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Japanese Management for a Globalized World

The Strength of the Lean, Trusting and Outward-Looking Firm

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Palgrave Macmillan Asian Business Series

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Preface

Global interest in Japanese management reached its height during Japan's high-growth years and then faded as the Japanese economy stagnated in the early 1990s. Recently, however, amid growing concern that corporate management has put too much emphasis on Anglo-Saxon free-market liberalism, economists and management specialists in the United States, Europe, and Asia have once again begun to look at the positive aspects of Japanese corporate management.

This book provides a comprehensive analysis of the changes that have taken place in the systems and practices of Japanese management over the last quarter century, identifies the positive and useful attributes that ought to be maintained, and clarifies the behavioral principles that form the groundwork of their strengths. Observing the changes in the business environment brought about by the forces of intensifying globalization, the book presents a highly effective management model that builds on the superior aspects of Japanese-style management while overcoming its weaknesses. It is a multilayered human-resource management model that combines the mutually complementary aspects of the Japanese and Anglo-Saxon systems, incorporating the strengths of both. This hybrid model is aimed at increasing workplace motivation, promoting the creation of new value, and enhancing performance and can be used successfully in many countries around the world.

My discussion, based on data and case examples taken from surveys and interviews I had conducted at companies in Japan and other countries in recent years, draws on theoretical frameworks and

methodologies from sociology, psychology, and economics along with the concepts that have been developed in the field of management science.

The content of the book may be summarized as follows.

Chapter 1 looks at the changes in the employment environment and the competitive pressures of globalization that are profoundly connected to these changes. They are the most significant factors that have given rise to the aforementioned renewed interest in Japanese management. Levels of workplace motivation have shown a downward trend in many countries over the past several decades. The analysis of empirical evidence of global trends on motivation, presented in this chapter, shows that the trend is closely related to changes in the employment situation brought about by structural changes in the global economy. These changes in the business environment form the backdrop in the search for effective alternatives to management models exceedingly market-principle-oriented that have become increasingly influential worldwide. The merits of Japanese-style management, which emphasizes the human side of the organization, are again drawing attention.

Chapters 2 and 3 trace the changes in Japanese management systems over the last quarter century, analyze the current situation, and assess the future directions they will take. How has management in Japanese companies changed during the dramatic upheavals of the last twenty-five years, from the collapse of the bubble economy in 1990 and the prolonged recession that followed, through the global economic crisis triggered by the Lehmann Brothers collapse in 2008? What did Japanese companies learn during this time? Chapters 2 and 3 investigate this process, examine the current state of Japanese-style management, and give a view of what it will be like in the future. Chapter 2 looks at personnel and employment systems and the internal decision-making structure of Japanese companies. Chapter 3 analyzes uniquely Japanese systems of intercorporate networks centered on "keiretsu" and corporate governance practices.

Chapter 4 analyzes the management principles that form the foundation of Japanese corporations' strengths and identifies the ideas and principles of behavior that deserve to be preserved. In Japan, it argues, the organizational principles and the structures of social relationships that originated in the traditional *ie* family system went beyond the level of the actual family unit and were transferred into modern corporations,

and that the trust cultivated and reproduced in this process was accumulated as "social capital." This Japanese-style social capital that combines the collectivism characteristic of the traditional community and the rationalism characteristic of modern organizations gave Japanese corporations a solid foundation and helped them to develop.

Looking at several specific examples, Chapter 4 focuses on four particular strengths of Japanese management born of Japanese-style social capital: (1) trust and the norms of reciprocity, (2) a human relations approach that satisfies employees' social needs, (3) egalitarianism and on-site management that emphasizes the experience and input of workers on-site, and (4) innovations created by enduring R&D projects and long-term commitment. It shows how these qualities have helped fortify Japanese companies today.

