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ABSTRACT

Does Governance Matter? Performance and Corporate Governance Structures of Japanese *keiretsu* Groups

by Andreas Moerke*

The paper presents an investigation of 72 Japanese manufacturing firms from five different industries with the focus on horizontal industrial groups (*keiretsu*). Data source was the "Kaisha Database" at the Science Center Berlin. The main findings are:
Using the hexagon criterion to estimate the excellence of firms, the independent firms achieved better results. Thus we conclude that belonging to a *keiretsu* is no longer a guarantee for the success of a company. A different bank-firm relationship leads to different income distribution: the „old" *keiretsu* pay higher wages while the independent firms pay more dividend per share. Our best speculation is that the "old" *keiretsu* are still somewhat isolated from the market and the independent firms have to be more attractive to their shareholders. The structure of the boards of directors differs in following points: *keiretsu* firms have clearly larger boards than independent firms. Independent firms have on the average less directors dispatched from financial institutions, but do have a higher number of outsiders. They appoint more amakudari bureaucrats from the Bank of Japan and the Ministry of Finance to outbalance the better bank-firm relations of the *keiretsu*. The *keiretsu*, however, appoint more bureaucrats from state institutions related directly to their business.

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ZUSAMMENFASSUNG

Ist Corporate Governance von Bedeutung? Zu Erfolg und Corporate-Governance-Strukturen japanischer Unternehmensgruppen

Die Studie präsentiert die Ergebnisse einer Untersuchung von 72 japanischen Industrieaktiengesellschaften hinsichtlich ihrer Betriebsergebnisse und Corporate-Governance-Strukturen. Besondere Aufmerksamkeit galt dabei den horizontal verflochtenen Unternehmensgruppen (*keiretsu*). Die Studie führte zu folgenden Ergebnissen:

Die Gruppenunternehmen waren im Mittel der 10 Jahre von 1986-95 weniger erfolgreich als die ungebundenen Unternehmen. Die Zugehörigkeit zu einer solchen Gruppe garantiert also den Erfolg nicht. Für die Kontrolle des Unternehmens von außen spielen Banken eine wichtige Rolle. Aufgrund der engeren Beziehung zu ihren Banken waren die Gruppenunternehmen unabhängiger vom Kapitalmarkt als die ungebundenen Unternehmen, was zu einer anderen Einkommensverteilung führte. Gruppenunternehmen weisen höhere Löhne aus, unabhängige Unternehmen höhere Dividenden. Zu den firmeninternen Kontrollorganen zählt das ‚Board of Directors'. Hier weisen die *keiretsu* deutlich mehr Mitglieder aus. Die ungebundenen Unternehmen haben in ihren Boards weniger Directors, die von Finanzinstitutionen entsandt wurden, aber mehr andere „Outsider" als die Gruppenunternehmen. In ihren Boards waren mehr pensionierte Ex-Bürokraten (*amakudari*) aus dem Finanzministerium und der Bank of Japan vertreten, hingegen in den Boards der *keiretsu* mehr Ex-Bürokraten aus den staatlichen Institutionen, die in direktem Zusammenhang mit dem Geschäftsfeld des Unternehmens stehen.

1. Introduction

Keiretsu networks were a focus of attention even before the Structural Impediments Initiative talks were held. They have provoked a substantial amount of research dealing with the questions of whether group membership is stabilizing performance, whether it is easing liquidity constraints and so on. Until recently it was safe to say that a *keiretsu* firm would not go bankrupt. But as one could see in the case of Yamaichi Shôken (which was close enough to Fuyô to participate in the regular *kondankai* ("familiar talks") meetings of the group), things are changing rapidly in Japan.

This paper focuses on the performance and aspects of corporate governance of the horizontal business groups (often called *'keiretsu'* in the Western context and *'kigyô shûdan'* in the Japanese) in comparison with the 'independent' companies. The largest and best known *keiretsu* are the Mitsui, Mitsubishi, Sumitomo, Fuyô, Sanwa and Daiichi Kangyô group, often called the "Big Six". They are understood as large networks of basically independent companies, with a bank (usually a large city bank), a trading company (*sôgô shôsha*) and some core firms in the center of it. Other characteristics are stable reciprocal shareholding (*kabushiki mochiai*), personal interlocking as well as meetings the top CEO hold regularly (*shachôkai*)[1].

Vertical business groups consisting of subcontractors, satellite firms and trading firms based around a large-scale manufacturing firm like Toyota are not taken into consideration.

Corporate Governance is understood as the process and mechanisms, by which the (capital) market monitors the action of corporate management (Sheard 1998: 7). The system of corporate governance in Japan "can only partially be explained by classic governance theory. The most important influence on Japanese corporate management is through a mechanism combining administrative and personal guidance" (Schaede 1994: 320). Especially in the case of the *keiretsu* there are some distinct features which have to be mentioned.

- The stable cross shareholding (*kabushiki mochiai*) is aimed to prevent hostile takeovers and to ensure that control is to be exercised by the shareholders rather than by third parties (Sheard 1996: 318-319). Since about 70 per cent of the large companies hold their annual shareholder's meeting on the same day (Demise 1997: 172), it seems fair to say that in Japan the individual shareholders are more or less insignificant.
- Financial institutions play a more important role. The main bank, which is one of the core elements of a *keiretsu*, is the main provider of loans, monitors the corporate results (cf. Schaede 1994: 304; Yabushita 1992; Yamanaka 1997: 25f) and, at the same time, is one of the main shareholders of the firm[2]. Financial institutions like the main bank exert control by sending CEOs or even auditors to the firms.

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1 According to the Fair Trade Commission, those meetings are not the place where strategic and business decisions are made (Kôsei torihiki iinkai 1992); but it is hard to imagine that they do not matter at all. Furthermore, the meetings can be seen as an institutionalized exchange of information, which is a point that matters in a world of global dynamic competition.

2 Due to the law, banks are restricted to a maximum 5% stake in the client corporation.

- Control is furthermore exerted by other firms, in the case of *keiretsu* especially by the Presidents' Council. The total number of shares owned by other firms of the same group is fairly high, so that the *shachôkai* represents a large shareholder and is able to govern. It is also common to send CEOs or auditors to other firms of the same *keiretsu* group.
- Two other corporate stakeholders have to be mentioned. First, government officials have been playing a crucial role in the Japanese economy for years. "In Japan, a company president is careful to attend the advice and counsel of former ministry officials who form the core of the OB network and act to coordinate and harmonize relations between business and government (Schaede 1994: 317)." Those "Old Boys" ensure smooth information flow between bureaucracy and industry and are loyal to both sides.
- The employees may not be a main governing power, but they have to be taken into account. Although the Japanese in-house trade unions do not have the power of western industry unions, the management can hardly ignore their interests. Until recently, the large companies, providing "lifetime" employment, a relatively sure career path and relatively high wages and bonuses, could assure the loyalty of their employees.

