Japanese *shacho* through the stories of *shacho* succession in the popular business press.

Table 3-1. The comparison of corporate governance system: U.S. vs. Japan

	U.S.- Market Governance	Japan – Relational governance
Organizational model	Property view of firm	Community view of firm
Financial market	Well developed security market	Weak financial market, strong main bank
Control characteristics	Control based on equity	Control based on loan, equity, & personnel exchange
	Arm's length	Tight control

Table 3-2. The board of directors at Sumitomo Metal Industries in 1995.

Title	Title in Japanese	No. of directors (Outsider)	Avg. age	Avg. tenure with the co. (Excl. outsider)
Chairman*	*Kaicho*	1	69	47
CEO & President*	*Shacho*	1	65	40
Vice president *	*Fuku shacho*	3 (1)	61	25.6 (36.5)
Senior executive director*	*Senmu*	2	58.5	35.5
Managing executive director	*Jomu*	6 (1)	58.2	29.5 (34.6)
Director	*Torishimariyaku*	16 (2)	56.1	28.4 (32.1)
Full time auditor	*Joninkansayaku*	2	57	33.5
Auditor	*Kansayaku*	2 (2)	74	1.5
Total		33 (6)	58.8	28.4 (32.8)

Source: *Yuka Shoken Hokokusho.*

*: directors with representative right.

Table 3-3 Share Ownership of All Listed Firms by Type of Investors in Japan

Type of shareholders	Five Years Average (Percentage of Listed Shares)				
	1970-74	1975-79	1980-84	1985-89	1990-92
Government	0.2	0.2	0.2	0.8	0.6
Financial Institutions	34.4	37.6	39.0	44.4	44.8
Banks	n.a.	n.a.	17.7	21.0	21.8
Investment Trusts	1.4	1.8	1.2	2.5	3.3
Annuity Trusts	n.a.	n.a.	0.4	0.9	1.0
Life Insurance	11.2	12.0	12.6	13.2	13.1
Other Insurance	4.6	4.8	4.9	4.3	4.0
Other Institutions	1.8	1.9	2.2	2.4	1.6
Business Corporations	25.6	26.3	26.0	24.6	24.7
Securities Companies	1.4	1.6	1.8	2.3	1.5
Individuals & Others	35.2	31.9	27.7	23.5	23.4
Foreigners	3.2	2.4	5.2	4.4	5.0

Source: Kojima (1997).

Table 3-4. Dispatched directors from main bank among publicly traded firms in Japan in 1993 (Total number of publicly held firms: 2240)

Top 10 Main Banks	Capital (Trillion)	Number of firms accepting dispatched directors	Number of dispatched directors
Nihon Kogyo Bank	31.4	102	137
Daiichi Kangyo Bank	40.0	138	224
Tokyo Bank	16.2	41	48
Sakura Bank	39.8	118	170
Mitsubishi Bank	37.0	131	187
Fuji Bank	39.1	130	174
Sumitomo Bank	37.6	83	166
Sanwa Bank	37.2	113	177
Tokai Bank	23.4	76	137
Asahi Bank	21.7	61	82

Source: *Nihonno jinmyakuto kigyokeiretsu* (1994).

Table 3-5. Related firms in Toyota Motor group.

Industry	Firm	% hold by Toyota Motors
Automobile	Hino Motors	11%
	Daihatsu	15%
	Toyota Shatai	43%
	Kanto Automobile	48%
Parts (Direct)	Toyoda Automatic Loom	23%
	Aichi Seikou	21%
	Toyota Koki	21%
	Aishin Seiki	21%
	Nippon Deso	23%
	Toyota Spinning	9%
	Toyota Synthetic fiber	41%
Part (Transaction Partner)	Tokai Rika Denki Seisakusho	30%
	Aisan Industries	31%
	Chuo Hassu	23%
	Hutaba Indusries	13%
	Kyowa Leather	33%
	Trinity Industries	30%
	Koyo Seiko	21%
	Tokyo Shoketsu Metal	25%
	Chuo kaen Industries	5%
	Owari Seiki	5%
	Koito	19%
	Shiroki Industries	14%
	Kayaba Industries	9%

Source: *Nihonnno jinmyakuto kigyo keiretsu* (1994, p. 149).

Table 3-6 Amakudari from MITI to industrial companies in 1993.

Industry	Executive Positions	Firms
Oil	Chairman	Showa Shell Oil*
	<u>Shacho</u>	Arabia Oil*
	Senior Exec. Dir.	Teikoku Oil
	Managing Dir.	Japan Energy
Electricity	Vice president	Chubu Electricity*, Chugoku Electricity* Tohoku Electricity*, Okinawa Electricity*
	Managing Dir.	Tokyo Electricity*, Hokkaido Electricity*
Gas	Senior Exec. Dir.	Osaka Gas*
	Managing Dir.	Tokyo Gas, Toho Gas
Construction	Vice President	Aoki Construction*
	Senior Exec. Dir.	Tekken
	Managing Dir.	Kajima, Kumadanigumi
	Director	Toda Construction
Chemical	Vice Chairman	Nihon Sheet Glass*
	Vice president	Asahi Glass*
	Senior Exec. Dir.	Showa Denko, Synthetic Rubber
	Managing Dir.	Sumitomo Chemical
	Director	Nihon Sanso, Ube Kosan, Toho Chemical, Takeda Pharmaceutical, Sumitomo Osaka Cement
Steel/Metal	Chairman	Kobe Steel*, Toho Aen*, Topure*
	Vice Chairman	Kawasaki Steel*.
	<u>Shacho</u>	Chugoku Industry*
	Vice president	NKK*, Sumitomo Metal*, Daido Specialty Steel*, Kobe Steel
	Senior Exec. Dir.	Kobe Steel
	Managing Dir.	Japan Steel, Furukawa Denko, Fujikura
Machine	Senior Exec. Dir.	Toyo Engineer*, Kubota
	Managing Dir.	Chiyoda Chemical Machinery
	Director	Komatsu
Electronics	**<u>Shacho</u>**	Tokimekku*
	Vice president	Mitsubishi Electronics*, Kanda Communications
	Senior Exec. Dir.	Matsushita*, Nippon Denso*, Hitachi, Sony
	Managing Dir.	Toshiba, Fujitsu, Sharp, Kyocera, Ricoh
	Director	Oki Electronics
Transportation	Vice president	Suzuki*

(Table continues in the next page)

Machinery	Senior Exec. Dir.	Mitsui Shipbuilding*, Nissan, Hino
	Managing Dir.	Mitsubishi Auto, Kawasaki Heavy Industries, Fuji Heavy Industries
	Director	Suzuki
Wholesale	Vice president	Itochu*
	Senior Exec. Dir.	Marubeni*, Tomen*, Mitsubishi Shoji*, Iwatani Sangyo
	Managing Dir.	Mitsui Bussan*, Nissho Iwai
Retail	Vice president	Nichii
	Senior Exec. Dir.	Seiyu*, Nagasakiya, Daiei, Izumiya
Others	Senior Exec. Dir	(1)**
	Managing Dir.	(2)**
	Director	(1)**
	Advisor	(3)**
	Auditor	(3)**
	Auditor	(3)**
Total	87 Companies	
	91 person	33 with representative rights (*).

Source: *Nihonno jinmyakuto kigyokeiretsu* (1994, p. 23).
* : Director with representative rights
** : number of directors in the parenthesis

Chapter 4. Rules of *shacho* succession in managerial firms

Organizational rules mirror the identities of organizations, providing guiding principles for everyday decisions. Organizational rules can be thought of as providing guidance in specific situations, in our case the situation of *shacho* succession. Each firm may develop scripts or 'theories' of *shacho* succession—that is, theories for selecting the best person—based on institutional logics and also based on organizational history. These 'theories' of succession are likely to share many of common elements as they are influenced by the institutional logic. Yet, these 'theories' of succession are likely to have idiosyncrasies, because they are shaped by the unique history of the firm. Succession rules reflect the 'theories' held by actors in organizational fields.

Linguistic framing is important in providing legitimacy for the succession rules (Hirsch, 1986), especially if the linguistic framing is grounded in popular culture. Linguistic framing can be especially useful when some of the actors break the rule. Breaking the rule is only natural, if we admit the human agency in the decision making process. When faced with rule-breaking behavior, both actors and observers try to make sense of the deviant behavior. The guiding principles of *shacho* succession provide a basis for evaluating these unusual *shacho* events. Deviant behaviors that are consistent with the guiding principle are less threatening than those deviant behaviors that directly go against the principles. Through the linguistic framing of these unusual successions, values are imposed on these deviant behaviors, which may help to strengthen the dominant institutional logic, or to give legitimacy to an emerging institutional logic.

In order to identify organizational rules of top executive succession, I examine the popular business journal articles on *shacho* succession published in *Keizaikai* between 1982 and 1991. There are two by-weekly business journals that provide extensive coverage on Japanese top management: *Keizaikai* and *Zaikai* (both could be translated as 'business world'). These journals are known not for their analytical power, but for the intimate details of *shacho* succession obtained either through interviews with principal actors themselves or through the 'anonymous' industry experts who provide the reporters with details of *shacho* succession. Although they may not be the best source to get insights on the Japanese economy in general, they are a good source for an outsider to learn about intricacies of *shacho* succession. I would also argue that these articles reflect the past practices of *shacho* succession in the organizational field, if not the current or future practices.

In the first section, I review the succession rules for Japanese *shacho* in four aspects: community identity and the guiding principles of *shacho* succession; procedural rules on succession; tenure rules; and two competing rhetorics of succession (rules on why there should be a succession or no-succession). Then, I examine some unusual successions—that is, *shacho* successions that break the prevalent rules—and see how they are framed in the press.

<u>Succession rules and Succession-as-usual</u>

Succession-as-usual reflects the existence of institutional rules of *shacho* succession. A succession in one firm is perceived as usual because it has followed the informal rules of *shacho* succession dominant in the organizational field. These informal rules specify who initiates the succession process, who the candidates will be, why succession occurs, and when succession occurs.

(1) Community identity and guiding principles of *shacho* succession

As discussed in Chapter 2, the logic of community provides an important source for organizational identity among large Japanese firms. The most important principle in *shacho* succession, as it is in any leadership succession, is to find the best person so that the organization will preserve its organizational identity and continue to prosper under the new leadership. The mandates of finding the best candidate and preparing him for the top position are the two most important things that the board of directors and the *shacho* have in mind when they initiate the *shacho* succession process. In fact, a Japanese *shacho* is evaluated for his ability to designate the best successor, which is revealed in the following comment.

> "A top manager is evaluated by the selection of his successor. For example, Mr. Ikeda, the adviser and the former *shacho* of Mitsui Bussan, used to have a low approval rate both within the firm as well as among business circles while he worked as a *shacho*. However, he has been reevaluated afterward because he has chosen such a brilliant successor, Mr. Yahiro, who did a wonderful job. (*Keizaikai*, 1985. 1.22)"

In addition to the need to find the best successor, there is an additional guiding principle in Japanese *shacho* succession—to rejuvenate the firm. The term *'wakagaeri'* (rejuvenation) is used again and again in describing most *shacho* succession. A Japanese management team, as well as the whole organization, is susceptible to aging because of the seniority principle and the abhorrence of laying off employees without very good reason. *Shacho* succession is an effective way to deal with the aging of the work place, because the vertical nature of Japanese social life makes it difficult for senior employees to stay when their subordinates assume higher positions in the organizational hierarchy. Thus, *shacho* change usually brings a string of promotions in the lower levels of the hierarchy and a sizable turnover in the higher levels, both voluntary and involuntary. Although there is really no reason why there shouldn't be continuous rejuvenation at other levels of hierarchy without *shacho* change, the lack of *shacho* turnover is often correlated with the large population of senior executives in Japanese firms.

Retirement is often framed as 'cherry blossom' in Japanese society, which emphasizes the virtue of early retirement. The image of *sakura* (cherry tree/cherry blossom) is often used to describe the last exit of the leader. The Japanese have a great fondness for the cherry tree. Each year, the entire country is captivated by the northward progress of the blooming of the trees—the so-called "cherry blossom front." Japanese love *sakura* not just for its beautiful flower, but also for its enchanting way the petals scatter in the wind. The scattering of cherry blossom provides a powerful image for Japanese to end their career without any lingering.

> "Japanese love the cherry blossom for its splendid scattering. As such, great leaders in Japan share the common character of exiting/resigning a bit early, with the regret of those who follow them. (*Keizaikai*, 1985.1.22, p.48)"

(2) The procedural rules of *shacho* succession

One of the most important elements of the 'normal' *shacho* succession is that the *shacho*, not the directors or the chairman of the board, initiates the succession process. The chairman of the board, who is usually the retired *shacho* in the same company, plays an important advisory role in the succession process. The rather passive role of the chairman in the *shacho* change process is expressed in the term '*inkyo*' (retirement from active life) which is used to describe the handover of the household head position from father to son. Once the father hands over the power to his son – that is, once he publicly announces his retirement (*inkyo*) – his role within the family is dramatically diminished, despite the fact that he is still living with the same family. Similarly, when a retiring *shacho* was questioned whether he would continue to be active in management decision making as chairman of the board, he answered, "No. Not at all. Japanese have a well-established retirement (*inkyo*) system for the chairman. I would of course give advice if the new *shacho* seeks one, but he (the new *shacho*) is now the head of the company. (*Keizaikai*, 1982.10.12)" Yet, as the mentor of the incumbent *shacho*, the chairman is consulted on several key aspects of *shacho* succession, such as the timing of the change as well as the selection of the new *shacho*.

Second, as mentioned already, another important procedural aspect of 'usual' *shacho* succession is that the outgoing *shacho* assumes the position of the chairman of the board on his retirement. Although he gives up the power of organizational decision making, he is still respected as the symbolic leader of the community until his successor decides to step up for his own retirement. The two-step process of retirement makes the incumbent *shacho* less reluctant in his retirement decision, especially when compared to a CEO in the U.S. who has to give up everything as he steps down from the top position.

The retirement of the *shacho* to become chairman is not automatic, however, and is contingent on many factors. For example, if the retiring *shacho* has done a bad job in his reign, he loses his legitimacy as symbolic leader of the firm. The existence of a powerful chairman who resist stepping down may also obstruct the 'normal' promotion of the *shacho*. In either cases, shacho may retire into positions other than chairman, such as advisor (*sodanyaku*), or vice chairman, usually without representative rights.