Chapter 5 discusses the transferability and adaptability of Japanese-style management to overseas operations. This chapter focuses on automakers that have transplanted Japanese production and management methods into their overseas operations, analyzing the management of overseas subsidiaries particularly with regard to lean production methods that are at the core of Japanese-style manufacturing. In spite of the keen interest shown in these systems by organizational scholars and the public, not much work has been done on the human aspects of the production floor—how employees work on a daily basis, their attitudes to working in teams, the way they feel about the wider organization, and how they produce high-quality products. Looking at these aspects of the workplace, this chapter elucidates the way lean production has been successfully functioning as a sustainable system in the overseas operations of Japanese firms.

Chapter 6 analyzes the motivation patterns of the major position groups within the organization and presents the hybrid human resource management model most effective for each group. Since the factor having the greatest impact on motivation patterns is the position held within the organization, as has been shown by past research, motivation patterns and work-related values are analyzed for four major position groups: (1) executives, (2) gold-collar employees (managers, professionals, entrepreneurs, consultants, etc.), (3) blue-collar, clerical, and service employees (permanent employees), and (4) blue-collar, clerical, and service employees (nonpermanent employees). The hybrid model presented on the basis of this analysis combines the mutually complementary aspects of the Japanese and Anglo-Saxon styles of

management to make the most of the strength of both. Although the two styles are often thought to be diametrically opposed, the proposed hybrid system, incorporating effective practices from both, can be successfully applied in many countries of the world.

This book maintains the comparative perspective throughout, comparing the management systems of Japan and the West. It shows how Western and Japanese corporations can overcome their respective shortcomings and learn from mutually different systems for further improvement of their management. It further discusses what Western managers, academics, and human-resource professionals can learn from Japanese practices as well as what Japanese companies should learn from Western practices in order to improve their management.

Here I would like to thank the people who have helped me in the preparation of this book. I am particularly indebted to Anthony Giddens, Michael Useem, Parissa Haghirian, Mari Sako, Hajime Ohta, Arthur Francis, and the late Joji Watanuki for their invaluable support and insightful comments. I take this opportunity to express my deepest gratitude to them all. Acknowledgements are also due to the many managers, team leaders, and employees at companies in Japan, Europe, and the United States, who helped me in the research for this book by readily accepting my interviews and responding to them generously, or by allowing me to conduct employee surveys.

I further wish to extend my sincere gratitude to the editors at Palgrave Macmillan, Jacob Dreyer, and Liz Barlow, Head of Business and Management, for their professionalism, efficiency, and responsiveness. The editorial assistant Anushangi Weerakoon was very responsive and helpful. I am also grateful to the reviewers for their encouraging comments and valuable suggestions. Finally, special thanks go to Masataka Watanabe for his generous cooperation and many constructive comments he provided throughout the course of the entire project.

Tokyo, Japan — Satoko Watanabe

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CHAPTER 1

The Competitive Pressures of Globalization and the Motivation Crisis

Stresses and Strains in the Business World

In the early phases of globalization, when the advanced countries dominated the global economy, there was not much fear that globalization would produce a race to the bottom or induce an interminable negative spiral. As emerging economies like India and China have come to exert an increasingly powerful influence, however, the atmosphere has changed. People in the advanced countries have started to realize that the process of globalization will not necessarily make their own prospects brighter. The dominance of China as the world's manufacturing powerhouse and the success of India as a center of service outsourcing pose particular threats to the established order. Evidently, global competition has become increasingly intense. The number of players in the global market has increased dramatically over past decades as former socialist countries and emerging nations have entered the capitalist economy. For companies, reducing costs and payroll expenses and improving quality are more urgent challenges than ever before.

Furthermore, companies have come under pressure to perform a growing number of roles for various stakeholders. Shareholders, clients, employees, and other stakeholders all make demands on companies, and society at large requires companies to fulfill numerous responsibilities. Nobody could have imagined these conditions forty years ago. Companies never had to face so many diverse demands then.

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Today, companies are required to achieve much higher levels of performance in order to survive as they are forced to meet the exacting demands of their various stakeholders and the wider society.