With respect to previous research, the following hypothesis will be tested:

1. It has been frequently suggested that affiliation to a *keiretsu* should be seen as a competitive advantage (Eli 1988, 1994; Nakatani 1984; Sydow 1991). Firms within a *keiretsu* have the advantage of economy of scope (Sheard 1998: 9), they can rely on support from the other member firms and especially the bank in times of crisis (Nakatani 1984: 229). This "mutual insurance scheme" is said to be the reason for the lower, but more stable profitability of the *keiretsu* firms (Ito and Hoshi 1992: 87). But things have been changing over time, and so Lincoln, Gerlach and Ahmadjian suppose that "… the combination of deregulation, structural change, and macroeconomic shocks explains the fast decay of the redistribution pattern among the big-six *keiretsu* after 1985" (1996: 81).

H1: *Keiretsu* affiliation is no longer a guarantee for excellent results.

2. According to Nakatani, "group formation makes it possible for individual firms to insulate themselves from the imperatives of market forces" (1984: 245). *Keiretsu* firms have a different relationship to their main bank, which allows them to operate with a lower equity ratio and ensures the flow of capital. They pay out income more heavily in wages, while independent firms have to attract the capital market.

H2: A different bank-firm relationship results in different income distribution. *Keiretsu* firms pay higher wages, independent firms higher dividends.

3. During the phase of high economic growth, Japan's industrial policy has been one of the main factors for the success of Japanese firms, especially the *keiretsu*. A constant information flow between bureaucracy and industry has been maintained through the employment of retired bureaucrats by the enterprises, called amakudari (Schaede 1994, van Wolferen 1989).

H3: Differences in the structure of the boards of directors reflect different bank-firm relationship and access to government-related resources.

2. Data Set and Methodology

2.1. Data

The sample analyzed in this paper comes from the “Kaisha Database” at the Science Center Berlin and is a subset of 72 Japanese manufacturing firms listed at the Tôkyô Stock Exchange. Since others have already given explanations on the setting of the Database, I restrict my remarks on the setting of this sample.

Determining, which firms belong to a *keiretsu* and which are independent, is somewhat difficult. It is important to keep in mind that group affiliation is not clearly defined, and even among and within the groups relations do vary. We use the definition of Ito and Hoshi (1992), according to which: a company belongs to a *keiretsu* group when it is a regular member of the “Presidents’ Council” (*shachôkai*). The advantage of this definition is that the sample is relatively constant and can be checked easily. Furthermore the firms joining a Presidents’ Council are said to belong to the most powerful companies in Japan. According to Kikkawa (1996), who pays close attention to the foundation of the Presidents’ Councils, as well as according to Miyashita and Russel (1994), the *keiretsu* groups were divided into the “old” (containing Mitsui, Mitsubishi and Sumitomo) and the “new” groups (with Fuyô, Sanwa and Daiichi Kangyô). As the later analysis will show, there are indeed significant differences between these groups.

Furthermore, the present investigation used five out of the eight industries defined in 1993 and represented in the “Kaisha Database”. To be precise, Machine Tools, Consumer Electronic & Parts and Shipbuilding had to be eliminated from the sample because they exclusively contained either affiliated or independent firms. The remaining industries are Chemicals, Pharmaceuticals, Industrial Machinery, Heavy Electric Machinery and Communication Equipment.

2.2. Methodology – the Hexagon Criterion

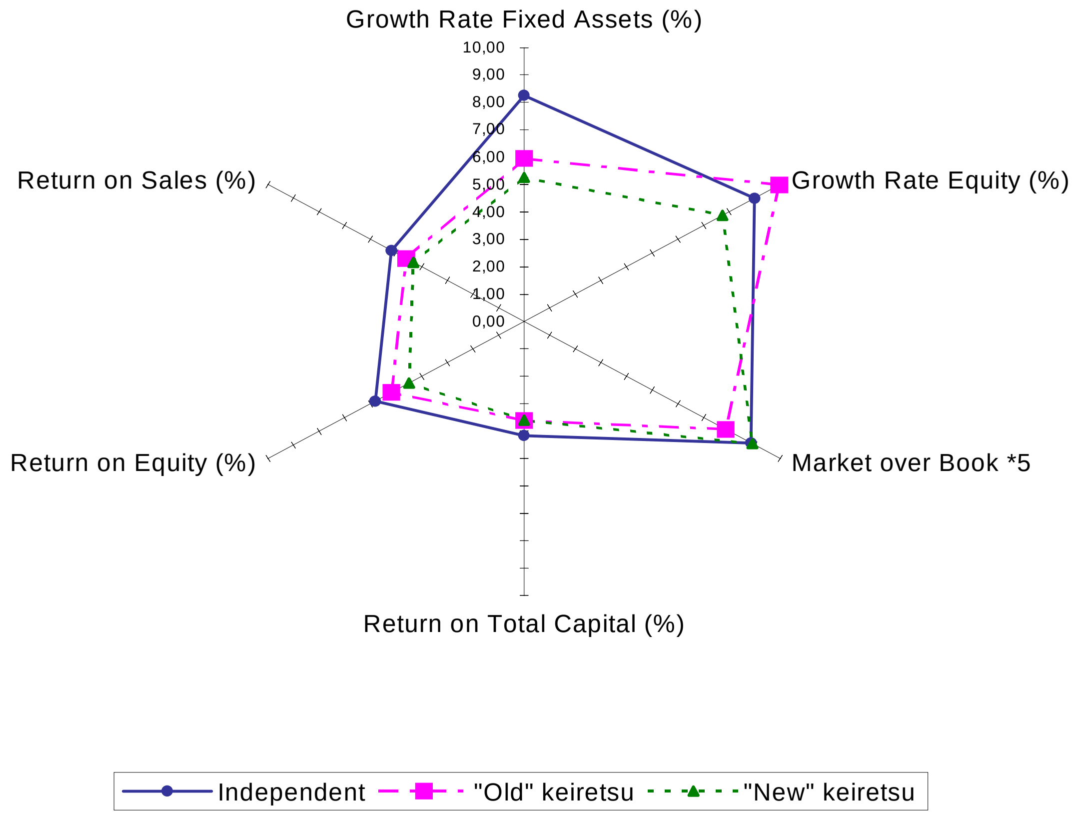
To measure the performance of the firms, a version of the hexagon criterion developed by Albach (cf. Albach 1987) and first applied to Japanese firms by Albach and Moerke (1996) was used. It consists of the dimensions growth rate of equity, growth rate of fixed assets, ratio of market value over book value of the firm, return on equity, return on total capital, and return on sales. These six dimensions are then integrated into a “Radar Chart”. The area of this radar chart hexagon is interpreted as a measure of the excellence of the respective firm. The advantage of this criterion is obvious: The performance of a firm is judged in a broader way than could be done only using profitability or sales figures, and it pays particular attention to the balance. The criterion has been applied to several studies in Germany (for instance, Pfannschmidt 1993) and has been a topic of discussion in Japan, too.

3. Results

3.1. Performance

The calculations show that the *keiretsu* firms are far from being better than independent companies.

Picture 1: Average Hexagon Value (1986-1995)



With the exception of Mitsubishi, the average hexagon value of all *keiretsu* groups is lower than that of the independent firms. This holds true for an analysis per industry.