Third, it is considered a usual *shacho* succession if the successor is an insider who has spent most of his career within the company. Often called *haenuki* (native born, born and bred) or *puropa* (professional manager), the insider *shacho* proves that a firm is capable of training its own leader, unlike some of the less prestigious firms which have to rely on external sources for their top management talent. The rule of insider succession is taken for granted once it is established within the firm. When insider succession has not been the rule, insider succession is expected to boost employee morale. In a society where the employees have limited opportunity for moving across firms, filling the position of *shacho* with an insider has a practical benefit of motivating employees across all levels of the hierarchy by signaling that they might also reach the top position someday.

Being an insider is not enough to make the *shacho* succession a usual one, however. To minimize the chance of losing top executives to other firms, Japanese firms tend not to designate the heir apparent. A horse race is the preferred mode, which is also reflected in the epithets accrued to the candidates, such as '*honmei* (the favorite)' and '*taikouba* (the rivals).' The race usually involves the two top ranks—vice president ('*fukushacho*') and senior executive manager ('*senmu*')—within the top management team[1]. Firms may vary in the number of vice presidents (*fukushacho*) or senior executive managers (*senmu*), but these two classes of top executives

[1] The hierarchical structure of top management is shown in Table 3-2 which shows the list of top executives at Sumitomo Metal Industries in 1996 as it appears in *Yukashoken hokokusho*, the Japanese equivalent of proxy statement. Most firms adopt the same titles for their top executives. Again, it reveals the highly institutionalized nature of Japanese business.

usually share the representative rights with the *shacho* and *kaicho*, signaling their status as candidates for the next *shacho* race. It is within these two classes of top executives that business journals will identify the favorite candidate (*'honmei'*) and his rivals (*'taikouba'*). When the new *shacho* comes from outside of these two ranks, it is considered 'unusual' even when he is also an insider. I will discuss these unusual cases in a later section.

(3) The tenure rules

A closer look at *shacho* change reveals the Japanese firms' reliance on various tenure rules. There are three types of tenure rules that are followed by many Japanese firms: the 2-year unit term rule, tenure-limit rule, and retirement age rule. *Shacho* succession is considered 'normal' when it follows the tenure rules within the organization. First, Japanese firms have a two-year unit term, which is called *'ki,'* for their *shacho*. Thus, the tenure of a *shacho* is often described as two-term-four-year (*'2-ki-4-year'*), meaning that the *shacho* has served for two 2-year terms, making four years in total. It is a norm that *shacho* change occurs at the end of the 2-year term, not in the middle of the term.

Second, another informal tenure rule is to have a pre-determined tenure limit for the office of *shacho*. Some Japanese firms are known for having these informal rules. For example, Mitsubishi Heavy Industries and Japan Steel had a 4-year tenure rule, while Hitachi had a 10-year tenure rule. These tenure rules were referred to as 'internal rules' (*naiki* in Japanese)' or 'unwritten rules' (*hubunritsu* in Japanese). [A vignette of *shacho* succession at Japan Steel is included at the end of the chapter as Appendix 4-1.] Tenure rules may vary across firms, yet Itami (1995) and

Miyajima (1996) both report that the tenure rules of two-term-four-years and three-term-six-years have become increasingly popular among large firms in recent years.

Third, the most popular tenure rule is to retire shortly before the retirement age, although few firms have an explicit mandatory retirement policy for the *shacho*. The age of seventy, which is given a special term, *koki* [2], is a socially accepted retirement age that is widely shared among Japanese firms. For example, the *shacho* and founder of Suzuki Motors, Mr. Suzuki, retired in 1957 without assuming any positions in the company. The explanation for his retirement was that he became *koki*. *Koki* is also celebrated among Japanese scholars with a commemorative publication that is a collection of writings by their disciples in the field (a *"festscrift"*).

Just like tenure limit rules, the retirement age rule creates an implicit limit for the *shacho's* tenure. When a firm does not have an internal rule on the desired tenure for its *shacho*, the retiring *shacho* may impose a limit by selecting a successor who is in the 'right' age band (Vancil, 1987). When the firm has an internal rule on the desired tenure for *shacho*, it would be important information to know who is considered as a candidate and who is not.

In addition to these organizational rules of tenure, it is also considered 'usual' to have *shacho* change at special historical moments, such the as 50th, 60th, or 100th anniversary of the firm's founding. The start of the new decade—more often the new decade in the Japanese reign-year system rather than the new decade in the Western calendar—also provided a timing marker for *shacho* change to occur.

[2] The term *koki* comes from a Chinese poem my Tu Fu, which sings "It Is quite an achievement to become 70. Why don't we hope for 70?" In referring to his own life, Confucius also had something to say about age 70: "at seventy I could indulge my heart's desire without overstepping the rules."

(4) The best time to retire: the rhetoric of *hanamichi* vs. *insekijinin*

If all the *shacho* successions in Japan occurred only by the tenure rules identified above, we would see complete decoupling of succession from performance and other criteria. Yet, researchers have found that Japanese top executive successions are related to performance (Kaplan, 1994; Miyajima, 1996). The coupling suggests that there is another logic of *shacho* succession that works together with tenure rules to guide *shacho* succession in Japan. There are two quite distinctive 'theories' of retirement in Japan: the *shacho* retires when he has done a terrible job; the *shacho* retires when he has done a terrific job. The former is called *insekijinin* ('retiring in order to take responsibility'), and the latter is called *hanamichi* ('flower passage').

The rhetoric of *insekijinin* is easier to understand from resource dependence theory. *Shacho* change is a time for readjustment with the changing external environments, facilitated by powerful stakeholders who may voice their concern through various channels. It is hard to deny the influence of powerful stakeholders, especially the main bank, but quite a few *insekijinin* result from a *shacho's* own judgment that he is not suited for solving the organizational problem.

Performance is only one of the reasons, and sometimes the least significant reason, for retirement as part of taking responsibility. *Insekijinin* is reserved for colorful failures. They range from financial crises—such as failure to pay the dividend, or losing market share to a rival, especially when it involves a change of ranking within the industry, such as Sapporo Brewery losing its second place to Asahi Brewery—to non-financial crises, including accidents, conflict between labor and management, and even downsizing.

The rhetoric of *hanamichi* is quite unique in Japan as it encourages a *shacho* to consider stepping down (or stepping up) when he is doing a good job. The word *hanamichi* originated in Japanese Kabuki theatre. It is a runway that passes from the rear of the theatre to stage right at the level of the spectators' heads. The entry on *kabuki* in the *Encyclopedia Britannica* has the following description: "An integral part of the Kabuki drama since the 18th century, it is used for climactic scenes—spectacular entries, exits, processions, and battles—and for scenes when intimacy and emotional rapport with the audience are desired. The name *hanamichi* suggests that it was once used to present flowers and gifts to the actors." *Hanamichi* as the ideal form of retirement is also shown in another Japanese word, which always accompanies *hanamich*, *yutai* (the brave/honorary retirement). The term *yutai* is often used in the military when a commander steps down voluntarily to make way for a younger colleague. *Yutai* is applauded because it leads to the rejuvenation of the community and the firm. Together, the rhetoric of *hanamichi*, *yutai* and *wakagaeri* recapitulate the logic of community in which leadership change is a time for celebrating the shared identity as a community—the benevolent leader making way for his younger successor, which will prepare the community for prosperity in the future as a result of rejuvenation.

To make the *shacho* succession even more spectacular, a *shacho* may schedule his exit so that he has some visible achievements of which to boast. The achievements that make a *shacho's* exit *hanamichi* are not confined to performance measures, such as return on investment or stock price, although the a dividend payout is one of the more frequently referred conditions for *hanamichi*. Other achievements include launching a new business, such as Mr. Yamazaki at Mazuda launching a new business in the U.S. market in 1985, or presiding over well-recognized national or global conventions, such as Mr. Tamaru at Dentsu presiding over the World Advertising Convention in 1985.

It is hard to say that good performance alone will be the predictor of *shacho* succession, especially when we think of various tenure rules established among Japanese firms. It is more appropriate to say that given limited tenure, a *shacho* will try to make his exit as festive as possible. When a great achievement coincides with the some of the tenure rules within the organization, journalists in Japanese media naturally expect a *shacho* change. It is another instance of a usual *shacho* change. In this way the normal and usual *shacho* change becomes a splendid *shacho* change.

The rhetoric of *hanamichi* is powerful because it is the key to becoming a chairman with real power (*jitsuryoku kaicho*) within the firm (*Toyokeizai*, 1971) and to have a say in the *Zaikai*, which could be translated as either "financial circles" or "business world"[3]. The four major business federations in Japan are Keidanren (the Federation of Economic Organizations), Nissho (Japan Chamber of Commerce and Industry), Nikkeiren (Japan Federation of Employer's Assocation), and Keizai Doyukai (Japan Committee for Economic Development). The appointment to the chairman position or to one of the few vice chairman positions in these federations largely reflects the status of firms within an industry as well as the status of industry within the

[3] Tanaka (1979) argues that both "financial circle" or "business world" is not an adequate translation of *Zaikai*. Instead, he defines *Zaikai* as that "group of people who, apart from their identification with specific companies or industries, speak from the capitalist position and exert a strong influence on politics (Tanaka, 1979, p.64)."

national economy. For example, the chairman of Keidanren usually comes from Japan Steel, the biggest company in the steel industry. Employees of Japan Steel usually express their pride in working in the steel industry, as they believe that steel is the most important industry in the national economic system. To give another example, one of the vice chairman positions goes to a representative of the electronics industry. Within electronics, it is also customary that the chairman from either Hitachi or Toshiba, the top two electronics company, will fill the position. In other words, the appointment of top leadership in the business world reflects the pecking order within the industry as well as that in the whole national economic system. If a *shacho* does exceptionally well and if his charisma is acknowledged by his fellow business elites, he has a chance to be active in the business federation, which is a big honor for him as an individual as well as for the firm he belongs to.

The other side of *hanamichi* is that a *shacho* may use the rhetoric to prolong his tenure when the firm is in trouble. For example, Mr. Takeda continued his *shacho* position into a third term, against the two-term-four-year *hubunritzu* (unwritten rule), because of the 'unusual' performance crisis in mid-1980s. *Shacho* Kawai at Komatsu is also an example. In 1982, *shacho* Mr. Kawai retired to the post of chairman. In an interview with Keizaikai, Mr. Kawai said, "I intended to stay on as *shacho* for 7-8 years when I was first appointed. Because of the unforeseen crisis—the Nixon shock and the two oil shocks—however, I ended up staying for 18 years. With the completion of the full line operation of construction machines and with the establishment of the foreign sales network, I decided to retire as chairman (*kaicho*). ... From now on, I'll play the role of an adviser." The article added that the good performance of Komatsu amidst the depression in the construction machine industry also helped him make his retirement decision (*Keizaikai*, 1982.10.12, P.27).

Succession-to-one's-surprise

There are two types of rule-breaking, positive and negative, if the rules identified above provide a reference point. A positive rule-breaking would be the one that is consistent with the logic of community. A negative rule-breaking would be one that goes against the logic of community or is unclear in nature.

(1) Positive rule-breaking

The first type of rule breaking includes voluntary retirement of a *shacho* long before he reaches retirement age or the tenure limit rule, if the firm has one. Mr. Tokusue at Teijin provides an example. Mr. Tokusue surprised the media twice with his decision to retire as *shacho* in 1983 after serving only three years in the position and again with his decision to retire as chairman in 1985 after only two years. The media praised his action as 'refreshing (*sawayaka*)'. Ironically, what he was trying to convey through his rule-breaking behavior, both against the dominant institutional rules which expect four to six years of *shacho* tenure and against the organizational rule of unlimited tenure (set by his predecessor Mr. Oya who stayed in the *shacho* position for 24 years before his death), was his resolution to set a new rule of early retirement of *shacho* around age 65. Mr. Tokusue learned from first-hand experience how hard it is to remove a long-tenured *shacho*, such as his predecessor Mr. Oya, absent rules and other control mechanisms. By showing his willingness to abide by his resolution, Mr. Tokusue successfully established a rule that is more likely to be observed by his successors. And indeed, the successors Mr. Okamoto and Mr. Itagaki faithfully followed Mr. Tokusue's lead. Some other examples of short-tenured *shacho* include Mr. Kumazawa at Oji, Mr. Sakaguchi at Unitica, and Mr. Nakayama at Nippon Kogyou Bank.

Another example of positive rule-breaking is to pick the successor from a lower rank of the management hierarchy. As mentioned above, the dominant rule is to select a successor from the top two classes under the *shacho*—vice president and senior managing directors. To select from a lower level is called '*batteki jinji* (pick out promotion)' and business journals often count the number of senior executives that the new younger *shacho* has moved ahead of. For example, when Mr. Idei was picked as *shacho* at Sony in 1995, it received media attention for its progressiveness in promoting such a lower rank executive, 15th in the top management hierarchy, to the top. It should be noted that 'progressiveness' comes not only from designating the younger executive but also from ignoring the norm of promoting the favorite candidate into the position of either vice president or senior executive director and then to *shacho*. Given the aging of top executives in Japanese firms, such progressive rule-breaking is often applauded in the press.

(2) Negative rule-breaking

Succession rules may be broken against the guiding principles of the logic of *kaisha*. Such rule breaking behaviors receive public attention. Organizational actors who are in the focus of such attention are pressured to give explanations. Often they would voluntarily invite the media for a press conference or for a private interview. I examine three kinds of *shacho* succession that break the 'usual' succession rules described above.

First, there are a few *shachos* who had a very long tenure beyond the implicit retirement age in the business world. The Japanese corporate governance system, which relies largely on a shared code of conduct among the business elite, is quite vulnerable to strong-willed *shachos* who insist on staying for a long time, ignoring the code of conduct. These shachos are often quite unusual leaders whose charisma has been invaluable for the growth of the firm. Some of the examples of these long-tenure *shachos* are Mr. Oya at Teijin who served for 24 years as *shacho*, Mr. Miyazaki at Asahi Chemical who served for 24 years, Mr. Kawai at Komatsu who served for 18 years, Mr. Yamamoto at Kubota who also served for 17 years, and Mr. Kawamata at Nissan who served for 16 years as *shacho*.

Note that each long-tenured *shacho* listed above has no ties with a founding family. They are the professional managers who arrived at the top of the organizational hierarchy rather early in their career due to exceptional ability as a manager. Their legitimacy within the firm and in the business world is often captured in the epithet attached to those names, 'the Father who revived the firm.' In other words, their charisma has transformed their power and legitimacy into that of the founder, and even the main bank may find it hard to challenge them unless the firm is about to go bankrupt.