Many corporations in advanced countries have responded to the intensified global competition by adopting increasingly market-principle-oriented policies. These steps have included strategic alliances, outsourcing, diversification of work contracts, flatter management hierarchies, downsizing and restructuring, and greater flexibility. These policies have helped to improve results in many companies. But they have also brought wrenching changes to the employment situation and working conditions for many employees in the advanced countries. International competition and breakthroughs in IT have made managers more focused than ever on short-term returns. Together with new management techniques, these changes have made workers' jobs more uncertain and contingent in almost every type of work.

Aiming for greater efficiency and seeking to cut payroll costs, many companies have reduced the proportion of permanent employees on full benefits, and instead increased the proportion of nonpermanent employees, including part-timers, fixed-term contract employees, and temporary staff. Companies have found they need to be able to adjust their workforce whenever necessary, in order to respond promptly to an ever-shifting business climate. Many companies have systematized non-regular employment as an important part of their recruitment policy to allow them to carry out such adjustments more easily. Many of the newly created jobs are overwhelmingly in these categories of non-regular employment. The change in employment patterns has had a significant impact on the structure of the labor market as a whole. The new economic environment in which free-market competition is being encouraged has produced a newly affluent class of people as successful entrepreneurs as well as a mass of workers without permanent jobs who move from one unstable, irregular, low-paid position to another. And in workplaces where permanent staff are being replaced by nonpermanent employees, remaining permanent employees often experience increased demands on their time and labor to make up for the insufficient knowledge or skills of the nonpermanent workforce.

Additionally, as noted above, many companies have worked to flatten their organizational hierarchies in an effort to become more competitive. This has led to the creation of decentralized units of profit and

power within the organization as responsibility has been delegated down the management chain. In today's knowledge, IT, and service industries, this type of shake-up in the workforce often means a heavier workload and more responsibilities on employees. Today, the production process depends on the involvement and commitment of employees to a much greater extent than was the case in the past. Formerly, employees worked with their colleagues on a particular stage of the production process; they were one of the cogs in the wheel. Today workers are called on to think, to be engaged, and to produce results for the company on their own initiative.[1] This tendency is particularly pronounced in the knowledge, IT, and service industries.

In the ever-expanding service sector, many jobs now involve a new kind of psychological stress not found in traditional blue-collar jobs. In the service industry, personal qualities like politeness, courtesy, kindness, and helpfulness have become the means by which people earn their living. People in these jobs must commodify not only their time and labor but also their very selves, including their personalities. They must constantly work to maintain a cooperative and amiable attitude—at least on the surface, and outwardly display the emotional state and expression that their customers and superiors require.[2] These conditions lead to stress and discontent.

Employees in managerial positions are also facing greater uncertainty. Until the 1980s, large companies in advanced countries were able to offer management-track employees what amounted to lifetime employment and a predictable route to promotion. This situation changed dramatically from the 1980s on. The competitive pressure of globalization has brought major changes to the unspoken agreements that previously defined the employment terms and practices among middle managers and other white-collar employees. The days of secure, lifetime jobs with predictable promotions and stable incomes are now widely believed to be a thing of the past.[3]

The spread of E-mail and other IT tools has helped make work more efficient, but have also led to longer working hours.[4] These changes in the working environment have had an obvious impact on people's attachment to work and levels of job satisfaction, as evidenced by the decline of employee motivation in many countries around the world. The following section takes a look at how workplace motivation has eroded around the world over the past few decades.

The Motivation Crisis

The Global Fall in Motivation: Objective Indicators

Workplace motivation has been on a downward trajectory in many countries over the past several decades, a trend that continues today. In a survey conducted by Gallup on 230,000 full-time and part-time employees in 142 countries between 2011 and 2013, only 13% described themselves as "engaged."[5] In other words, fully 87% of respondents answered that they were either "not engaged" or "actively disengaged." This phenomenon is found worldwide. The proportion of people describing themselves as "engaged" in Gallup surveys was no higher than 30% even in the United States, the country with the highest rate among leading countries, followed by Brazil (27%), Spain (18%), United Kingdom (17%), Sweden (16%), Canada (16%), Germany (15%), France (9%), India (9%), Japan (7%), and China (6%) (see Table 1.1).