Table 1: Average Hexagon Value per Industry (1986-1995)

	Independent Firms	***Keiretsu* Firms**
Chemicals	12.87%	12.37%
Pharmaceuticals	16.71%	13.23%
Industrial Machinery	10.44%	6.09%
Heavy Electric Machinery	10.37%	7.85%
Communication Equipment	12.95%	8.93%

When looking at each individual dimension over ten years (cf. appendix), some remarks should be added. The higher growth rate of fixed assets can be seen as an attempt to substitute work-intensive by capital-intensive production and includes heavy investment in R&D facilities (Goertzen 1998). Since the growth rate is highest between 1989 and 1991, an over-investment during the bubble period can not be excluded. But we can say for sure that the rise in fixed assets is not mainly caused by property speculation during that time. Although the absolute value of the owned property rises, it is rising stably, and the ratio of property owned to total capital stagnates between 1987 and 1992 (“old” *keiretsu*) or even decreases (“new” *keiretsu* and independent firms).

The growth rate of equity is highest for the Mitsubishi and Mitsui groups, followed by the independent firms. It is safe to say that all companies tried to use the rising share prices during the bubble economy. One hint of this is the point that the number of newly issued shares dropped clearly after the bubble burst. To make this clear, we divided the ten years investigated into two parts, the period from 1986 to 1990 and from 1991 to 1995.

Table 2: Growth Rate of Market and Value over Book Value

1986-1990	**Delta Fixed Assets**	**Delta Equity**	**Market over Book**
Independent	10.13%	14.19%	202.52%
“Old” *keiretsu*	5.97%	17.50%	179.73%
“New” *keiretsu*	6.93%	12.97%	202.19%
1991-1995			
Independent	6.73%	3.80%	152.11%
“Old” *keiretsu*	5.93%	2.40%	133.52%
“New” *keiretsu*	3.59%	2.51%	154.54%

The ratio of market value over book value peaks for every sample 1989. And then, except for a short break from 1992 to 1994, it continuously decreases and falls even lower than the 1986 level. Obviously the market remains skeptical about the prospects of success.

The return ratios we have calculated are aimed to prepare for a comparison of Japanese and German companies which is the topic of investigation right now. This is why they differ from those mostly used in Japan. While in Japan the ordinary profit (*keijô rieki*) is common, we use the current profit (*zeibikimae tôki jun rieki*) and include interest of liabilities. As a check, the Japanese return ratios were calculated, too. These results lead to nearly the same rankings – the independent firms in all cases reach the highest values. The differences to our calculation is to be seen in that the “new” *keiretsu* reach second place in return on total capital and hexagon criterion.

As to be seen above, in the investigation with the Hexagon Criterion the independent firms reach better results. Therefore it is safe to say that affiliation to a *keiretsu* is no guarantee of the excellence of a company.

4. Consequences of a different Bank-Firm Relationship

4.1. Capital Structure

Previous research showed clear differences in capital structure. To explain everything in detail would go beyond the scope of this paper, so I shall briefly summarize the results which were crucial to our interpretation that the *keiretsu* firms do in fact have a closer relationship to their main banks. The first table in this section shows how the proportion of shares and liabilities have changed from the first year of this investigation (1986) to the last one (1995).

Table 3: Capital Structure

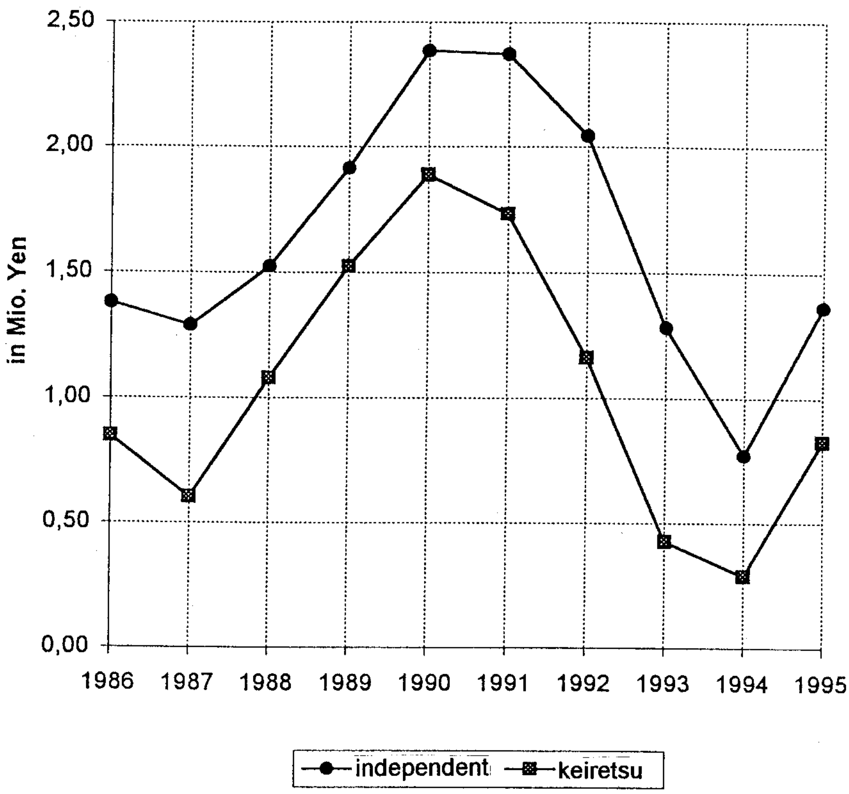
1986	**Independent**	**“New” *keiretsu***	**“Old” *keiretsu***
Equity	41.88%	29.09%	19.92%
Current Liability	41.88%	50.21%	56.72%
Long-term Liability	16.24%	20.70%	23.36%
1995			
Equity	46.19%	35.44%	29.11%
Current Liability	32.23%	40.11%	41.43%
Long-term Liability	21.58%	24.45%	29.46%

The rising equity ratio of all samples is obvious. That the “old” *keiretsu* managed to increase their ratio more, can be explained by the number of newly issued shares. During the time investigated they issued a number of shares that would correspond to 30 % of the total number of shares in 1986 (while the “new” *keiretsu* and independent firms issued approximately 20%). The “old” *keiretsu* want to loosen their ties to the banks – a process Yabushita calls “*ginkô banare”* (Yabushita 1992: 27). Furthermore, the “old” *keiretsu* increased their long-term liabilities and decreased their current liabilities more than the other samples did. Since quick access to money through banks is not very likely in the current situation, this can be seen as an attempt to secure investment and stabilize the supply of capital. Looking at the lower equity ratio, it seems fair to say that the “old” *keiretsu* still must have a closer connection to their main banks. This matches the findings by Hoshi, Kashyap and Scharfstein, that “the closer a firm moves to the group banks, the more easily a firm can attract funds to finance investment projects” (1991: 49).