Although the business journals do not criticize these *shacho* simply for their long tenure, they nevertheless regularly report the succession race in these firms, such as who are the likely candidates and whether there will be a change at the end of the current *ki* (term), regardless of the *shacho's* own thought on the issue. Some business journalists, such as the chief editor at the by-weekly magazine Keizaikai, often visit these long-tenured *shacho*, giving frank but unwanted advice on succession planning. They report such visits and the interviews in detail, often contrasting these long-tenured *shacho* with other charismatic leaders who refused the temptation to stay too long. For example, Mr. Saito, the chief editor of *Keizaikai* magazine, compares Mr. Kawamata at Nissan with one of Mr. Kawamata's contemporaries, Mr. Nakayama at Nippon Kogyo Bank, in one of his articles that pushes Mr. Kawamata to retire as follows:

> "The secret of the power of Mr. Nakayama, who is only a *ronin* ('masterless samurai' which indicate that the person does not have any formal position), is the fact that he resigned Nippon Kogyo Bank at the age of 62 when he could have stayed much longer as the head of the bank. (*Keizaikai,* 1985.1.8, p.26)"

Again, it is hard to say that Mr. Nakayama remained influential only because he retired early, especially given his achievement during the 1970s. Yet, the above statement makes it clear what kind of behavior is more valued and respected within the business circle.

Another type of rule-breaking behaviors that are framed negatively by business press is the dismissal of *shacho* by the powerful chairman. This is closely related to the first type of rule-breaking behaviors since it is usually those long-tenured *shacho* who become the powerful chairman and reign over their own successor *shacho.* They are called '*jitsuryoku kaicho* (chairman with real power).' One of the reasons why the current study focus on *shacho* instead of chairman is the institutionalized rule that chairman does not hold the power to make personnel decision against the will of *shacho.*

Although there are quite a few powerful chairmen actively involved in strategic decisions especially during the first few years of transition, there are only a handful of chairmen who actually dismiss their own successors, partly because the dismissal of the *shacho* is an acknowledgement of their own lack of foresight. It is also true that if the successor does happen to be a disappointment to everybody, both organizational members and stakeholders expect the chairman to correct the mistake. The correction takes several forms depending on economic and political factors, such as how badly the *shacho* has been performing, or how powerful the chairman is, etc. The most gentleman-like behavior for the chairman is to allow the current *shacho* to step up as a chairman by retiring into a position of advisory role. If the chairman is recognized as representing the firm, he may still stay as a chairman while putting his successor into another position such as a vice chairman or advisor.

Finally, on a very rare occasion, *shacho* succession could occur as a result of a coup d'etat by top executives who are hierarchically lower than the *shacho*. Such an incident happened in 1982 at Mitsukoshi Department store, which received extensive publicity within the Japanese business community. Gerlach provides a good summary of the "Mitsukoshi Incident" in his book that looks at the role of horizontal *keiretsu* in Japan (Gerlach, 1992, p.111-113). This is an unusual *shacho* succession drama that involves many actors playing a variety of roles in the removal of the *shacho*. The general outline is that the *shacho* behaved dishonorably and nearly ruined the firm, and he refused to step aside. A "mutiny" instigated by *keiretsu* board members and managers was required to remove him.

Although Gerlach introduces this case to illustrate how horizontal *keiretsu* membership could affect the *shacho* succession in Japan, this is a very unusual case in many senses. First, firms in the horizontal *keiretsu* usually do not intervene in each other's *shacho* succession process. A *shacho* may solicit opinions on the quality of candidates, but as *shacho* Okada put it, the intervention by a representative of another firm was "meddling in affairs that were none of his business." Second, the overthrowing of the superior by the inferiors[4] is also unthinkable in most Japanese organizations. It is almost criminal when such acts are done publicly. The way the incident finally resolved shows how unthinkable the coup d'etat is in Japan. All the directors who staged the coup d'etat were also fired after the incident, except for the vice president Mr. Ichihara, the only person against the coup d'etat. Mr. Ichihara became the next *shacho*, supported by Mr. Koyama from Mitsui Bank.

In fact, it is not entirely true that the Mitsukoshi incident was viewed negatively. The subordinates clearly acted out of their loyalty for the community, if not for their immediate superiors. They may have even known that they were giving up prospects for further promotion, which is hard to explain without knowing what the company means to these top executives.

Conclusion

I have identified the succession rules for *shacho* by analyzing the *shacho* succession stories appearing in the popular Japanese press. The linguistic framing of *shacho* succession shows that 'community' comes before the individual *shacho* in most firms. The succession is celebrated as a rejuvenation for the organization and as a time to receive all the credit from the employee and also from the business world for the individual *shacho*. The elaborate application of tenure rules

[4] The term *gekokujo* (overthrowing of the superior by the inferiors) carries a moral element that such act is wrong.

make the *shacho* succession more or less predictable in terms of timing. But, one could never be sure about the new *shacho* because it is totally up to the *shacho* to decide his own successor. Relative certainty in the timing of the change combined with the uncertainty in the identity of the new *shacho* makes the review of possible *shacho* candidates an everyday business of the Japanese business press.

Organizational actors do not always follow the rhetoric and institutional logics, however. They often change the rules or use different logic and rules for their own advantage or for the benefit of the firm. The active agency of *shacho* and of other organizational actors urges us to study to what extent these various rules and rhetoric affect the actual *shacho* succession process and outcome. In the following chapter, I take one of the succession rules—the tenure rule—and examine how the rule affected the actual *shacho* succession process in Japan.

Appendix 4-1: *Shacho* succession at Japan Steel

The history of Japan Steel runs back to 1857 when Oshima Takato set up the first westernized blast furnace at Kamaishi Kozan in Iwate-ken. The demand for steel increased dramatically during the Russo-Japanese war, and Yawata Steel was established as a state-operated enterprise in 1901. The Great Depression after World War I was a painful period for most steel makers in Japan, and Yawata and 5 other steel companies merged to form Japan Steel in 1934. At the time of the merger, Japan Steel dominated the steel market with a market share of 96% for pig iron. When the World War II ended, however, Japan Steel became the target of the anti-monopoly policy. Under the guidance of GHQ, Japan Steel was divided into 4 separate entities—Yawata Steel, Fuji Steel, a shipping division (Nittetsu Kisen), and a brickyard manufacturing division—and restarted as private enterprises. In order to strengthen global competitiveness, Yawata Steel and Fuji Steel decided to merge in 1968. The merger announcement received wide support from government and business circles. The merger was finally achieved in March 1970, and the name was changed to Japan Steel (*Shin-Nippon-Seitetsu,* the New Japan Steel).

Japan Steel is one of the largest companies in Japan, yet it does not belong to six *keiretsu* groupings. Table 4-1 shows the ownership structure of Japan Steel. Unlike Nippon Flour Mills, in which Mitsui group firms dominates the top 10 shareholder list, Japan Steel is owned by financial institutions of various *keiretsu* groupings. By having all major *keiretsu* firms as a major shareholders, Japan Steel achieves independence from any of these shareholders. Moreover, the top 10 shareholders own only 20% of the total shares. Also, there is a remarkable similarity in the top 10 shareholders list at Yawata Steel and Fuji Steel in 1963, which also gives a clue to the successful merger between the two companies. Although Japan Steel does not have crossshareholding arrangements like other *keiretsu* member firms, it still enjoys the stability of shared ownership. The composition of its top shareholders in 1973 and in 1983 remains almost the same.

The *shacho* profile of Japan Steel is shown in Figure 4-1. The dividing line in the year 1970 indicates the merger between Yawata Steel and Fuji Steel. The information on their organizational basis—i.e. whether they have been with Yawata or with Fuji before the merger—is kept next to the name of each *shacho*.

Although the *shacho* change pattern at Japan Steel is similar to other large firms in some major aspects—the dominance of the insider, the orderly progression through rank hierarchy, and the old age of *shacho* at the time of appointment—it also reveals additional dimensions of the *shacho* change process that is quite unique in merged companies. First of all, there is a friendly exchange of the *shacho* position between top executives from Yawata Steel and those from Fuji Steel. For example, Mr. Hirai, the first *shacho* after the merger, was from Yawata Steel, while his successor Mr. Tazaka came from Fuji Steel. The *shacho* change showed the take-turn pattern throughout 1980s and 1990s, from Mr. Saito (from Yawata), to Mr. Takeda (from Fuji), to Mr. Saito (from Yawata), and finally to Mr. Imai (from Fuji). Such a pattern of taking turns is called *tasukigake* (suspender style promotion) in Japanese. *Tasukigake* is a common solution for *shacho* change whenever there is a merger between firms with equal status. A similar arrangement is also found at Mitsubishi Heavy Industries after the merger of three firms in 1964, as well as at Unitika after the merger between Nichibo and Nippon Rayon in 1969.

Tasukigake reflects the nature of mergers in Japanese business. A merger takes place on friendly terms and the interests of employees group are discussed quite explicitly in the process of the merger. Merger deals frequently fall apart if one of the firms has doubt on protecting the interests of its employees after the merger. There is a historical legacy for such friendly mergers in Japan, however. Quite a few merger incidents took place among firms that were artificially dissolved by GHQ during the Occupation period. Thus, many employees, especially at the top level, had known each other as colleagues before the dissolution. It is much easier to cooperate with one's own brother than with a complete stranger. At the same time, firm-based factions are recognized as legitimate internal factions even after the merger.

The rhetoric of *tasukigake* is not free of criticism, however. The criticism is often made that *tasukigake* style promotion could dampen organizational effectiveness, because it pays too much attention to fairness among different factions, rather than individual merit in personnel decisions. Despite the criticism, *tasukigake* is used quite frequently in the merged firms.

When internal factions are identified and are recognized as legitimate, firms may be more conspicuous in resolving the fairness issue among different internal factions. In firms after the friendly merger, such effort to ensure fair promotion opportunity is often achieved by establishing an explicit tenure limit rule. For example, Japan Steel has established a 2-term-4-year rule. Mitsubishi Heavy Industries also has established a 2-term-4-year tenure rule after the merger. Although such a rule is still considered informal (*hubunritsu,* unwritten rule), it often becomes public knowledge that both employees and business media expects the *shacho* to change whenever the incumbent *shacho* has reached the expected term limit.

The retirement age rule for directors in general or for specific titles can result in an effort to control the traffic at the top. For example, Japan Steel has a 65 year age-limit rule for *fuku-shacho*. The age-limit rule for top executives became popular as the age of directors grew older. Thus, the incumbent *shacho* may have to take into account the age of his favorite candidate when deciding the timing of his own retirement.

Another interesting aspect of *shacho* change found at Japan Steel is that it reveals another aspect to the *hanamichi* rhetoric: the *shacho* may use it to prolong his tenure when the firm is in trouble, so as not to bequeath a troubled situation to his successor. For example, Mr. Takeda continued his *shacho* position into a third term, against the two-term-four-year *hubunritzu,* because of the unusual performance crisis in the mid-1980s.

Finally, *shacho* change may be influenced by the external career of the chairman as well. In the case of Japan Steel, *shacho* Takeda excused himself for going one more term to give a chance for Chairman Saito to be elected as the chairman for Keidanren. To apply for the Chair of Keidanren, one has to be the current chairman of a major company. As one executive in the Steel industry has put it, "Japan Steel is very proud of being in the Steel industry. It is often said that 'Steel is the basis of a nation' among Japan Steel employees. Based on such pride, it is very likely that the firm [and *shacho* Takeda] will do its best to support Chairman Saito to be elected as the chair of *Keidanren,* as a *zaikaisosai* (the leader of the business in Japan). Several steel industry experts have predicted that *shacho* Takeda will remain for another term in order to support Chairman Saito for the chair position of *Keidanren.* (Keizaikai, 1985.4.9.) Such career for the *shacho* and the Chairman is often reserved for the biggest and the largest firms in Japan, and may not be relevant for the smaller firms, though.

Table 4-1. Top 10 shareholders at Japan Steel in 1963, 1973, and 1983

1963				1973		1983	
Yawata Steel	**%**	**Fuji Steel**	**%**	**Japan Steel**	**%**	**Japan Steel**	**%**
Kogyo Bank	2.68	Kogyo Bank	2.69	Nihon Kogyo Bank	2.99	Nihon Kogyo Bank	3.09
Fuji Bank	2.14	Toyo Trust	2.07	Nihon Life	2.53	Nihon Life	2.97
Mitsubishi Trust	1.88	Mitsui Trust	2.04	Daiichi Life	1.87	Meiji Life	2.01
Tokyo Marine	1.86	Sanwa Bank	1.93	Meiji Life	1.85	Daiichi Life	1.85
Sanwa Bank	1.78	Fuji Bank	1.91	Fuji Bank	1.85	Fuji Bank	1.81
Sumitomo Bank	1.78	Kobe Bank	1.91	Sumitomo Bank	1.72	Sumitomo Bank	1.69
Mitsui Trust	1.67	Sumitomo Bank	1.91	Sanwa Bank	1.69	Sanwa Bank	1.65
Mitsubishi Bank	1.64	Tokai Bank	1.80	Tokyo Marine & Fire	1.67	Tokyo Marine & Fire	1.63
Toyo Trust	1.59	Mitsubishi Trust	1.76	Daiichi Kangyo Bank	1.59	Daiichi Kangyo Bank	1.56
Sumitomo Trust	1.25	Mitsubishi Bank	1.72	Mitsubishi Bank	1.49	Mitsubishi Bank	1.50
Sum	18.3	Sum	19.7	Sum	19.3	Sum	19.8

Source: *Keiretsuno Kenkyu* (1965, 1975, and 1985).