Trends to the Present

Europe and North America

The observation that workers are less motivated and engaged than they used to be is nothing new. The first studies noting a decline in positive attachment to work in advanced countries appeared in the late 1970s

Table 1.1 Employee engagement by country (*Source* Gallup, "State of the Global Workplace," 2013)

	Engaged (%)	*Not engaged (%)*	*Actively disengaged (%)*
United States	30	52	18
Brazil	27	62	12
Spain	18	62	20
United Kingdom	17	57	26
Sweden	16	73	12
Canada	16	70	14
Germany	15	61	24
France	9	65	26
India	9	60	31
Japan	7	69	24
China	6	68	26

and early 1980s. The University of Michigan's Survey Research Center reported a "significant drop" in Americans' job satisfaction levels between 1973 and 1977. The Center's director is quoted as emphasizing the findings "because it's the first confirmed decline in the national level of job satisfaction."[6] Similarly, a Harris Poll carried out in the United States in 1981 found that the levels of motivation and dedication had dropped significantly from ten years previously, and showed that workers' own expectation levels regarding their job performance had also fallen.[7] A look at the results of Gallup surveys reveals that whereas in 1980, 88% of respondents agreed with the statement that "it is personally important to me to work hard and do my best at work," by 1983 this figure had fallen to 57%.[8] In a Gallup survey on work attitudes carried out in the United States in 2001, only 30% of people described themselves as "engaged." This figure has not changed significantly in the years since, and remained at 30% in the 2011–2013 survey, as already noted.

Similar developments can be seen in Europe. In the 1950s, a majority of people in what was then West Germany told a public opinion survey that they thought "industriousness" was their most admirable virtue. By the 1970s, however, increasing numbers of people were more skeptical about working too hard, and more than half of young people admitted to feeling dissatisfied at work.[9] In a survey in West Germany in 1983, only 26% of respondents supported the work ethic statement that they always gave their best at work.[10] Further, in the 2011–2013 Gallup survey, just 15% of Germans described themselves as "engaged." Similar results have been reported from public opinion polls in Sweden.[11]

The motivation and enthusiasm of workers in advanced countries dropped dramatically in the 1970s and 1980s, and have remained at those low levels ever since. The 2011–2013 Gallup survey and several other Gallup surveys carried out in recent years show that morale and motivation continue to be low around the world. Among the advanced countries surveyed, the highest proportion of engaged workers was 30%, in the United States. Even there, in other words, 70% of workers described themselves either as "not engaged" or "actively disengaged," showing a clear decline in the levels of workplace engagement and motivation compared to thirty or forty years ago.

Japan

It is generally agreed that Japan's remarkable postwar growth was made possible to a large extent by the work ethic of its people. Once

the high-growth years were over, however, there was a notable decline in motivation among workers in Japan too, and in recent years it has fallen to strikingly low levels. This decline started more than a decade later than in the West, and is generally thought to date from the late 1980s and early 1990s. My research group has analyzed the changes in workplace motivation over this period based on data from a questionnaire filled out by company employees in a survey conducted by the Mental Health Research Institute of the Japan Productivity Center.[12]

We analyzed the responses given to questions regarding work attitudes and work-related values, including motivation, work ethic, and sense of belonging to the company. For the analysis, we used data from questionnaires carried out in 1985 (4884 respondents), 1990 (4803 respondents), and 1995 (5304 respondents). The proportion of people answering, "Yes" to the question: "Do you feel motivated to do your present job?" for example, fell from 77% in 1985 to 66% in 1990 and to 56% in 1995. A similar decline was seen in the proportion of people responding positively to other questions. While 61% of people answered "Yes" to the question "Does your present job give meaning to your life?" in 1985, this fell to 45% in 1990 and to 42% in 1995. For the question, "Would you like to be given more responsibility at work?" the percentage answering, "Yes" fell from 50% in 1985 to 37% in 1990 and to 34% in 1995. While 57% of respondents agreed with the statement "I feel I can rely on the senior management in my company" in 1985, this percentage fell to 46% in 1990 and to 41% in 1995.