4.2. Income distribution

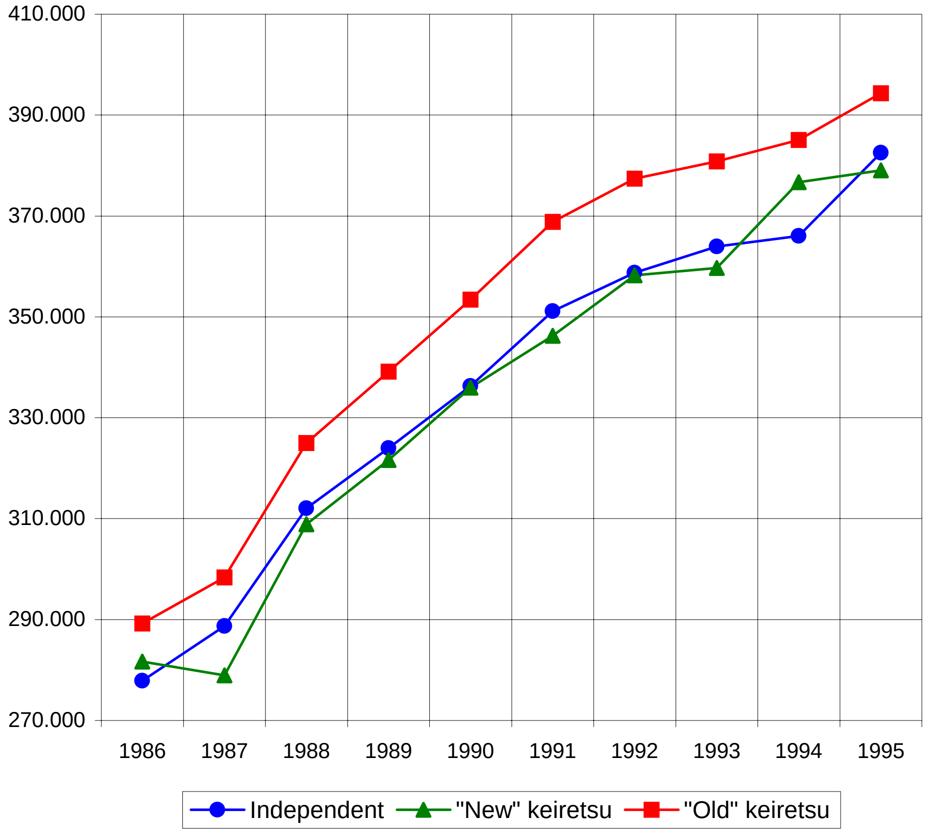
According to Nakatani, group membership increases the monopoly power of respective members, which is not necessarily used for raising the profit, but to “maximize … the joint utility of its corporate constituents – employees, financial institutions, stockholders and management” (1984: 228). He points out that for managers of large Japanese corporations a main goal of corporate policy is to enhance the welfare of the firm's employees, what can be seen as contrary to the situation in the United States, but similar to that in Germany (cf. Yoshimori 1995, Sakakibara 1995). Our supposition that differences in the income distribution could exist, came from our observance of differences in the ratio of current profit before tax (*zeibikimae tôki jun rieki*) per employee. As one can see in picture 2, the independent companies reach a higher profit/employee ratio throughout the years.

Picture 2: Current Profit per Employee



Nakatani's findings, that the average income of an employee in a “G firm” (group firm) is higher than that of an “I (independent) firm” employee, to a certain extent match the results of this study. According to the statements in the *yûka shôken hôkokusho* (which may be biased because they do not take into account the differences in age, job-tenure etc.), the monthly salary in the “old” *keiretsu* firms was higher than in the independent firms as well as in the “new” *keiretsu*. The last two turn out to be rather similar.

Table 4: Average Wages (per month), in Yen



It is furthermore of interest to ask how independent companies and *keiretsu* firms differ in terms of dividend distribution. It turned out that the independent firms which have, compared to the *keiretsu*, issued relatively few shares (245 million vs. 657 million for the “new” and 1.01 billion for the “old” *keiretsu* on average), pay a higher dividend. Table 5 shows, that the average dividend per share that the independent firms paid, was higher than for each of the *keiretsu* groups. Due to the large number of shares issued, the ratio of paid dividends to net profit (after tax) is higher for the *keiretsu* firms. It would be even higher if the cross share-holding within the *keiretsu* groups didn’t reduce the burden to a certain extent.

Table 5: Dividend and Dividend/Profit Ratio (Average, 1986-1995)

Sample	Dividend per Share (Yen)	Paid Dividends/Net Profit (%)
Independent	8.54	15.98
“Old” *keiretsu*	5.76	23.92
Mitsui	5.69	18.54
Mitsubishi	5.88	27.34
Sumitomo	5.60	25.60
“New” *keiretsu*	6.01	19.27
Fuyô	5.67	18.01
Sanwa	6.83	15.63
DKB	6.34	21.91

To summarize: In this section we were able to show that the wages derived from the *yûka shôken hôkokusho* are still higher for the “old” *keiretsu* and remain very similar, but lower, for the “new” *keiretsu* and the independent firms. On the other hand, independent firms pay a higher dividend per share. Together with the different capital structure, we interpret these facts as support for Nakatani's view, that *keiretsu* firms, because somewhat isolated from the (capital) market, can favor their employees over their shareholders. But first of all, this has to be limited to the three “old” *keiretsu* groups. Furthermore it has to be taken into account, that the situation is constantly changing towards a more shareholder-oriented view (Otto 1997).

5. The Board of Directors

5.1. Structure

The structure of the Japanese board of directors was first influenced by the German (dualistic) model, but changed in 1950 more or less towards the American structure with one body. The board of directors, which is elected at the shareholder's meeting, consists of directors at several levels, beginning with the Chairman (*kaichô*), the President (*shachô*), Senior Managing Directors (*senmu torishimariyaku*), Managing Directors (*jômu torishimariyaku*) and the directors (*torishimariyaku*). Every position is not necessarily found in every firm. Representative Directors (*daihyô torishimariyaku*) are chosen among the top level directors, they fulfill the task of representing the company and they often decide upon the firm's strategy and business tasks relatively independently (cf. Otto 1997: 55, referring to an investigation of Keizai Dôyûkai from 1996).

The question, who governs, still remains. It turns out that the main governing body is the board itself (Baum 1994: 122). But – different to the American system, where “outside directors” fulfill the task of governing - this does not hold for Japan. The number of outsiders is simply to small, and the boards is more or less “coterminous with the company's senior management” (Lincoln, Gerlach and Takahashi 1992: 565).

The auditors (*kansayaku*), who are also elected at the shareholder's meeting, at least on a theoretical level fulfill the task of controlling the management. Since they are appointed by the board (Otto 1997), it is unlikely that they can act independently. The situation improved slightly with the last revision of the Commercial Law (*shôhô*) in 1993, because it is now obligatory for “large firms” (paid-in capital more than 500 million Yen) to have at least one “outside” auditor. (Otto 1997: 49). But in fact a lot of the so-called outsiders did spend most of their career within the firm or at least an affiliated firm. Therefore control shifts to the main bank or to the firm which is the main shareholder as well as to other firms of the same group.

For the investigation, we had a look at the personal data concerning the *torishimariyaku*, which can be found in the *yûka shôken hôkokusho*. The analysis of the present sample is based on the following assumptions: People were treated as outsiders, when they spent more than half of their working life outside the firm. They were treated as amakudari, when they had spent more than half of their working life in a state institution. Customs office is also taken into account, as well as NTT. Since NTT developed from a ministry and is still highly regulated and connected with the Ministry of Post and Telecommunications, people from this firm are seen as amakudari.