Figure 4-1. Shacho change profile of Japan Steel

Name (Birth/Entry /Director/Retire)	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95
Imai, Takashi (29/52/81/NA)	Fuji Steel					Todai Law ('52)																					Hira		Jomu						Fukushacho				Shacho		
Saito, Hiroshi (20/42/73/NA)	Yawata Steel					Todai Business('42)													Hira				Jomu				Senm		Fukushacho				Shacho					72			
Miki, Akira (22/43/73/92)	Fuji Steel					Kyoto Law ('43)													Hira						Jomu		Senm		Fukushacho				Vice		Kaicho						
Takeda (14/39/65/90)	Fuji Steel										Jomu					Senmu							Fukushacho				Shacho					72	Kaich		Todai Law ('39)						
Saito (11/41/61/90)	Yawata Steel						Hi	Jomu					Senmu						Fukushacho				Shacho			69	Kaicho								Todai Econ. ('35)						
Tazaka (08/42/57/76) *Died in 1977	Fuji S		Hira			Jomu		Fukushacho								Fukushacho						Sh	Death												Todai Law ('33)						
Hirai (06/31/58/77)	Yawata St			Jomu				Senmu					Fukushacho						Shach		69	Hira													Todai Law ('31)						
Inayama (04/28/50/82)	Jomu					Fukus		Shacho										68	Kaicho								Hira								Todai Econ. ('27)						
Nagano, Shigeo (00/26/46/82)	Shacho of Fuji Steel															Kaicho			Hira																Todai Law ('26)						
Kojima (1893/41/41/66)	Fu	Shacho					68	Kaicho																											Todai Law ('19)						
																(1970)Merger between Yawata Steel and Fuji Steel to form Japan Steel																									

Chapter 5. The role of tenure rules and tenure milestone in *shacho* succession

In this chapter, I take on a large sample longitudinal study to test the implication of one of the succession rules—the tenure rules—identified in Chapter 4. Drawing on analogies from the political arena, I first review three types of tenure rules—the unit term rule, the tenure limit rule, and the retirement rule—for *shacho* and discuss their functions in regulating the timing of executive exit. In Section 2, I introduce the concept of 'tenure milestone' where the predecessor's tenure works as an informal rule for *shacho's* tenure decision. Focusing on the role of tenure precedents, I discuss how precedents may be either strengthened or ignored, and how *shacho* performance may interact with this evolution of tenure rules. Section 2 concludes with a set of empirical hypotheses based on the observations and discussion.

The main objective of the chapter is a systematic, empirical analysis of *shacho* tenure, or how long a *shacho* serve, in the top 200 manufacturing corporations in Japan. Section 3 discusses the data and the empirical methodology. The data set is a collection of tenure and other personal information of *shacho* from *yukashoken hokokusho* (the Japanese counterpart to 10K reports and proxy statements in the U.S.) supplemented by corporate information from various sources. Event history analysis is employed to systematically analyze the data and test the hypotheses. Section 4 presents and discusses the results, to be followed by a brief conclusion in Section 5.

1. Tenure rules for *shacho*

Why corporations need tenure rules for *shacho*

Tenure rules refer to a set of organizational decision rules, formal or informal, that regulate temporal aspects of personnel change. Tenure rules for the *shacho* help firms achieve a smooth transition at the top. Organizational rules have often taken on an unfortunate negative connotation, reminding people of bureaucratic red tape, but establishment of impersonal rules are an essential ingredient in any smoothly functioning organization, especially if the organization is large. The enabling functions of organizational rules were emphasized probably most prominently by the classical sociologist Weber (1978, reprinted).

Following the Weberian tradition, Ocasio (1999), among others, identified positive functions of rules and routines in organizations that apply equally well to tenure rules. First, tenure rules for the *shacho* provide readily available solutions, scripts, and procedures for the *shacho* change process. Tenure rules may provide a *shacho* with a time horizon, during which he could prepare for his own exit. Tenure rules may also provide the board of directors with a timetable so that they may start the search process for the next *shacho* in a timely manner. The rules may also synchronize organizational activities in a way that minimizes the disruption caused by the change at the top. Second, tenure rules for the *shacho* provide accountability and reliability in the *shacho* change process. Tenure rules help reduce the risk of *a shacho* serving too long with harmful consequences for the firm. Finally, tenure rules help enable board actions and decisions by limiting and channeling political conflicts in organizations. The political competition may be limited to a period around the expected date of *shacho* change, freeing the organizational resources and the *shacho's* attention for more productive purposes.

<u>Three types of tenure rules for *shacho*</u>

Tenure rules for the *shacho* may regulate the length of the unit term, the maximum number of years allowed, or the maximum age allowed for the office. For each of these, I explore the main characteristics, its function in regulating the timing of executive exit, and its potentially dysfunctional aspects.

The first type of tenure rules concerns the length of the unit term. The rule is usually made explicit and firmly observed for political offices. The unit term for U.S. presidency is 4 years, 7 years in France, and 5 years in Korea, for instance. In the corporate scene, the contract length for CEO is comparable to the unit term in political systems. The contract term for CEOs and other members of the board is usually standardized within a national boundary. As for Japanese *shacho*, two years is the universally accepted unit term. For example, a *shacho*'s tenure is often expressed using the notion of *'ki'* (term), as in two-term-four-year or three-term-six-year.

The existence of a unit term provides stability in the leadership for the specified duration. It provides a time horizon during which the *shacho* is expected to deliver results. It results in entrainment, or synchronization, of the monitoring process by various stakeholders, which renders efficiency to such efforts. Yet the unit term may prove dysfunctional if the duration of the unit term does not match the rate of change in the environment. An appropriate duration of the unit term may be hard to set to begin with. Even when a firm has found the right duration at one point in time, subsequent changes in business environment may make the duration unsuitable in the future.

The second type concerns the tenure limit, that is, the maximum number of years in the top position. The tenure limit rule may vary across firms and institutions. Again, a useful analogy is found in the political arena, in presidential offices in the U.S., France, and Korea for example. American Presidents serve a maximum of eight years in two terms of four years each. The presidency in France does not have any tenure limit, at least under the current constitution. For instance, President Miterrand served 18 years before he died in office. Korean presidents are subject to the most severe tenure limit of just five years, as they are required by the constitution to step down after one term.

The tenure limit rule limits the power of the incumbent, which may increase with the tenure of the leader. It is interesting to note that Korea adopted the most restrictive presidential tenure limit rule after the experience with the late President Park Chung Hee, whose autocratic rule continued for 18 years until his reign came to an abrupt end with his assassination in 1979. A dysfunctional aspect of tenure limit rule, especially if it is strictly followed, is that the incumbent may become a lame duck as he reaches the final years in office. Anticipating the shift of power at the top, organizational participants may refuse to cooperate with the incumbent, waiting for the new leader to emerge.

For Japanese *shacho*, a few firms have a widely known tenure limit rule. For example, a *shacho* with Hitachi Corporation serves for ten years, while Mitsubishi Heavy Industries and Japan Steel have *shacho* who serve for four years. These rules are referred to as '*hubunritsu* (an unwritten rule),' and are widely known within the organization as well as among business journalists. The rules have been followed without an exception for more than 30 years in the case of Hitachi, and for more than 20 years in the case of latter two firms.

Finally, establishing a retirement age, formal or informal, is another form of tenure rule. As a *shacho* may be reluctant to give up the position, which is often the last step in his life-long career, and usually have the power to lengthen his reign, establishing a retirement age can serve as the last safeguard that ensures a smooth, timely transition.

In addition to limiting the power of the *shacho,* the retirement age rule may be useful in motivating aspiring young executives. It will be particularly useful in firms that rely heavily on the internal labor market for the next crop of top managers. An established retirement age for the incumbent may assure them that they will have a shot at the top corporate position. The retirement age rule may have a similar dysfunctional aspect as the tenure limit rule: a *shacho* may become a lame duck towards the end of his tenure. The other dysfunctional potential of the mandatory retirement age rule is that age is often not a precise measure of ability. By setting the mandatory retirement age, firms may forego the service of old but wise leaders.

Japanese firms do not usually have written rules for the *shacho* mandating a compulsory exit before a certain age. Yet, Itami (1995) documents that the standard deviation is very small around the mean retirement age of 68. In my sample, analyzed below, more than 80% of *shacho* retire before age 70. This suggests that the Japanese *shacho* is often expected not to serve beyond a certain age, even though written rules to that effect may not exist.

It is important to bear in mind that these rules, if they are established, usually allow a considerable degree of flexibility, which makes the rules quite elusive to pin down. It is often quite hard to verify, on a case-by-case basis, whether a given *shacho* change event is following the rules. The *shacho* and the board under his control sometimes have the power to bend or rewrite the rules. Changing business environment may sometimes justifiably require certain rule bending. Sometimes, there may be a conflict between rules. For example, a firm may have an expected retirement age of 67 and the expected tenure limit of 10 years. If the *shacho* was appointed at the age of 60, the board might flexibly decide to let him serve for 10 years, ignoring the limit on retirement age.

Figure 1 presents the hazard rates of *shacho* departure in my sample of the top 200 Japanese manufacturing firms from 1955 till 1995. The hazard rate for a year is a conditional probability of departure conditional on that the subject *shacho* has survived up to the given year. For instance, the hazard rate for the 8th year is shown to be about 0.2, meaning that of those who have served for 8 years, about 20% will depart from the top position during the 8th year. Figure 1 illustrates how the unit-term rule and the tenure limit rule may operate in Japan. Hazard rates are significantly higher for the even-numbered years (4th, 6th, and 8th years for instance) than for the odd-numbered years. This confirms the presence of the 2-year unit term, at the end of which *shacho* change is more likely than in the middle of the unit term. At the same time, hazard rates are far from zero in odd-numbered years, suggesting that the unit-term rule is applied flexibly. By the 10th year the survival rate is only 30 percent, that is, about 70 percent of *shacho* end their tenure before year 10. In fact, the surviving 30 percent includes a fairly large number of founders or their family members. Thus we may conclude from the figure that a tenure limit rule operates in many Japanese corporations, limiting the maximum tenure, especially for a *shacho* not related to the founding family (*puropa shacho*).

2. The concept of tenure milestone and hypotheses

Predecessor's tenure as a milestone

One of the important themes in the study of organizations is to understand the evolution of organizational rules. Yet, to my best knowledge, nobody has studied the evolution of CEO tenure rules either in Japan or in the U.S. Given the elusive and often nebulous nature of tenure rules, this chapter focuses on the role of precedents to the rule-forming process. Precedents are important in the development of organizational rules (Selznick, 1957; Zucker, 1977; March & Olsen, 1989; Kelly & Amburgey, 1991; Amburgey & Miner, 1992; Ocasio, 1999) and the predecessor's tenure may provide an important milestone for successors. Every *shacho* takes part in the evolution of tenure rules, in the absence of formalized written rules, by setting precedents with their own decision on when to step down. The successor must make his own departure decision under the common knowledge of the precedent(s) shared by all interested observers.

The concept of tenure milestone suggests an interesting new way to look at the life cycle of a *shacho*. The period leading up to the tenure milestone may be called a honeymoon period, as the precedent tends to protect the incumbent. Then, there is a tenure milestone period, during which the incumbent may have to decide whether to follow the precedent amid aroused interest and scrutiny by various stakeholders. If the *shacho* decides to stay on in the top position, he enters the third phase. His performance may need to be sufficiently high to satisfy the potentially hostile stakeholders whose expectation has been once betrayed by the *shacho*'s refusal to step down during the milestone period.

The following is an illustrative example. Suppose that the predecessor's (A) tenure was 5 years. If the successor (B) serves for 10 years, his 10-year tenure may be divided into the following three sub-periods. The first three years may be called the honeymoon or trial period. During this period, the new *shacho* may be exempted from undue pressure to perform, while some new *shacho* may be prematurely forced out, failing to establish a minimum level of control. The next three years may be called the tenure milestone period, when he contemplates on whether to follow in the predecessor's footsteps or not. I allow one-year buffer before and after the predecessor's exact tenure, reflecting the 2-year unit term. The final four years are the extended tenure period, where he is setting a new, longer precedent for his own successor.

(A) |-------1-------2-------3-------4-------5 (Predecessor's tenure)

(B) |-------1-------2-------3---|---4-------5-------6----|---7-------8-------9-------10

(Honeymoon or Before-the-milestone) (Tenure milestone) (Over-the-milestone)

Informal tenure limit rules may evolve as a result of repeated confirmations of a precedent. In the absence of extraordinary circumstances, the incumbent may be pressured to step down during the tenure milestone period. A precedent repeatedly confirmed then carries more weight in affecting the departure decisions of successors. Figures 2(a) and 2(b) illustrate this rule-forming process. Figure 2(a) shows the hazard rates of *shacho* who serve under the precedent of 6-year tenure by the predecessor. The hazard rates for the entire sample are also graphed for comparison. For those with the 6th-year milestone, the hazard rate is highest at about 30 percent during that year. Moreover, if we follow the definition of the extended tenure milestone period, allowing a one-year buffer before and after the exact precedent tenure, the hazard rate for the milestone period, 5th to 7th year, is over 50 percent[1]. Figure 2(b) considers the case of a *shacho* with the precedent of 8 years in tenure. A similar pattern is observed, except that a higher portion of *shacho* in this case decide to respect the precedent. In view of these observations, I present the first empirical hypothesis.

H1: *Shacho* succession is more likely during the tenure milestone period.

Performance and the tenure milestone

Several authors have studied the role of corporate performance on *shacho* change in Japanese corporations. Kaplan and Minton (1994) is probably the most well-known of these studies, at least in the U.S. Despite substantial differences in institutional settings, they find that bad performance is likely to increase the probability of top executive change, to a similar extent in Japan and in the U.S.[2] Miyajima (1996) considers a list of performance measures, each likely to be deemed essential by different groups of stakeholders, and studies the changes in the role of various performance measures in different time periods. He also finds in his probit analysis that bad performance as measured by poor rates of return on assets increases the probability of *shacho* change. Similar findings regarding CEO change in the U.S. corporations have been

[1] There are 146 CEOs who start under the precedent of 6 years. Of 75 who survive until the 5th year, 38 step down from the top position during the following three-year period.
[2] They sampled top 120 manufacturing companies in Japan from 1980 till 1990. In comparison, my sample includes top 200 manufacturing companies and the sampling period is also longer, from 1955 till 1995. Kaplan and Minton employ a probit model, whereas this chapter adopts a duration model for a more satisfactory statistical analysis. More important, their paper does not specifically focus on *shacho* change, as they model changes among the top executives with representative rights, consisting of *shacho*, chairman of the board (*kaicho*), and vice presidents (*fuku-shacho*).

reported in Kim and Ocasio (1995), Ocasio (1994), Puffer and Weintrop (1991), and Weisbach (1988).

In view of the three-period division of a *shacho's* life cycle introduced above, one interesting question is whether performance affects the probability of *shacho* change in the same way in each of three periods, honeymoon, milestone, and over-the-milestone. In particular, *shacho* serving beyond the precedent tenure milestone may operate under an increasingly critical and potentially hostile scrutiny. For them, bad performance may be more likely to lead to *shacho* change.