On questions about work ethic, the statement "Company work should be given priority over private life" met with agreement from 48% of respondents in 1985, compared with 27% in 1990 and 21% in 1995. "It is acceptable to do just enough work commensurate with my pay" was a sentiment only 19% of respondents admitted to sharing in 1985, compared to 28% in 1990, and 32% in 1995. Likewise, the percentage of people agreeing with the statement that "I tend to neglect my work when no one is watching" rose from 13% in 1985 to 18% in 1990 and to 21% in 1995. At the same time, there was a gradual increase in uncertainty and anxiety about the future. While 53% of respondents agreed with the statement "I don't feel particularly anxious about the future" in 1985, this had fallen to 44% in 1990 and to 40% in 1995.

These figures reveal a clear fall-off in people's commitment and motivation during this period, and show that the sense of self-sacrifice and belonging also dropped at the time. During the second half of

the 1980s, when the property bubble still in full swing, escalating land prices persuaded many companies, not only financial organizations, to invest in real estate. It seems likely that this phenomenon served to speed up a change that was already beginning to take place within the hearts and minds of many people in Japan. The bubble years led many Japanese to question the meaning of hard work, conscientiousness, and dedication to the company that had been the foundations of the traditional work ethic.

The recession that began after the bubble burst prompted a further drop in motivation levels. From the 1990s, faced with increasingly intense global competition, many Japanese companies started to carry out management reforms, abandoning some of the traditional Japanese practices and adopting market-driven systems. The proportion of non-permanent jobs without full benefits began to increase while the proportion of permanent jobs decreased. These changes resulted in a tougher job market and more difficult working conditions, and diminished job security for many people. A prolonged economic slump ensued and average pay in Japan has been falling since 1998.[13] There was a slight improvement in 2013 and 2014, but given higher prices this can hardly be called an increase in real terms.

The 2011–2013 Gallup survey indicates that motivation levels in Japan are even lower than the global average. Only 7% of Japanese workers were "engaged," with 69% describing themselves as "not engaged" and 24% as "actively disengaged." In other words, fully 90% of the workforce felt no motivation about their work. In the 2005 Gallup survey, the proportion of "engaged" workers was 9%, suggesting a small decline over the intervening six or seven years.[14] In a 2005 survey carried out by the consulting firm Towers Perrin on 86,000 workers in 16 countries, only 2% of Japanese respondents described themselves as "highly motivated," lowest among the 16 countries.[15] Given that the average figure for all 16 countries was 14%, it is clear that the level of motivation in Japan was extremely low. Data from a number of studies, including those carried out by Nomura Research Institute, the Mental Health Research Institute of the Japan Productivity Center, and the Institute of Labor Administration, also indicate a decline in employee motivation in Japan.[16] The high morale and industriousness of Japanese employees gained worldwide attention during the period of rapid economic growth, but these surveys show that the motivation of Japanese employees today has fallen dramatically.

Motivation and Economic Growth

Increasing motivation is vital to achieving sustainable growth for companies, communities, and countries. How to increase workplace motivation is undoubtedly a crucial question for company managers. But the problem of motivation does not concern managers alone—it is an issue that affects society as a whole as it affects productivity and economic growth. A country's economic growth rate is determined to a great extent by the rate at which productivity increases, and productivity depends greatly on the motivation level of individual employees of that country. And for individual employees motivation is a matter of finding meaning in their work.

Of course, the motivation and commitment of employees are not the only factors that affect a company's results. Numerous other factors have an important impact, including investment in facilities, production technology, the management system used, and overall conditions of the economy. But there can be no question that motivation is one of the most important factors in determining the labor productivity and company results. American psychologist D. C. McClelland conducted an empirical study to compare 30 countries around the world in terms of motivation among workers and managers. The results of the study showed that the need for achievement—a basic motivator of human behavior—is an essential element of the entrepreneurial spirit and correlates significantly with a country's economic growth.[17] In other words, McClelland's study demonstrated that the countries' economic growth is notably affected by the motivational levels of their population regardless of differences in culture and stage of historical development.