According to Hirata (1996) and Otto (1997), the top management is defined as consisting of the Chairman (*kaichô*), the President (*shachô*), Senior Managing Director (*senmu torishimariyaku*) and Managing Director (*jômu torishimariyaku*). Those representatives constitute the *jômukai*, the organ which is aimed to deal with strategic decisions and prepare suggestions to be discussed and which are usually accepted by the board (Otto 1997). Furthermore, the Representative Directors (*daihyô torishimariyaku*) are taken into account.

The analysis lead to the following results: The total for numbers of board members, for Representative Directors and for the top management respectively rose from 1986 to 1992 and than declined. The number of auditors, which had not changed very much up to 1992, rose about 30 percentage points due to the revision of 1993. Detailed Data is provided in table 6.

Table 6: Total Number of Board Members

Year	Total	Representative Directors	Top Management	Auditors
1986	1438	261	688	218
1989	1521	278	748	216
1992	1644	294	802	222
1995	1572	275	801	285

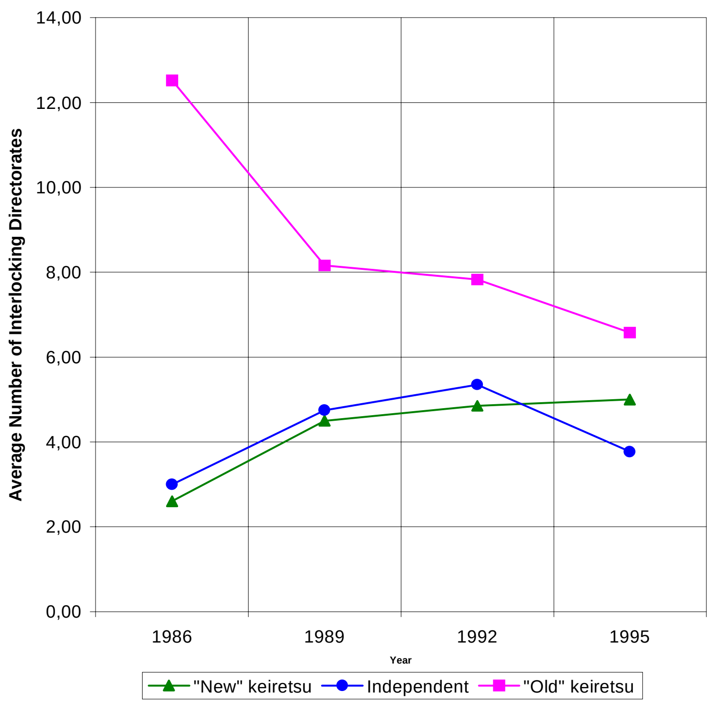
Since the aim of this paper is to investigate the differences between industrial *keiretsu* and independent companies, the next step is to present the structure of the board for “the average” independent or *keiretsu* firm. On the average, an independent firm has 19.2 directors; 3.5 of them are Representative Directors. The top management consists of 9.3 members, and at least 3.2 auditors are on duty. The typical “old” *keiretsu* firm in our sample has 25.8 board members (compared with 24.3 for the "new"), 6.2 Representative Directors (3.2), a top management of 13.1 members (12.0) and 3.5 auditors (3.5). It turns out that the *keiretsu*, which are on average bigger in terms of sales, of total capital and of people employed, do have larger boards than the independent firms. Since the *keiretsu* firms do not perform better than the independent companies, it seems fair to assume that their boards are too large to maintain flexibility.

5.2. Interlocking Directorates

Lincoln, Gerlach and Takahashi (1992) stress the importance of interlocking directorates in Western economies, but state that their *economic* significance for Japan is uncertain. For Germany, Pfannschmidt (1993) was able to show that there is a positive correlation between interlocking directorates (especially when banks dispatch board members) and the "excellence" of a firm.

The situation in Japan is somewhat different. Gerlach (1992) points out, that in Japan directorship exchanges are less common but more influential than in the West. They are understood as a signal that one business partner has a deep interest in influencing the other. One might add that interlocking directorates are still another important form of information dissemination in Japanese industry, and therefore one should not underestimate their role. For the present sample one can say that there is still a difference between numbers of interlocking directorates in the "old" *keiretsu* on the one hand and the "new" *keiretsu* and independent firms on the other, but obviously the samples are converging.

Picture 3: Interlocking Directorates



5.3. Director Dispatch

Lincoln, Gerlach and Takahashi point out that directors are more or less "… dispatched from the owning company to the owned company, not the other way around" (1992: 577). It goes without saying that the banks and other financial institutions have an outstanding interest in monitoring the firm and exerting control. Therefore we first have a look at board members and auditors dispatched from banks and other financial institutions. The following table will show in detail that the independent firms have on the average less people dispatched from financial institutions (including the main bank) than the *keiretsu* have. The only exception - the lower number of dispatched directors from all financial institutions in the case of the "old" *keiretsu* - is outbalanced by the higher number of auditors. We interpret the fact, that there are more representatives of the main bank for the *keiretsu*, as a further indication (next to the different capital structure with lower equity ratio) for a closer bank-firm relationship. Since the number of bank-related auditors in the case of the *keiretsu* is higher, too, one can assume that the main bank monitors and governs through the auditors as well as through dispatched directors.

Table 7: Average Number of Board Members and Auditors Dispatched from Financial Institutions

	Independent	**"New" *keiretsu***	**"Old" *keiretsu***
All Financial Institutions			
- Total Number	1.10	1.89	1.40
- Directors	0.67	1.03	0.52
- Auditors	0.43	0.86	0.88
Main Bank			
- Total Number	0.63	0.94	0.98
- Directors	0.44	0.59	0.46
- Auditors	0.19	0.35	0.52

Note: The main bank was estimated according to the annually published "Kigyô keiretsu sôran".

At the beginning we said that the number of "outside" directors in Japan is lower than in the West. Nevertheless, it remains an interesting point to analyze the differences between *keiretsu* and independent firms. Since the present sample mostly contains large companies with a lot of affiliates, the number of receiving firms is not very high. During the investigation there was empirical evidence that a lot of firms in our sample do send board members to affiliated firms, but due to the data availability and time constraints only a brief overview can be given. In the following table the average number of outside directors and outside directors dispatched from the largest shareholder will be shown. These numbers exclude directors from financial institutions, because they have been discussed above.

Table 8: Average Number of "Outside" Directors

	Year	Independent	"New" *keiretsu*	"Old" *keiretsu*
Outsider	1986	2.08	0.75	2.67
	1989	1.95	0.45	2.25
	1992	1.90	0.55	1.75
	1995	2.28	0.95	2.08
Average		*2.05*	*0.68*	*2.19*
from largest Shareholder	1986	0.92	0.70	0.67
	1989	1.15	0.25	0.92
	1992	1.27	0.25	0.67
	1995	0.87	0.20	0.33
Average		*1.05*	*0.35*	*0.65*

Note: The largest shareholder was estimated according to the annually published "Kigyô keiretsu sôran".

The relatively high number of outsiders in the boards of the independent firms can be regarded as an attempt to equalize the better main bank relationship of the *keiretsu* firms. Independent firms give (or have to give) their shareholders more opportunities to take part in the decision-making process. That the "old" *keiretsu* still have the highest ratio of outside directors, is in our view linked to cross shareholding and close main bank relation (cf. Ito and Hoshi 1992).