H2: Poor performance during the over-the-milestone period is more likely to lead to *shacho* change, compared with the periods before.

If this hypothesis is borne out by an empirical test, we will have identified an important mechanism that favors the rule-strengthening tendency in the *shacho* change process. A *shacho* may have to consider the risk of being forced out of the top position in disgrace, while an earlier departure may be camouflaged as a noble, precedent-following act (*yutai,* honorable exit), even under the cloud of poor performance.

Once a precedent is set, the successors will have an incentive to respect it. A precedent once confirmed may carry an even more weight in the subsequent *shacho* changes. This process of cumulative confirmations of a precedent then may lead, over time, to the establishment of a tenure limit rule that carries a considerable degree of authority, even though it may be of an unwritten nature (*fubunritsu*).

During the tenure milestone period, a different logic may prevail. An auspicious and honorable way to end one's career as *shacho* is to leave in the midst of respectable corporate performance. A leader who steps down while goings are good is said, in the popular Japanese business parlance, to be walking down the "*hanamichi*", literally the flower way[3]. The decision then would be applauded as an honorable decision (*yutai*, honorable exit). The flip side of the coin is that if the *shacho* is unlucky enough to find himself stuck with poor performance during the tenure milestone period, he may get even more reluctant to step down. He may argue that strong, experienced leadership is needed to see off the tough challenges faced by the corporation[4]. Newspaper and magazine articles in Japan about *shacho* changes teem so much with references to "*hanamichi*", that the concept seems to be an essential part of Japanese business culture governing the *shacho* change processes. The following hypothesis is based on this observation.

H3: Good performance during the tenure milestone period is more likely to lead to *shacho* change.

It is also possible that performance will not have any effect during the tenure milestone. This is especially so, if tenure milestone is used as a tenure limit rule, in which case the *shacho* will step down regardless of the performance during the milestone period.

[3] See the discussion of *hanamichi* in the last chapter.
[4] Japan Steel in 1985 provides a case in point. *Shacho* Takeda at the time decided to stay for another term despite the two-term-four-year tenure rule at the company. The explanation was that strong leadership was necessary to overcome the crisis of high yen (*Keizaikai*, 1991.4.23).

Organizational and political variables and the development of tenure rules

So far we have focused on the role of a predecessor's tenure and its interactions with performance. There are other variables, organizational and political, that may affect individual tenure duration and the evolution of tenure rules. I suggest three such variables—the larger talent pool for the potential future *shacho*, merger between firms of comparable stature, and prior incidents of *shacho* change during the tenure milestone—that may encourage *shacho* change during the tenure milestone period, thereby facilitating the development of tenure rules.

In Japan, the American-style external labor market for top executives is practically non-existent, even though a limited number of executives may be sent in from the main bank or the parent company or government ministries. Most *shacho* are selected among the insiders (*haenuki*). Therefore large and prestigious firms may enjoy a more congenial environment for the development of tenure rules as *shacho* change is facilitated by the larger talent pool of potential future *shacho*. One proxy indicator of a larger talent pool is the ratio of elite university graduates among the board of directors.

H4: *Shacho* succession is more likely during the tenure milestone period in firms with higher ratios of elite university graduates among the board of directors.

Tenure rules limit and channel the political conflicts within the organization. The need for tenure rules thus may be higher when there is a fierce political conflict within an organization. Firms that have experienced a recent merger may be a good example. The post-war corporate history in Japan produced a large batch of such firms with potential subunit rivalry.

Immediately following the end of the war, many firms were ordered by the Allied Occupation to dissolve into smaller-sized firms. Beginning from the late sixties, however, there were waves of friendly mergers that reversed the post-war anti-trust decisions. Japan Steel, discussed in the appendix to the previous chapter, provides one example. A pattern of taking turns by rival internal factions, called *tasukigake* (suspender style succession), developed in merged firms. In an effort to ensure fair opportunities for promotion, many of the merged firms established explicit tenure rules that limit the maximum length of tenure for *shacho*. Two-term-four-year in New Japan Steel and Mitsubishi Heavy Industries is a good example.

H5: *Shacho* change is more likely during the tenure milestone period in firms that experienced a merger between firms of comparable statue.

Informal rules are strengthened when they are followed repeatedly. When a *shacho* confirms existing tenure rules by following the predecessor's tenure, his successor is more likely to continue in the tradition.

H6: *Shacho* succession is more likely during the tenure milestone period when there is a prior confirmation of the precedent tenure.

2. Data and Methodology

Sample and sources of data

I selected the top 200 manufacturing companies in terms of sales in 1980. All firms are publicly traded in the Tokyo Stock Exchange. Although the sample is obviously skewed toward large firms, firm size varies considerably, ranging from 30 billion yen in assets to 3 trillion yen and from 400 to 70,000 in terms of the number of employees in 1980. Ownership structure is also diverse in the sample: 50 percent belong to the top six *keiretsu* groups[5], 15 percent are family-controlled, and 30 percent have other industrial companies among major shareholders.

The unit of observation is the company-year, covering the years from 1955 to 1995. I dropped 7 firms in the sample for which financial data were missing, leaving 193 firms. The seven firms are the ones that merged during the 1980s. Compared to the U.S. firms, Japanese firms showed remarkable stability in identity during the period: none of the Japanese firms in the sample became bankrupt or went private. Not all companies had data for the entire period. Many became publicly held after 1960. The final sample included 7,021 company-years of data and 823 *shacho* change events.

The backbone of the data base consists of *shacho* change profiles compiled from *yukashoken hokokusho,* the Japanese equivalent of the proxy statements in the U.S. *Yukashoken hokokusho* provides information on a *shacho's* career path, such as the date of entry at the firm, functional background, date of entry into the board of directors, past positions held in the board, as well as some personal demographic information on educational background and the date of birth. Figure 4-1 in Chapter 4 gives an example of a *shacho* change profile for the case of Japan Steel.

[5] Membership in a *keiretsu* is often difficult to pin down. See Gerlach (1992) for more details. I define *keiretsu* membership based on whether the company has a seat in the *keiretsu* Presidential Club (*shachokai*). The top six *keiretsu* groups are Mitsubishi, Mitsui, Sumitomo, Sanwa, Fuyo, and Daichi-Kangyo.

Financial data for the companies were obtained from the *NEEDS ZAIMU* database. The data base also provided data on the number of employees, location of headquarters, and industry classification. Data on ownership structure were obtained from various annual issues of the *Keiretsuno Kenkyu*. Founding and incorporation dates were obtained from the *Nihonno Kaishashi Soran* (1995). Educational backgrounds of board members were taken from *Kaisha Shokuinroku* (1975).

Model and Measures

Shacho change data are statistically analyzed following the methodology of continuous-time event history analysis (Tuma & Hannan, 1984). The methodology is commonly used to analyze data on "survival time", the length of time before a change-event takes place, such as the life length of patients, electric light bulbs, duration of unemployment, etc. Economists usually call the statistical model a duration model. Survival analysis is a preferred term in medical research. The use of event history analysis of *shacho* change is preferable to the usual practice of sampling only for the years of change events, which suffers from sample selection bias and implicitly assumes equilibrium in the change process. It is also preferable to probit or logit analysis in that they handle the problem of right censoring in the most natural way, and easily incorporate time-varying covariates. I use STATA, a general-purpose statistical package, for maximum likelihood estimation of the models.

Weibull specification is adopted to model the baseline hazard. Weibull specification is more flexible than the basic exponential specification as it allows monotonic changes in the baseline hazard[6]. The hazard rate r(t) of *shacho* change in the t-th year of tenure is specified as follows: $r(t_j)= h(t)\ g(X_j)$, where $h(t)= p^*\ t^{(p-1)}$, the baseline hazard function for Weibull distribution, and $g(X_j)= e^{X_j\beta}$, a nonnegative function of the covariates.

The dependent variable is *shacho* change events. I treat changes as a result of sudden death or illness of the incumbent as right-censored at that point.

Tenure milestone is a dummy variable with the value of 1 for the years covering the tenure milestone period, meaning the three-year period centering on the predecessor's tenure. If the precedent is a 6-year tenure, the tenure milestone period for the incumbent is the three-year period from the fifth to the seventh year in his tenure. The three-year buffer to make the concept of tenure milestone operational reflects the following two considerations: (a) there is a margin of error as I measure the tenure in terms of years, not months and (b) two years is the length of the unit term in Japan. **Over-the-milestone** is another dummy to designate the last phase of the incumbent's tenure after the milestone.

To measure corporate performance, I use the previous year's rate of return on assets (**ROA**). Corporate performance may be measured by various means including sales growth and dividends per share, but the standard measure in the U.S. literature on *shacho* changes is ROA.

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[6] I have also tested the hypotheses using the exponential specification which showed similar results.

The size of internal talent pool for future *shacho* is proxied by the **ratio of elite university graduates in board**, or the ratio of graduates from the top five universities[7] among the board members in 1973. **Merger experience** is a dummy proxying for subunit rivalry. It takes the value of 1 if the company experienced a merger between two firms of comparable stature between 1955 and 1975. Two pre-merger firms were deemed to be of comparable stature if both the firms had been in the top 200 ranking. **Prior confirmation** is a dummy taking the value of 1 if the precedent tenure has been endorsed at least once before in the *shacho* change profile of the company.

The Appendix 5-1 at the end of the chapter provides brief descriptions and definitions of control variables. See Table 5-1 for standard descriptive statistics for all the variables.

3. RESULTS

Tables 5-2 and 5-3 present the main estimation results. Specifications reported in Table 5-2 focus on some of the key explanatory variables identified in Section 2, such as ROA, indicator variables for the tenure milestone period and the over-the-milestone period, and interaction variables of the period indicators and ROA. The results reported in Table 5-2 may be used for first-pass tests of the hypotheses 1 to 3. Results reported in Table 5-3 refine those in Table 5-2 by employing a more extensive list of explanatory variables. The results in Table 5-3 confirm the test results for the first three hypotheses as reported in Table 5-2, and in addition, provide test results for the remaining hypotheses 4 to 6. As coefficient estimates in event history analysis are

[7] Business journals generally consider the following universities as the top five: Tokyo University, Kyoto University, Hitotsubashi University, Keio University, and Waseda University.

rather hard to interpret in the raw form, I also present Table 5-4 to summarize the results found in Table 5-3 for more expedient interpretations.

Table 5-2 presents estimation results for six specifications. Model 1, the simplest one, offers the benchmark for comparison for the more sophisticated models 2 to 6, and includes just the main effect of performance, apart from the control variables to be employed throughout the models in both Table 5-2 and 5-3. The negative coefficient estimate for ROA, while statistically insignificant, suggests that the worse the performance, the higher the conditional probability of *shacho* change will be. The subsequent models all report negative coefficient estimates for ROA, and the results are consistent with the earlier findings in Miyajima's (1996) and Kaplan's (1994) studies of top executive change in Japan.

Models 2 to 6 present alternative specifications modeling the effects of the tenure milestone and their interaction effects with performance. The chi-square contrasts of models 2, 3, 4, 5 and 6 with the benchmark model 1 are 6.72, 15.29, 21.94, 22.14 and 24.78, respectively, and are all statistically significant at the level of 0.001. This suggests that the tenure milestone set by the predecessor's tenure is a significant factor in the *shacho* change process. The specification in model 2 adds just one more variable, the dummy for the tenure milestone period, so that the coefficient for the dummy represents the increase in the hazard during the tenure milestone period compared to the periods before and after (honeymoon period and over-the-milestone period, respectively). Model 3 adds one more variable to model 2, the dummy for the over-the-milestone period. The coefficients for the tenure milestone dummy and the over-the-milestone dummy in model 3 thus measure the increases in the hazard compared to the honeymoon period, the first phase of the incumbent's tenure cycle. Model 4 to 6, in addition to the two dummies in model 3, also has interaction effects with performance. Model 4 tests the interaction effect between tenure milestone period and performance, while Model 5 tests the interaction effect between over-the-milestone period and performance. Model 6 includes the interaction effects together.

The estimates in model 2 support the hypothesis H1 that the hazard is higher during the tenure milestone period, reflecting the binding influence of a precedent. During the tenure milestone period set by the predecessor's tenure, the hazard is higher for *shacho* change, compared to the honeymoon and the over-the-milestone periods. In models 3, 4, 5 and 6, the coefficient estimates for the milestone-period dummy stay positive, but turn insignificant. The results suggest that *shacho* who have decided to stay on past the milestone are in there for the long haul, and the hazard for them is accordingly smaller, as indicated by the strong negative coefficient estimate for the over-milestone dummy.

The hypothesis H2 states that the negative relationship between performance and the hazard – the worse the performance is, the more likely the *shacho* is to leave – is strengthened once the *shacho* is past the tenure milestone period. The results for model 5 strongly support this hypothesis. In order to measure the effect of performance on the hazard during the over-the-milestone period, the main effect of performance and the interaction effect between over-the-milestone and performance must be added. The combined effect has a coefficient estimate of –6.33 and is significant at the level of 0.01.

The findings do not support the hypothesis H3 that performance has a positive effect for *shacho* change during the tenure milestone period. The combined effect of performance for the tenure milestone period is almost zero. The zero performance effect, however, reveals the nature of change during the tenure milestone period. If a *shacho* is operating under the norm of stepping down during the tenure milestone period, he will do it regardless of performance during the period. Although the results do not support the *hanamichi* effect as hypothesized, the zero-performance-effect during the milestone period suggests that tenure milestone operates as an informal tenure limit for the incumbent *shacho*.

Table 5-3 presents results for models that include the political and organizational environmental variables designed to test the hypotheses H4 to H6 in addition to the variables considered in models in Table 5-2. The coefficient estimates for the main variables that were already considered in Table 5-2 remain almost the same in the new models in Table 5-3. And the results in Table 5-3 lead to similar test results for the first three hypotheses H1 to H3. Therefore, the reader may focus on testing the latter three hypotheses H4 to H6 using the results in Table 5-3.

Recall that the hypotheses H4 to H6 concern the effects of organizational environmental variables on the hazard during the tenure milestone period. To test the hypotheses, we need to look at the sum of the main effects of these variables and their interaction effects with the tenure milestone dummy. Raw results as reported in Table 5-3 are not convenient for the purpose, and thus I provide Table 5-4 presenting the sum of the main effects and interaction terms with the milestone dummy.