A long-term fall in motivation is presumably caused by a variety of factors. But one major factor, as we have seen, is undoubtedly the shift toward market-driven hiring and human resource policies in the face of increasing global competition. It seems highly likely that deteriorating working conditions and job security, brought on by frequent personnel cutbacks and increasing use of nonpermanent contracts, have been a major factor behind the decline in motivation. The 2011–2013 Gallup survey shows that companies in the United States and Canada that are reducing the size of the workforce are more likely to have "actively disengaged" workers than companies that are expanding the size of the workforce.[18] Given the vital importance of motivation for businesses and for economic growth, this widespread decline in motivation should be a matter for deep concern for not only company managers but the wider society as well.

Increased Expectations and Workplace Reality

While employment and working conditions have deteriorated in the actual workplace, people's needs and expectations regarding their work have continued to rise. This has led to a widening gap between reality and expectations and seems to be another major reason for declining motivation in the workplace. People's motives for working, and what they look for in their jobs, have gradually shifted in step with the socio-economic changes of the past several decades. In the era of economic development, when living standards were still low, the purpose of work for most people was to earn the money to provide food and shelter for the family. When the consumer society flourished during the period of rapid economic growth, people's aim in life was to enjoy a prosperous consumer lifestyle. There was a tendency to think of work as simply a means to make this possible. But the changes in the industrial structure brought by the process of post-industrialization over the last half century and the resultant changes in the occupational structure, along with the improvement in material standards of living, have brought about major changes in the way people think about work and organizations.

Today, many people seek more than material compensation from their work. In many cases, they expect their jobs to fulfill social needs, esteem needs, and self-actualization needs.[19] Social needs refer to the desire to belong to an organization, to be accepted by peers and friends, to become part of a group, and to give and receive friendship and affection. The esteem needs, also called egoistic needs, involve the desire for self-approval, self-confidence and autonomy resulting from achievements, competence, and knowledge, and for acceptance and recognition from others in the form of social status, reputation, and respect.

"Self-actualization needs" refer to the desire to realize one's potential, to continue self-development, and to be creative in the broadest sense. Together, social needs, esteem needs, and self-actualization needs are often referred to as "post-material needs."[20] Today a substantial proportion of the working population in advanced nations seeks these post-material needs, and now regard work as something that should satisfy their pride and self-esteem, give meaning to their lives, and play an important role in the process of self-realization and self-development.

This steady rise in people's needs and expectations regarding their work over the past several decades has not coincided with a commensurate increase in the number of "good jobs" that can satisfy these increasingly

high demands.[21] Since the mid-1970s the number of paid jobs, not to mention full-time permanent jobs, has been decreasing in all countries and unemployment has risen. Faced with increasingly intense global competition, companies have been constantly reducing their workforces for many years, and this has resulted in the loss of a huge number of jobs.

To make matters worse, the information and knowledge industries that are one of the few areas of growth today are mostly made up of a small elite of managers, entrepreneurs, scientists, professionals, computer programmers, and consultants. Unless new growth areas are developed, these fields alone will not be able to absorb more than a small proportion of the millions of people who will lose their jobs in future due to corporate job cuts and technological innovations.

It is clear that there are far more qualified candidates than vacancies for these jobs that promise to satisfy employees' self-actualization and other post-material needs. The reality is that most people do not have much opportunity to satisfy their esteem or self-actualization needs in the actual workplace. One might surmise that those who described themselves as "engaged" on the Gallup survey are the lucky ones who have landed jobs that allow them to fulfill their high expectations. As we have seen, in the 2011–2013 Gallup survey, such people made up around 30% of the workforce in the United States and Brazil, less than 20% in Spain, the United Kingdom, Sweden, Canada, and Germany, and less than 10% in France, India, Japan, and China. These are people who have acquired skills and knowledge in short supply, which allowed them to find jobs full of opportunities for stimulating problem-solving, self-expression, ego-assertion, and self-development. The rest of the working population are denied similar opportunities for self-actualization and self-development; their job satisfaction is correspondingly low and they feel little or no motivation for their work. In particular, respondents who described themselves as "actively disengaged" are likely to be the least lucky people with little drive and ability to learn new skills, stuck in jobs that no one would do except for the money, harassed by worries about unemployment and forced to continue in their present jobs for lack of any more promising alternative.