5.4. Amakudari

One distinct feature of the Japanese boards has to be mentioned – the presence of high-ranking ex-bureaucrats (*amakudari*). In one of her studies on the "Old Boy" networks Schaede describes the existence of the network as an "institutionalized 'lubricating' system for government-business relationship" (1994: 2), that ensures access to information and reduces dependency. One of her main findings is the significant positive association between a firm in an export industry and a high number of retired bureaucrats (1994: 29). Van Rixtel, on the other hand, sees amakudari as a "mechanism to equalize differences in access to bureaucratic information" (1995: 5).

Although the retired bureaucrats might have played an important role in the past, it is not clear yet whether they are still to be considered useful for the firms in times when market deregulation is happening so quickly. Some researchers even hold the view that the success of the Japanese companies was possible despite their burden of amakudari (Noguchi 1995).

The main results for this sample are the following: The total number of amakudari bureaucrats as well as their number in relation to the number of directors, increased from 1986 (34) to (1989: 42) and peaked in 1992 with 46. In 1995, the number has decreased to 36 and therefore almost reached the same level as 10 years before. One could see this tendency as correlated with the ongoing deregulation and fewer needs for the firms to maintain good contacts with the authorities.

It has been frequently suggested in the literature that the *keiretsu* have been a favored place for the *amakudari* (cf. Usui and Colignon 1997), and indeed the average number of retired bureaucrats is the lowest in the independent firms (with the exception of 1986).

Table 9: Average of *amakudari* per Firm

Year	Independent	"New" *keiretsu*	"Old" *keiretsu*
1986	0.37	0.45	0.25
1989	0.35	0.65	0.75
1992	0.47	0.65	0.67
1995	0.31	0.40	0.58
Average	*0.38*	*0.54*	*0.56*

The situation looks somewhat different when we only take the number of firms and of amakudari into account. It turns out that more independent firms have *amakudari* in their boards, although their number is not very high (between 1.1 and 1.6 ex-bureaucrats per "target-firm", compared with 1.7 to 2.4 for the *keiretsu*). So our conclusion is that widespread use of information channels is already possible with a few *amakudari*, and more does not necessarily mean better.

When analyzing *amakudari*, it is, of course, of interest to ask which ministries are represented. Thinking of Chalmers Johnson's "MITI and the Japanese Miracle", one could suppose that there is still a strong presence of former MITI bureaucrats in the industry. And indeed for the present sample their number is higher than that of any other ministry or state institution. This matches Goeseke's finding, that this ministry is still a relevant force (1997: V). On the other hand, MITI is not alone. Schaede's main "results offer strong support for the general hypothesis that industries employ OBs from ministries that have regulatory relevance" (1995: 313).

For this sample, it turned out that basically the *keiretsu* firms appointed more retired bureaucrats from the MITI, from the Ministry of Post and Telecommunications (PT) and from NTT. In the independent firms, there are slightly more *amakudari kanryô* (bureaucrats) from the Bank of Japan (BoJ) and clearly more from the Ministry of Finance (MoF). Obviously, independent companies have chosen to appoint ex-bureaucrats from the financial sector to outbalance the better relations *keiretsu* firms have with their main banks.

Table 10: Main Origin of Amakudari Bureaucrats in Independent (I) and *Keiretsu* (K) Firms

	MITI	MITI	MoF	MoF	BoJ	BoJ	PT	PT	NTT	NTT
Year	I	K	I	K	I	K	I	K	I	K
1986	7	5	2	0	1	0	1	2	2	3
1989	5	7	5	2	1	1	0	2	3	6
1992	8	9	4	1	1	1	1	4	4	7
1995	5	6	4	1	2	1	3	2	2	4

Since the *keiretsu* seem to appoint amakudari coming from an origin relevant for the industry a firm belongs to, our next step was to take a look at the industries. The findings of Schaede that “industries that are heavily involved in cross boarder transactions (exports/imports …) seem to hire more OBs than industries that primarily serve the domestic market” (1994: 28-29), match our results. In the chemical and pharmaceutical industries, which are not export-oriented, the average number of hired ex-bureaucrats is lower than for the Industrial Machinery, Heavy Electric Machinery and Communication Equipment branches. Furthermore it is interesting that in the chemicals and pharmaceutical industries the independent firms appoint far more *amakudari* than the *keiretsu*, whereas the *keiretsu* have more *amakudari* in the remaining three industries. Especially the Communication Equipment industry where global players like NEC and Fujitsu are found, has very close ties to bureaucracy.

To summarize: A look at the board of directors shows that the *keiretsu*, which are on the average bigger in terms of sales, capital and employees, have larger boards than the independent firms. Since they do not perform better than the independent firms, one can assume that their boards are too large to maintain flexibility. Independent firms have on the average less directors dispatched from financial institutions, but do have a higher number of outsiders. They appoint more amakudari bureaucrats from the Bank of Japan and the Ministry of Finance to outbalance the better bank-firm relations of the *keiretsu*. The *keiretsu*, however, appoint more bureaucrats from state institutions related directly to their business.

6. Concluding Remarks

This study has focused on performance and aspects of corporate governance of Japanese corporate groups (*keiretsu*) in comparison with independent firms. The *keiretsu* which played an important role in Japan's postwar economic growth are no longer the successful players they used to be. They still do have a better main bank relationship and therefore they are to a certain extend isolated from the capital market. Corporate governance is exerted by the main bank and – due to reciprocal shareholding – by other firms of the group as well as by the state through the network of retired ex-bureaucrats.

Independent firms depend more on the capital market than the *keiretsu,* but their governance structures still differ from those in the West. Even now, the number of outside directors is relatively low. The combination of administrative and personal guidance, which is a distinct feature of the *keiretsu*, works in the case of the independent companies, too. They try to out-balance the main bank relationship of the corporate groups by appointing more amakudari bureaucrats from the Bank of Japan and the Ministry of Finance.

To overcome the current economic crisis, the Japanese economy has to undergo severe changes. The ongoing deregulation of the financial sector , the "Japanese Big Bang", is only one example. Since the independent firms reach better results and act flexibly, they seem to be on the right way. With Sony, an independent company for the first time introduced stock options for managers, Others promised to increase the number of real outside directors, and so on. Japan is changing and will therefore continue to be a topic of research.