Somewhat disappointingly, the test results are rather mixed. In its original form, only hypothesis H5 is supported, implying that firms with past merger experiences have higher hazard rates during the tenure milestone period. The hypothesis H4 is weakly supported, suggesting that firms with a larger talent pool tend to have higher hazard rates during the milestone period. However, the empirical results suggest some intriguing reinterpretations of the role of the tenure milestone as a precedent.

Related to the hypothesis H5, it is interesting to note that hazard rates are higher not only during the tenure milestone period, but also during the other phases of the *shacho's* tenure cycle. This suggests that merger experiences between firms of comparable stature in general may have the effect of encouraging early departures, shortening the average tenure of *shacho*. Itami (1995) documents that the average tenure keeps getting shorter over time in post-war Japan. My findings suggest that merger-induced shortening of *shacho* tenures is one of the factors behind the phenomenon.

The hypothesis H6 is not supported by the tests. Yet, the estimates suggest an interesting reinterpretation of the role of the tenure milestone. For the over-the-milestone period and also during the honeymoon period, the effects of prior incidence of confirmed precedent significantly increase the hazard of *shacho* change. It seems that prior confirmation tends to encourage early departure by the incumbent *shacho*. Thus, prior history of rule following also seems to contribute to the general shortening of *shacho* tenures as reported by Itami (1995).

4. Conclusion

This chapter is an empirical study of tenure rules governing *shacho* change in Japanese business. Compared with the extensive empirical literature on change and succession of the top executive officer in the U.S., Japanese counterparts are few in number and limited in their scope. This chapter may be considered an exploratory attempt to understand the complicated body of rules regulating the Japanese *shacho* change process, only a few aspects of which have been understood till now.

A key concept for my empirical analysis is the milestone in the *shacho's* tenure set by the predecessor's tenure as a precedent. The incumbent *shacho's* tenure cycle may then be divided into three periods, honeymoon period, tenure milestone period, and the over-the-milestone period. Once the *shacho* decides to stay on in the top position beyond the precedent set by his predecessor, his performance may be closely scrutinized by increasingly hostile stakeholders within the organization and without. This unpleasant prospect may give the *shacho* an additional incentive to step down in time respecting the precedent. Once confirmed, the precedent may carry a higher authority in affecting the subsequent *shacho's* departure decisions.

Shacho change data for the top 200 Japanese manufacturing companies during 1955 and 1995 are statistically analyzed using the methodology of event history analysis, also known as duration models in other fields. The empirical results lend a partial support for the hypothesis that the hazard rate is higher during the tenure milestone period. The hypothesis is strongly supported that hazard rates have a stronger negative relationship with performance past the tenure milestone period. A large internal talent pool may increase the hazard rate during the tenure milestone period, even though the coefficient estimate is not statistically significant. Firms with recent merger experience also show higher hazard rates during the tenure milestone period, suggesting that subunit rivalry may facilitate rule-following practices in organizations.

Organizational theorists have been studying how rules form and develop within an organization. Rule formation in the area of *shacho* change/succession has been rarely studied, however. This chapter represents an important contribution to the literature with its study of dynamics in the development of tenure rules in *shacho* change in Japanese business. The finding that precedents play an important role in the process may be applied in empirical studies of rule formation in other areas.

The chapter also sheds light on the role of performance in Japanese *shacho* change. The relationship between performance and *shacho* departure is shown to be in the "right" direction from the corporate governance perspective: *Shacho* are more likely to depart when performance is poor, especially when the *shacho* has stayed in the top position longer than the informal norm set by the predecessor's tenure.

Appendix 5-1: List of covariates

Middle of unit term is defined as a dummy variable, which has the value of 1 for the odd-numbered years in the *shacho's* tenure. This variable is meant to capture the effects of the 2-year unit term rule in Japanese *shacho* change.

Age 67-70 is defined as a dummy variable with the value of 1 when *shacho's* age falls between age 67 and 70.

Age 71 and over is defined as a dummy variable with the value of 1 when the age of *shacho* is over 71.

Year of CEO appointment is included to control for the historical trends over time. Itami (1995) reports that *shacho* tenure has been shortening over the years. Ocasio (1994) also found that *shacho* change risk has been changed over the years in the U.S.

Returning CEO is a dummy variable with the value of 1 if the *shacho* has served in the same position in the same company before. The few cases involve sudden departure by the previous *shacho* due to death or illness. The returning *shacho* are less likely to use predecessor's tenure as a milestone in his retirement decision.

Firm size is measured by the logarithm of the size of assets in each year.

The number of employees is actually measured as a logarithm of the number of employees.

Firm age is measured as the logarithm of the firm age since incorporation.

Family ownership is a dummy variable with the value of 1 if a member of the founding family is among the top 10 shareholders.

Family membership is a dummy variable indicating the ties to founding family, with the value of 1 if the CEO is a member of the founding family.

Parent company is also a dummy variable with the value of 1 if another industrial company owns more than 10% of shares.

Debt-to-assets ratio is used to indicate the degree of main bank control.

Keiretsu membership is noted by 6 dummy variables for each of the six *keiretsu* groups. The membership in the Presidential Club of the *keiretsu* is used to define membership in a *keiretsu*.

Industry Dummy variables are created for each industry using the 3 digit Japanese SIC code. The food industry is the omitted category.

Table 5-1. Means, Standard Deviations, and Pearson Correlation Coefficients (N=7021)

Variable	Mean	S.D.	1	2	3	4	5	6
1. ROA	0.051	0.056						
2. End of term	0.472	0.499	-0.000					
3. Tenure Milestone (TM)	0.168	0.374	-0.041	0.012				
4. Over Tenure Milestone (OTM)	0.187	0.390	-0.004	0.039	-0.216			
5. Age 67- Age70	0.233	0.423	-0.040	0.030	0.076	0.062		
6. Age 71 Over	0.108	0.310	0.041	0.023	-0.030	0.166	-0.191	
7. Employee size	8.669	0.941	-0.116	-0.003	0.029	-0.015	0.056	-0.001
8. Ratio of Elite U. Graduates on Board	0.244	0.149	-0.166	0.003	0.036	-0.019	0.040	0.014
9. Rank in 1965	0.776	0.417	0.059	-0.005	0.012	-0.008	0.002	-0.010
10. Merger before 74	0.052	0.223	-0.106	-0.002	0.065	0.000	0.079	-0.026
11. Prior precedent following	0.137	0.344	-0.033	-0.001	0.120	-0.057	0.053	-0.054
12. Year of shacho appointment	71.065	14.132	-0.185	-0.032	0.142	-0.243	0.049	-0.230
13. Founder	0.052	0.222	0.140	0.012	-0.102	-0.112	-0.061	0.122
14. Firm size by asset	11.715	1.427	-0.193	-0.005	0.119	-0.081	0.115	-0.058
15. Firm age	4.099	0.515	-0.199	-0.004	0.086	-0.048	0.089	-0.051
16. Returning shacho	0.007	0.085	-0.013	-0.007	0.029	0.036	0.000	0.127
17. Family control	0.182	0.386	0.215	0.007	-0.080	-0.056	-0.098	-0.004
18. Family membership	0.176	0.381	0.181	0.010	-0.071	0.009	-0.127	0.010
19. Parent control	0.290	0.454	0.079	0.002	-0.007	0.021	-0.013	-0.001
20. Debt to asset ratio	0.706	0.144	-0.447	-0.002	0.037	-0.035	0.103	-0.036

Variable	7	8	9	10	11	12	13	14
7. Employee size								
8. Ratio of Elite U. Graduates on Board	-0.007							
9. Rank in 1965	0.035	0.003						
10. Merger before 74	0.283	-0.069	0.013					
11. Prior precedent following	0.072	0.094	0.023	0.079				
12. Year of shacho appointment	0.087	0.039	0.012	0.042	0.207			
13. Founder	-0.203	-0.132	-0.019	-0.029	-0.094	-0.430		
14. Firm size by asset	0.569	0.068	-0.009	0.209	0.169	0.697	-0.330	
15. Firm age	0.254	0.157	0.106	0.170	0.100	0.358	-0.359	0.452
16. Returning shacho	0.059	-0.011	0.034	0.018	-0.024	-0.049	-0.020	-0.005
17. Family control	-0.078	-0.156	0.074	-0.111	-0.144	-0.130	0.275	-0.113
18. Family membership	-0.093	-0.115	-0.021	-0.109	-0.130	-0.248	0.303	-0.174
19. Parent control	-0.187	-0.029	-0.169	-0.095	-0.008	-0.008	0.078	-0.141
20. Debt to asset ratio	-0.026	0.178	-0.076	0.142	0.066	-0.055	-0.048	0.043

Variable	15	16	17	18	19
15. Firm age					
16. Returning shacho	-0.009				
17. Family control	-0.016	-0.032			
18. Family membership	-0.091	-0.018	0.540		
19. Parent control	-0.257	-0.051	-0.155	-0.119	
20. Debt to asset ratio	0.064	0.002	-0.302	-0.232	-0.004

Table 5-2. Maximum likelihood estimate of shacho change: Tenure milestone effect

Variables	Model 1		Model 2		Model 3		Model 4		Model 5		Model 6	
	β	s.e.	β	s.e.	β	s.e.	β	s.e.	β	s.e.	β	s.e.
<u>Performance</u>												
ROA	-1.81	(1.31)	-1.92	(1.31)	-2.08	(1.31)	-3.75**	(1.46)	-1.24	(1.32)	-2.60	(1.61)
<u>Timing rules</u>												
Tenure milestone period			0.22***	(0.08)	0.11	(0.09)	0.12	(0.09)	0.12	(0.09)	0.01	(0.12)
Over-the-milestone					-0.28***	(0.10)	-0.29***	(0.10)	-0.07	(0.13)	-0.14	(0.13)
<u>Interaction with performance</u>												
ROA * Tenure milestone							3.90**	(1.52)			2.64	(1.67)
ROA * Over tenure milestone									-5.09**	(2.00)	-3.69*	(2.21)
<u>Control Variables</u>												
Middle of the term	-0.43***	(0.09)	-0.43***	(0.09)	-0.44***	(0.09)	-0.36***	(0.10)	-0.41***	(0.09)	-0.37***	(0.10)
ROA * midterm	3.30**	(1.40)	3.27**	(1.41)	3.37**	(1.41)	1.78	(1.49)	2.78**	(1.38)	1.87	(1.49)
Age 67-70	0.92***	(0.09)	0.92***	(0.09)	0.93***	(0.09)	0.93***	(0.09)	0.93***	(0.09)	0.93***	(0.09)
Age over 71	1.22***	(0.10)	1.22***	(0.10)	1.24***	(0.10)	1.24***	(0.10)	1.24***	(0.10)	1.24***	(0.10)
Year of shacho appointment	0.08***	(0.01)	0.08***	(0.01)	0.08***	(0.01)	0.08***	(0.01)	0.08***	(0.01)	0.08***	(0.01)
Founder	-0.40	(0.22)	-0.41*	(0.23)	-0.59*	(0.23)	-0.58**	(0.23)	-0.66**	(0.23)	-0.63**	(0.22)
Firm size by asset	-0.41***	(0.08)	-0.40***	(0.08)	-0.41***	(0.08)	-0.42***	(0.08)	-0.41***	(0.08)	-0.41***	(0.08)
Firm age	0.16	(0.11)	0.14	(0.11)	0.13	(0.11)	0.13	(0.11)	0.11	(0.11)	0.11	(0.11)
Returning shacho	0.39	(0.36)	0.40	(0.36)	0.48	(0.36)	0.46	(0.36)	0.43	(0.36)	0.43	(0.36)
Number of Employee	0.53***	(0.08)	0.53***	(0.08)	0.53***	(0.08)	0.53***	(0.08)	0.52***	(0.08)	0.53***	(0.08)
Family control	0.06	(0.13)	0.07	(0.13)	0.04	(0.13)	0.06	(0.13)	0.02	(0.13)	0.04	(0.13)
Family member	-0.73***	(0.14)	-0.72***	(0.14)	-0.75***	(0.14)	-0.74***	(0.14)	-0.74***	(0.14)	-0.74***	(0.14)
Company control	0.03	(0.10)	0.03	(0.10)	0.03	(0.10)	0.03	(0.10)	0.04	(0.10)	0.03	(0.10)
Debt to Asset ratio	1.53***	(0.32)	1.49***	(0.32)	1.46***	(0.32)	1.23***	(0.33)	1.29***	(0.33)	1.19***	(0.32)
Constant	-13.40***	(0.80)	-13.23***	(0.78)	-13.28***	(0.79)	-12.92***	(0.80)	-12.96***	(0.80)	-12.80***	(0.80)
/ln_p	0.91***	(.03)	0.91***	(0.03)	0.95***	(0.04)	0.95***	(0.04)	0.95***	(0.04)	0.94***	(0.04)
Number of change events	823		823		823		823		823		823	
D.f.	33		34		35		36		36		37	
Log likelihood	-560.23		-556.87		-552.58		-549.26		-549.16		-547.84	

1. * $p < .10$; ** $p < .05$; *** $p < .01$
2. Keiretsu dummy variables and industry dummy variables were included in the models, although the coefficients are not reported in the table. The complete results are available upon request from the author.

Table 5-3. Maximum Likelihood Estimate of Shacho Change: Organizational and Political Variables.

Variables	Model 6		Model 7		Model 8		Model 9		Model 10	
	β	s.e.	β	s.e.	β	s.e.	β	s.e.	β	s.e.
Performance										
ROA	-2.60	(1.61)	-2.68*	(1.61)	-2.59	(1.61)	-2.86*	(1.62)	-2.96*	(1.63)
TM * ROA	2.64	(1.67)	2.94*	(1.69)	2.64	(1.68)	2.66	(1.67)	3.03*	(1.70)
OTM * ROA	-3.60*	(2.20)	-3.56	(2.23)	-4.07*	(2.21)	-2.87	(2.62)	-3.13	(2.26)
Competitive Internal Labor Market										
Ratio of Elite U. Graduate			0.18	(0.40)					0.21	(0.40)
TM * Ratio of Elite U. Grad.			0.60	(0.60)					0.61	(0.60)
OTM * Ratio of Elite U. Grad.			0.10	(0.56)					0.03	(0.57)
Subunit Rivalry										
Merger before 1974					0.64***	(0.25)			0.63**	(0.25)
TM * Merger					-0.09	(0.32)			-0.03	(0.32)
OTM * Merger					-0.48	(0.36)			-0.40	(0.36)
Prior Precedent Following										
Prior Precedent Following							0.35**	(0.16)	0.33**	(0.16)
TM * Prior Precedent Following							-0.11	(0.22)	-0.13	(0.22)
OTM * Prior Precedent Following							0.11	(0.23)	0.11	(0.23)
Constant	-13.20***	(0.79)	-13.25***	(0.80)	-12.83***	(0.81)	-13.08***	(0.81)	-12.66***	(0.83)
/ln_p	0.95***	(0.04)	0.95***	(0.04)	0.96***	(0.04)	0.96***	(0.04)	0.97***	(0.04)
Likelihood Ratio	-547.84		-546.39		-542.92		-541.46		-535.10	
D.f.	37		40		40		40		46	
Number of events	823		823		823		823		823	

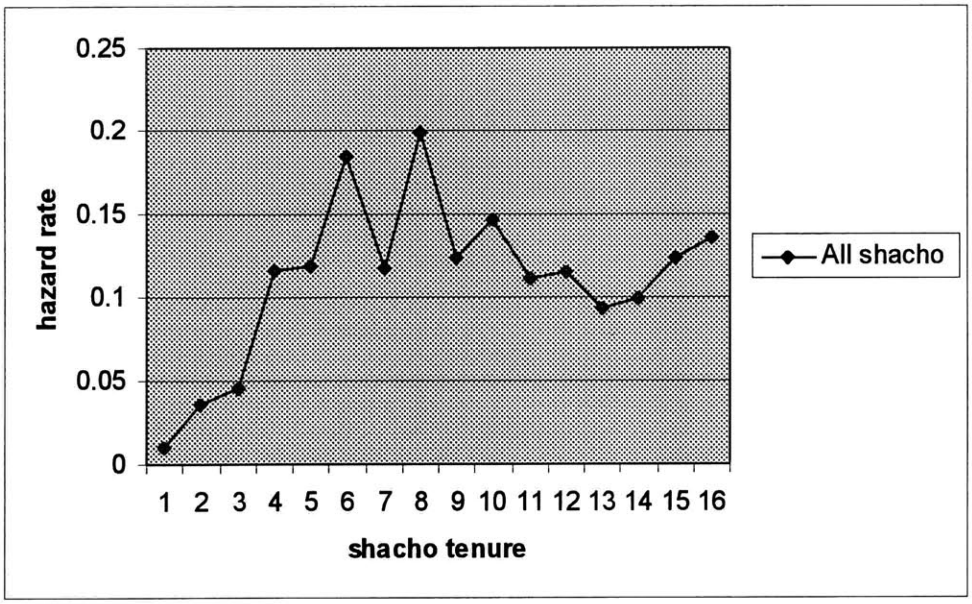
* $p < .10$; ** $p < .05$; *** $p < .01$

Table 5-4. The effects of organizational and political variables for three periods

Variables	Before Tenure Milestone	Tenure Milestone	Over Tenure Milestone
	β	β	β
Performance			
ROA	-2.96*	0.07	-6.09***
Competitive Internal Labor Market			
Ratio of Elite U. Graduate	0.21	0.82*	0.24
Subunit Rivalry			
Merger before 1974	0.63**	0.60**	0.23
Prior Precedent Following			
History of shacho change during the TM period	0.33**	0.20	0.43***

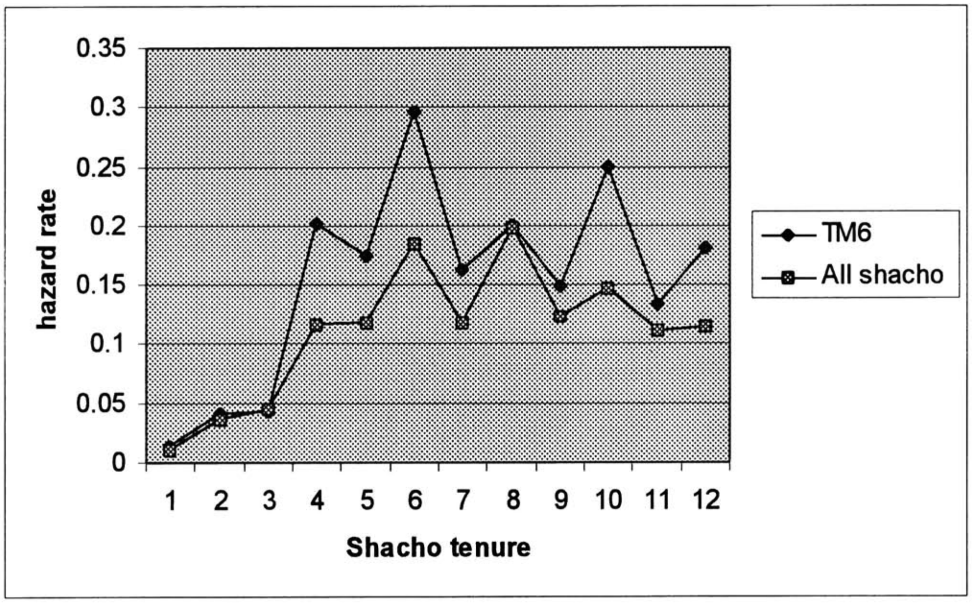
1. * $p < .10$; ** $p < .05$; *** $p < .01$

Figure 5-1. Hazard rate of *shacho* change: all sample



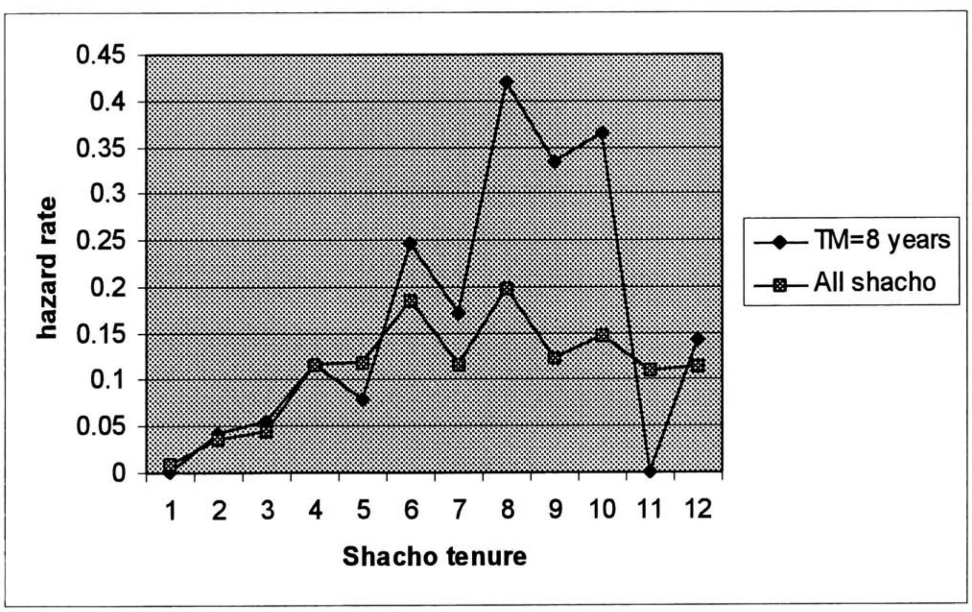
1174 subjects
911 failures
9557 total analysis time at risk

Figure 5-2(a). Hazard rates of *shacho* change (6^{th} year as the tenure milestone)



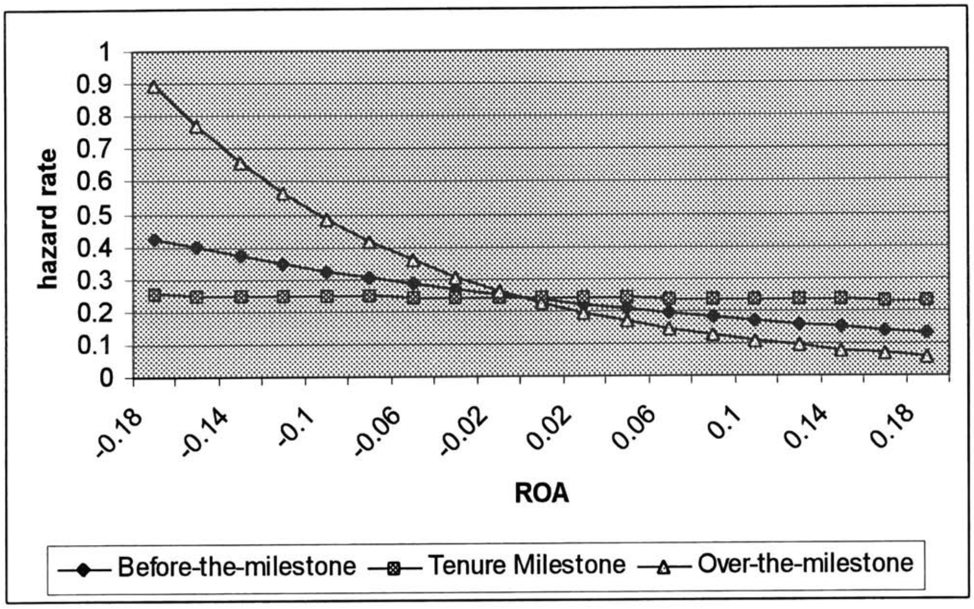
142 subjects
99 failures
803 total analysis time at risk

Figure 2(b). Hazard rates of *shacho* change (8^{th} year as the tenure milestone)



101 subjects
74 failures
629 total analysis time at risk

Figure 5-3. Predicted hazard rates as a function of performance



Chapter 6. Conclusion

(1) Summary: Succession rules for Japanese *shacho*

The dissertation starts from an observation that it is not an easy or natural thing for leaders to prepare their own exits. Existing studies on CEO succession in the U.S. have relied on power theory and examined the various political processes that solve the syndrome of the reluctant hero. Taking institutional theory, which emphasizes the role of formal and informal rules in structuring organizational activities, and combining it with political approaches has proved to be a fruitful approach to the study of CEO succession. The institutional approach to CEO succession is especially important in understanding the phenomenon in the Japanese context, because the political processes that govern the CEO succession process and outcome in the U.S. are not available under the Japanese corporate governance system. Therefore, following the institutional theory of action (March & Olsen, 1989; March, 1994; Ocasio, 1999), I have suggested the concept of organizational identity and rules as a way to understand the dynamics involved in CEO succession. That is, both power and institutional logic affect CEO succession by shaping organizational identities and rules.

The application of the institutional theory of action to the Japanese corporate governance system shows that both institutional logic and dominant stakeholders are indeed important in shaping *shacho* succession process in Japan. Yet, solving the succession conundrum, especially in the managerial firms where *shacho* and top managers are given enormous autonomy from dominant stakeholders, poses a challenge that can only be met by exploring the role of succession rules in governing Japanese *shacho* succession.

The dissertation shows that *shacho* succession in Japan is guided by various succession rules that reflect community identity. Both community logic and dominant stakeholders shape organizational identity and the *shacho* succession process. The review, however, leads us to the puzzle of how CEO succession is managed in managerial firms in which dominant stakeholders do *not* play a role in shaping CEO succession. I took both qualitative and quantitative approaches to addressing the problem of the reluctant hero.

By examining *shacho* succession stories from the popular business press, I identified several rules of CEO succession in Japan. First, the *shacho* takes the initiative in the CEO/*shacho* succession process. Second, insider succession is prevalent in most firms. The insider usually came from the top two ranks—vice president or senior executive manager—of the top management hierarchy. Third, the *shacho* steps up as a chairman as he retires from the *shacho* position. Fourth, many firms relied on rather explicit tenure rules that guide *shacho* succession. Often times, organizational actors, especially the *shacho*, broke the rules. The rule breaking was evaluated along the two guiding principles: the rhetoric of rejuvenation and the rhetoric of 'flower way.' When the rule breaking confirmed the guiding principles of *shacho* succession, it was put in a positive light. However, when the rule breaking went against the guiding principles, the *shacho* succession went through intense public scrutiny.

Next, I examined in a quantitative study how the rules and rhetoric identified from the qualitative study influence the actual *shacho* succession process and outcome in large Japanese firms. In particular, I have tested for the role of tenure rules. The difficulty of studying organizational rules in general is that organizational rules tend to differ across firms. Tenure rules are not an exception. Some firms had a 4-year tenure rule, while others had 6-year or even 10-year rules. I overcome this difficulty by suggesting the concept of tenure milestone. The concept of tenure milestone provides an interesting view on the life span of a *shacho*. That is, a *shacho's* life cycle can be divided into three distinctive periods based on tenure milestone—before the milestone, milestone, and over-the milestone—presenting different mandates for the incumbent *shacho*. It is hypothesized that if the *shacho* succession is guided by tenure rules, there should be more *shacho* succession during the tenure milestone period. As predicted, the *shacho* succession was more likely during the *shacho* succession, regardless of performance. Interestingly, past the tenure milestone *shacho* succession was related to poor performance, suggesting the stricter scrutiny of dominant stakeholders. Moreover, organizational and political factors, such as the existence of a large internal talent pool and subunit rivalry resulting from merger, also facilitate *shacho* change during the tenure milestone period.

(2) Japanese *shacho* succession in comparative perspective

Now that we know *shacho* succession in Japan follows a set of succession rules, what does it say to the CEO succession literature in general? Is it a story that is only pertinent to Japan? Or, is the story generalizable to other national economies? The quick answer is that it is both a story of CEO succession in general, and a story of Japan. The comparison of succession rules for CEO in the U.S. illustrate the point. Consider the CEO succession profile of Avon that Vancil (1987) take up as an example. What we find from the CEO succession profile of Avon is that rules that I identified in Japan—such as insider selection, separation of President and Chairman, and stepping up to Chairmanship—have been the rules of CEO succession in the U.S. as well, at least before the 1980s. These rules reflect the community identity, which was the dominant institutional logic before the shareholder revolution took place in the late 1970s, as several researchers on corporate governance have pointed out (Blair, 1995; Useem,1996).

The commonalities in the two countries challenge us to think about the underlying conditions for the development of community identity and the succession rules that match the identity. What could have been the underlying structural conditions that created the community identity in the two countries? The fact that some of the common succession rules are found mainly in managerial firms in Japan rather than in stakeholder-controlled firms suggests that the separation of ownership and control was a major condition for the development of the community firm. Community identity is difficult to cultivate when there is a strong stakeholder who could shape an organizational identity that represents his narrowly defined interests.