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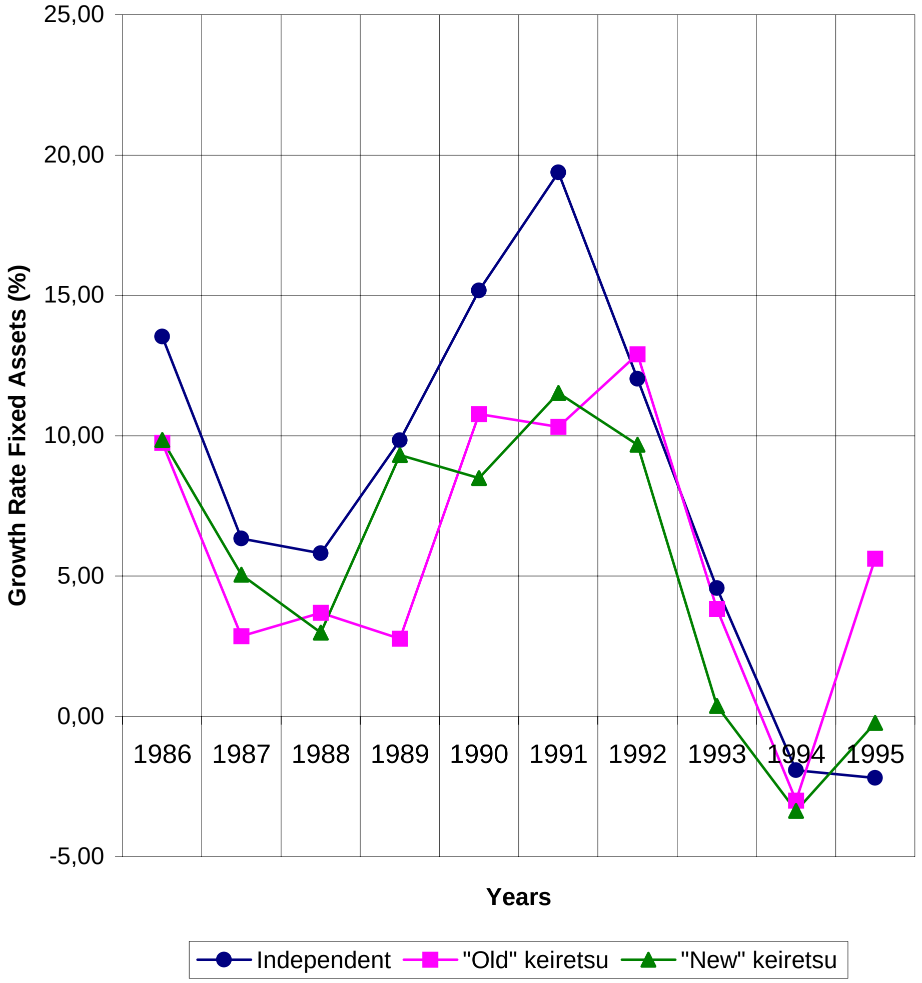
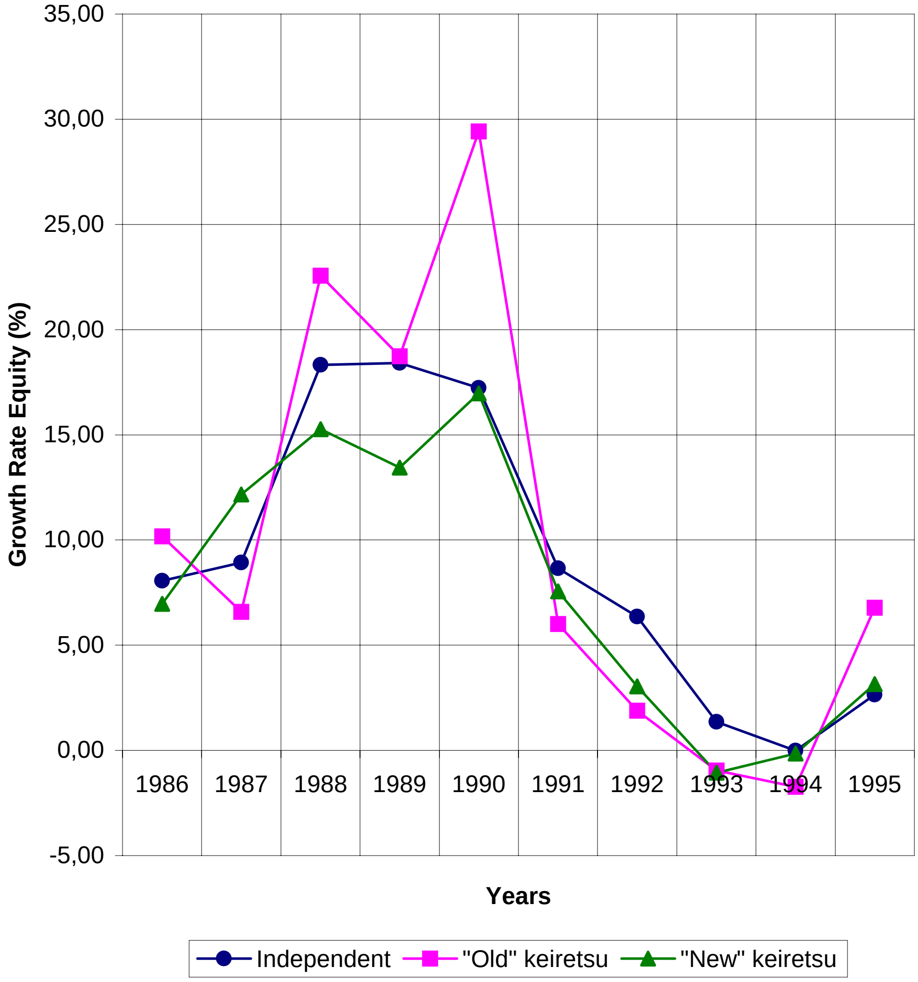
8. Appendix