At the same time, however, we don't see the development of tenure rules in the U.S. nor do we frame the CEO succession in terms of rejuvenation or the flower way. I doubt tenure milestones has played a major role in the CEO succession process and outcome in the U.S., although it remains an empirical question. In other words, we see succession rules that guide CEO succession differ in the two countries. The difference may reflect that the Japanese community firms have been more successful in constructing "community" that is independent from any one stakeholder. Now, what made the difference between the J-type community firm and A-type community firm? In the previous chapters, I surmise that the notion of '*ie* (household)' that had developed in the pre-modern Japan may have provided an enduring model for the modern firm. as providing the model for firm that overcomes the boundary of time and space. However, I would not like to suggest that the traditional notion and associated symbols will explain everything by themselves. I've mentioned that there is an important departure between the concept of household in pre-modern Japan and the concept of community in modern Japanese corporations. Rather, I am suggesting that organizational actors have used these shared symbols to create the J-type community firms that we see in the post WWII Japan. In other words, the diversity in the succession rules not only reflects the differences in the shared cultural artifacts, but also the role 'agency' plays in constructing those rules.

Another important question is what was the reason for the change in the U.S? And why don't we see the change in Japan? Can we attribute the rise of the shareholder revolution to a purely structural mandate? Can we say that it is simply a matter of time before Japanese firms will accept the property conception of firm as they are under similar pressure from the ever-globalizing financial market? I do not intend to deny a role for the structural conditions that are putting pressure on J-type community firms. Still, I believe that the "agency" of various stakeholders deserves more attention in the maintenance of a community firm. I start with the proposition that construction of community identity, or the creation of institution in Selznick's sense, requires an explicit and implicit commitment by all stakeholders—that all stakeholders put the community interest before individual interests. If one or more stakeholders take advantage of the "community," community identity may collapse quite easily. In other words, community identity may deteriorate if one of the stakeholders abuses the system. Thus, what is really remarkable is not the shift from the community firm to shareholder firm, but the maintenance of the community firm and how stakeholders keep their commitment, as has been the case with the J-type community firms.

I would like to reconsider the morality and breach of trust among stakeholders in this light. I wonder whether the shift to the shareholder property conception was also accompanied by both top executives and employees who put their interests before the interests of the community as a whole. For example, although it may have been confined to only a few firms, some executives enjoyed managerial perquisites and exorbitant compensation. On the other hand, the growth strategy that put the interests of employees as the main priority could also be thought of as an example of abusing the system.

In contrast, when faced with economic shocks that put J-type community firms under test, Japanese top executives and labor union have been more willing to make compromises in the name of preserving the community. For example, we see few instances of drastic downsizing. The goodwill of top executives, in which both CEO and chairman shared the responsibility by resigning after the restructuring, may have caused labor unions to make concessions. The income differential between top management and employees has been quite small in Japan compared to that in the U.S.

Japanese top management's and employees' success in defending community identity does not mean that community identity will be continued in the future. It will depend on the agency as well as morality of top management and employees, given the increasing pressure from the international financial market. In fact, I would argue that it is not the routinization that is threatening the Japanese economy, but the loss of the ethos of the 'community' conception of firm through various actor's opportunistic activities. For example, some CEOs have refused to step up or down, but are insisting on remaining as CEO. This puts them in a position where nobody could control their interests. The other example is the unconscious development of the firm as being the property of managers, which has been also captured in Itami (1994)'s study.

(3) Conceptual implications.

The dissertation has at least three conceptual implications for the study of CEO succession and for the study of organizational action in general. First, organizational identity and the rules attached to the identity provide an alternative way to theorize 'agency' in organizational theory. The concept of agency in most organizational theories has been closely tied to self-interest and power (Pfeffer and Salancik, 1978; DiMaggio, 1988; Oliver, 1991) and its manifestation was various ways to 'resist' institutional pressure (Oliver, 1991). The concept of agency in institutionalized action theory is much broader, in that it is related to the general process of constructing organizational identity and establishing the rules that match the identity (March, 1994) and to the general process of interpreting and institutionalizing the meaning in organizational actions (March & Olsen, 1989). It is the agency in the sense of having 'choice' over the construction of identity and rules, where accepting the institutional logic is as much a manifestation of agency as resisting the institutional logic, rather than the agency in the sense of having self-interest that transcends history and its institutional context. The role of institutional contexts is emphasized as shaping self-interests and power (Thornton & Ocasio, 1999) rather than as homogenizing organizational responses.

Even when we accept that there are certain dimensions of self-interest and power that are less historically contingent, the institutionalized action theory suggests that there could be another source of divergence in organizational response which follows from the creative interpretation of institutional rules. In my qualitative analyses of rule breaking behavior in Japanese *shacho* succession, I showed that some rules are broken—appointment of new *shacho* from the lower hierarchical ranks instead of the usual top two ranks within the top management team—not as a result of self-interest but as a result of being true to the guiding principle of *shacho* succession—rejuvenation. In this sense, organizational actions could be conceptualized as having three distinctive layers: actions characterized by self-interests and incentive, actions characterized by duty and norm, and actions that embody the 'spirit (or *zeitgeist*)' of the institutional rules. The third layer of action, which could be also characterized as 'beyond-the-call-of-duty,' was illustrated by one of my advisers who, even when ill, continued to provide thesis supervision for the author, against the common rule of not risking health for work.

It needs to be mentioned that the third layer is not necessarily morally superior over the other two layers of action. In fact, we have seen occasions in history where fringe groups have successfully manipulated individual and organizational identity to encourage socially harmful behaviors that go against the institutional rule of civility. Even the community identity of firm in Japan could be criticized for inducing *karoshi* (death-on-duty), an expression of excessive loyalty to the community conception of firm. It is sufficient to say that identity is a powerful way to control individual and organizational action.

Second, organizational identity formation, especially the construction of community, could be interpreted as providing the answer to a central economic problem—the management of common resource property (Ostrom, 1990). With no particular owner in place, people have free access to the resources. No individually rational agent cares about the negative externalities that his use of resources inflicts on the others. Thus everyone ends up overusing or abusing the resources to the detriment of everyone's welfare. This is the famous problem of "the tragedy of the commons" (Hardin & Baden, 1977). Yet in practice, one can quite easily find successful instances of common resource management (CRM). Ostrom (1990) draws on studies by economists, political scientists, and anthropologists, and tries to characterize the essential elements in successful practices and the necessary conditions for them. Examples of common resources studied include common grazing grounds for cattle, fishing grounds, and water. It seems that nobody has thought of modern corporations characterized by separation of ownership and control, such as Japanese firms, as an example of common property resource.

Resources under corporate control are of course different from grazing grounds. However, it seems to me that one may think of Japanese firms, with no particular owner willing to exercise monitoring authority, as an example of common resources with some particular characteristics, such as (a) the corporate hierarchy and (b) the threat of contingency-based intervention by the creditors. Thus, applying the common resource management perspective could generate an interesting theoretical insight into the maintenance of the Japanese style community firm in the future.

Third, the tenure rules and the concept of tenure milestone provide a way to study the temporal aspects of CEO's tenure—a rather unexplored aspect of executive decision making (Hambrick & Fukutomi, 1991). In an attempt to model the temporal features of CEO's tenure, Hambrick and Fukutomi (1991) argue that "there are discernible phases, or seasons, within an executive's tenure, and that these seasons give rise to distinct patterns of executive attention, behavior, and ultimately, organizational performance." Reviewing several behavioral characteristics throughout the tenure of a CEO, they develop a time-phase theory of CEO tenure where CEOs go through five seasons: (a) response to mandate; (b) experimentation, (c) selection of an enduring theme, (d) convergence, and (e) dysfunction. Despite the perceptive analysis of behavioral changes across the seasons of a CEO's tenure, their study did not generate empirical studies because they did not attempt to model the temporal aspect directly. Moreover, the realization of five seasons may depend on the existence of formal or informal tenure rules, such as the tenure milestone that we see in Japanese *shacho* succession. Thinking explicitly in terms of tenure rules generates additional questions that ask about the appropriateness of the time horizon for expecting performance results for new CEOs. For example, do firms in the U.S. have the right time horizon for their CEOs to learn their job as the CEO? Is the performance pressure ignoring the wisdom of allowing the experimentation during the first three seasons suggested by Hambrick and Fukutomi (1991)? The concept of tenure milestone and the closer examination of tenure rules will shed light on these exciting new questions on CEO's behavior. It also provides an important extension for the theoretical development that looks at the role of time and temporal aspects of organizational life (Gersick, 1991; Bailyn, 1993; Ancona & Chong, 1996; Perlow, 1999).

(4) Methodological Implications

The current study on CEO succession rules states that it is necessary to combine qualitative and quantitative methodology in the study of rules. Rules are basically context specific. It is a result of interaction among multiple actors. Even when firms have a similar organizational identity, succession rules differed across national context and even within national boundaries. For example, tenure rules were developed only in Japan, largely because age was used deliberately to structure the organizational competition as well as organizational information. Without identifying the rules through qualitative research, we cannot understand how rules affect organizational action. At the same time, however, we also need a large sample quantitative study because some of the rules identified through qualitative studies may exist only as rhetoric and because we want to know the process through which some of the rules gain legitimacy across a population.

The current study illustrates the merit of iterating between quantitative and qualitative methodologies. That is, the qualitative study was employed after finding some obvious pattern—routinization of *shacho* succession—through quantitative study. The findings from the qualitative analysis of succession stories were than used to generate testable hypotheses for the quantitative study. The examples are good performance, instead of bad performance, facilitating *shacho* succession (the *hanamichi* hypothesis) and prior merger experience facilitating the rule following. In fact, I did not plan for the qualitative study from the outset. I started collecting the stories of Japanese *shacho* succession only as a way to collect data on *shacho* succession due to death or ill health that were not available from official documents of firms, such as the Japanese equivalent of proxy statements and company history books. At the same time, during my qualitative analysis I often went back to my quantitative data base to see the trends and to confirm how dominant some rules, such as the rule of insider selection and the rule of retiring as a chairman, have been acted on in the study period. The data base was especially useful in distinguishing the stories that were not substantiated in the actual succession process from the stories that had a broader factual basis.

The current study also shows the merit of taking a comparative perspective in studying organizational rules. Rules are often taken for granted by both organizational actors and academics studying organizational phenomenon. In the current study, I was able to identify succession rules because I had CEO succession in the U.S. as an explicit reference point, and I was able to look at Japanese CEO succession as an outsider. There is clearly merit in being an outsider in the study of CEO succession. For example, both Itami (1995) and Miyajima (1996) are aware of the role of some of the rules that affect the CEO succession process. Yet, to them, these rules were something that should be 'controlled' for, rather than something that is worthy of independent investigation.

Taking a comparative perspective need not be a direct comparison between two national systems. In fact, one has to be careful when launching a direct comparison of two systems because it is likely to produce a non-interesting result as one country is compared to the standard of another country. I am not saying that good comparative study is impossible. Rather, I am considering the risk of mechanical comparison of different business system. We need to understand how similar structural elements are 'interpreted' in different business system. We need to understand how meanings are construed in different economic systems.

The study of Japanese CEO succession was also important in finding the change in CEO succession rules that accompanied the shift in dominant institutional logic that happened around the 1980s in the U.S. In fact, now that we know Japanese CEO succession rules, we could have a new look at CEO succession in the U.S.

In short, while the qualitative approach provides an insider's perspective for the researcher, the comparative approach provides an outsider's perspective. The study of organizational rules shows the merits of the healthy tension between being an insider and being an outsider at the same time.

(5) Further research agenda.

Several issues remain to be addressed in this dissertation. First, I have not looked at how the tenure rules emerged in the beginning and how linguistic framing helped them emerge. I have only shown that the rules exist under various conditions but I have not explored how the actors actively developed institutional and organizational rules through sharing what they believed to be a morally superior way of managing the firm. In fact, this is a real problem. Although I stated explicitly the role of agency in using the institutional rules, I have only revealed the agency of top management in a few cases where they broke the rules. I have not explored systematically how agency did play a role in the development of CEO succession rules. I have shown that agency of top management and labor unions was important in shaping community identity during the early post World War II period, but I have not explicitly dealt with the emergence of various rules directly. So the next step will be going to similar qualitative studies to see the role of various actors in the initial emergence of succession rules, especially tenure rules.

Also, there has been a great change in corporate governance in Japan. Recent changes make the board of directors look more like the U.S. board of directors. The size of the board of directors has been significantly reduced. Moreover, the directors have been divided into two groups: executive directors and regular directors. The purpose of the executive directors is to make the locus of decision making clearer so that it is known who is responsible if a strategy fails. However, it is not clear whether regular directors could do their job as a monitoring agent, because they are still insiders who actually stay in the lower ranks in the organizational hierarchy. In any case, the pressure of performance and doubts about the Japanese type business system are putting pressure on the current form of *shacho* succession. This has been expressed by Itami (1995), who regards routinization as something of a negative quality in Japanese management. Thus, it is important to know how this self-doubt plays out in the *shacho* succession process and outcome and how such self-doubt changes the *shacho* succession rules. The commons resource management perspective will actually give some light to evaluate whether these changes will be good for Japanese management in the future.

Also, a very interesting research venue follows naturally from the study of succession rules in Japan. We have tested hypotheses regarding tenure rules. We could also extend our study to test quantitatively whether some of the other rules of succession are affecting CEO succession. Two points are especially worthy of testing—*hanamichi* and rejuvenation. The *hanamichi* hypothesis was tested in Chapter 5, but it did not consider how such logic will play out in the dynamics between CEO and chairman. The easy prediction will be that the *hanamichi* phenomenon will be more likely to be observed in CEO succession cases that involve the retirement to chairman. Where rejuvenation is concerned, an interesting question is whether a performance crisis will bring younger executives into top management. Thus, we might expect the age of a new *shacho* to be younger following a performance crisis. It will be interesting whether the rhetoric really reflects what happens in the real world, or whether it just remains as rhetoric.

Another fruitful extension should be to explore the development of CEO succession rules in Korea. Korea provides a very interesting place to extend the study because Korea is also very conscious of age. Age is also very important in structuring organizational life. Korean firms are different from Japan in many ways, however. First, the concept of household is somewhat different—the principle of primogeniture has been more important, for instance. Second, management and control are not yet separated. Third, Korea has been learning from two models, instead of one, that is the U.S. business model and the Japanese. Thus, it would be interesting to study how the organizational actors use the different models.

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