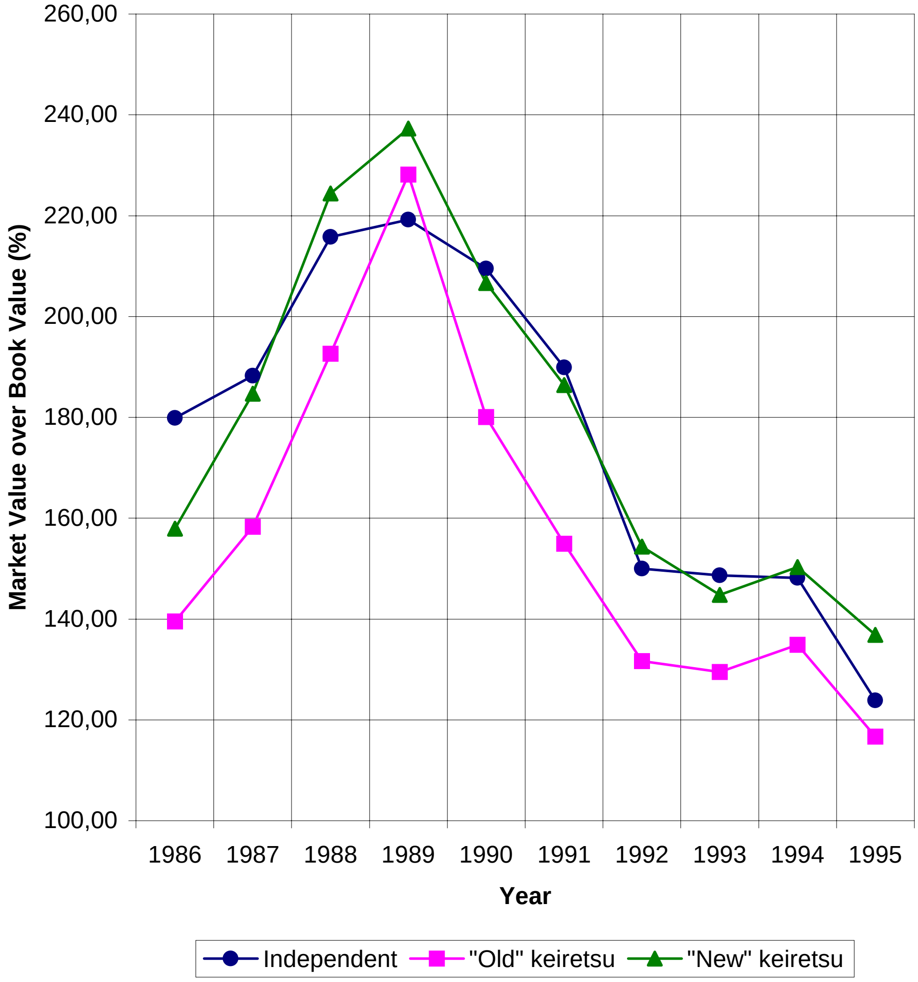
Growth Rate of Fixed Assets



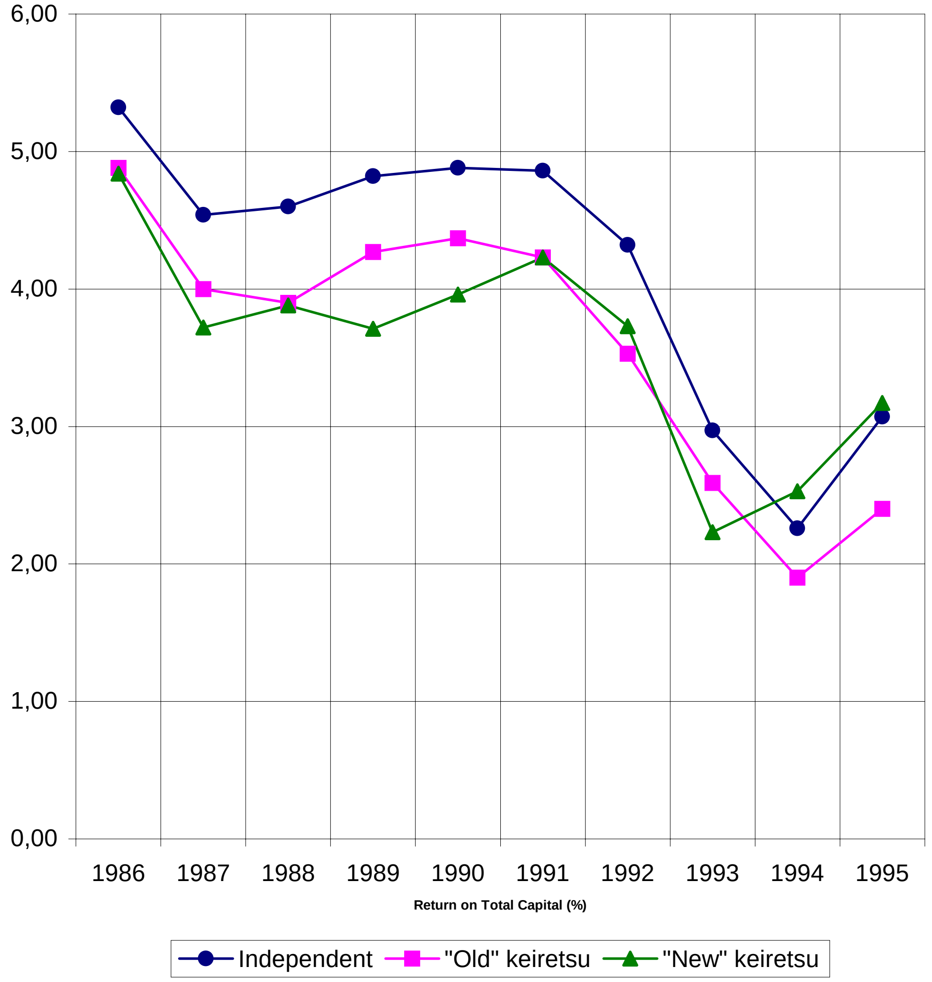
Growth Rate of Equity Fixed Assets



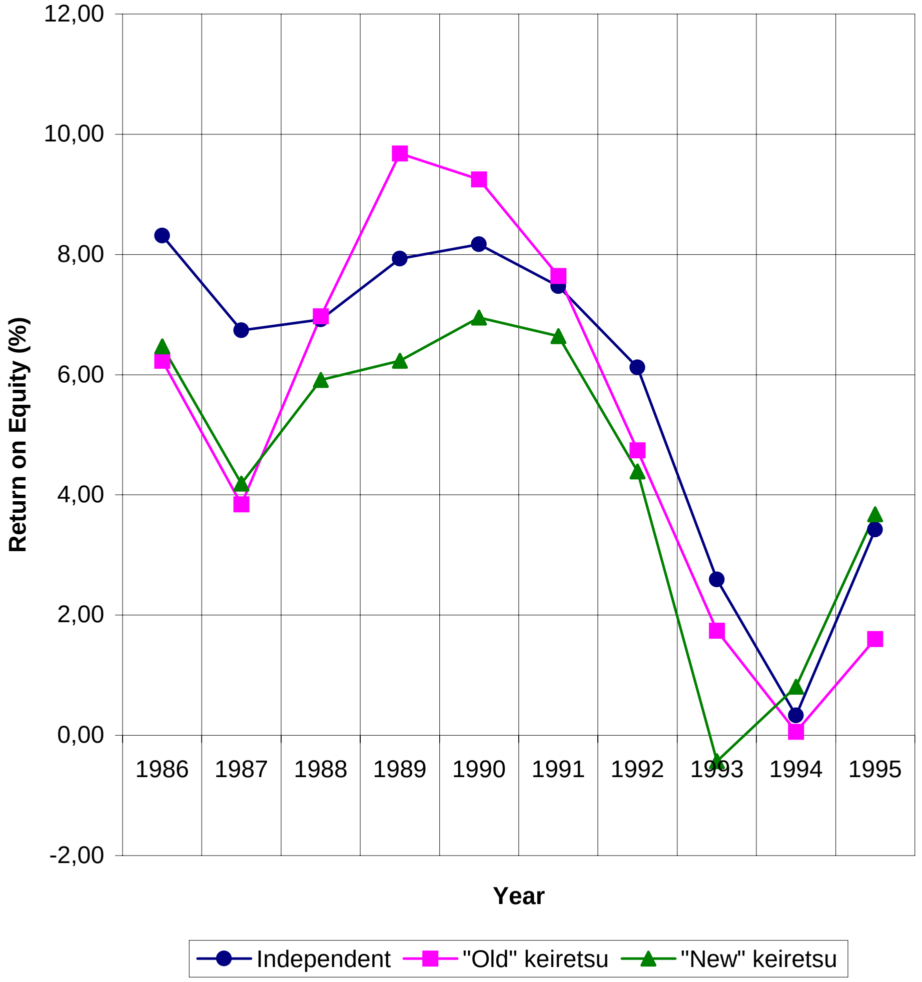
Market Value over Book Value of the Firm



Return on Total Capital



Return on Equity



Return on Sales