Conclusion

As we have seen, people today expect more from their work than ever, and expect their jobs to fulfill esteem needs and self-actualization needs, but the number of "good jobs" that might satisfy such high expectations

has, on the contrary, decreased. Many employees feel dissatisfied and unenthusiastic as a result of this gulf between their expectations and the grim reality. It is highly likely that these dissatisfactions have led to the long-term decline in motivation that we have seen.

Insofar as this gap between expectations and reality has in large part been brought about by post-industrialization-engendered changes, however, as well as by the increasing market-orientation of company policies as a way to cope with global competition, restoring the level of employee motivation will not be easy.

This book suggests a policy for using some of the strengths of the Japanese-style management as a way to find a breakthrough in the current impasse. In particular, Japanese management's emphasis on the human aspects of organizations can help to restore employees' confidence and motivation in Japan and in other countries. Over the past twenty-five years, the reputation of Japanese management has fallen both in Japan and other countries, but recently managers and specialists in Japan and in other countries, Western and non-Western countries alike, have begun to look again at the strengths of the Japanese approach.

The Lehmann Brothers collapse and the ensuing global recession spurred concerns that free-market capitalism had gone too far under the pressure of global competition, and this has led people to reevaluate the Japanese approach as an effective alternative to the Anglo-Saxon model. This book analyzes the principles that form the foundations of the Japanese model and its strengths. On the basis of this analysis, the book puts forward an approach for making the most of these strengths in today's context, which, I believe, will lead to successful strategies for overcoming the current crisis of motivation, promoting the creation of new values, and contributing to improved company performance and results.

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19. The definition of needs here is based on Abraham Maslow's five-stage hierarchy of needs (see p. 116 in Chapter 4 of this book).
20. Ronald Inglehart, *Silent Revolution: Changing Values and Political Styles Among Western Publics* (Princeton, NJ: Princeton University Press, 1977), pp. 41–42.
21. Arne L. Kalleberg, *Good Jobs, Bad Jobs: The Rise of Polarized and Precarious Employment Systems in the United States, 1970s–2000s* (New York: Russell Sage Foundation, 2011).

CHAPTER 2

Japanese Management: Changes and Survivals

For half a century following the end of World War II, Japanese-style management as defined in the pages below made a major contribution to the development of Japan's postwar economy.[1] During the rapid economic growth of the 1960s, this approach to management enabled high productivity, made companies more competitive internationally, and played an important role in the country's remarkable economic growth. As the economy matured and entered a period of low growth, however, the disadvantages of Japanese-style management began to grow manifest. Beginning in the early 1990s, many companies came to examine the distinctively Japanese practices they had used in the past and initiate various kinds of reforms.[2] Around the turn of the twenty-first century, however, many of these companies realized that the reforms had gone too far and shifted tactics again, moving back to some of their original practices.

Japanese-style management has both disadvantages that can hinder a business and merits that ought to be maintained from now on. How has management in Japanese companies changed during the dramatic upheavals of the last twenty-five years, from the collapse of the bubble economy in 1990 and the prolonged recession that followed, through the global economic crisis triggered by the Lehmann Brothers collapse in 2008? What did Japanese companies learn during this time? In this chapter and the next, I will trace the circumstances of change in Japanese management over this quarter century, analyze the current state and assess the future directions it will take. This chapter discusses the personnel and employment system

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as well as internal decision-making. Chapter 3 looks at a company's relationships with other companies and with its outside stakeholders—in other words, the intercompany networks and corporate governance systems.

What Is Japanese Management?

Corporate Practices Supporting Japanese Management

In a broad sense, the term "Japanese-style management" refers as a whole to management practices that have been followed in large-scale organizations in Japan. The Japanese style of corporate management is said to be made up of four systems: (1) a system of personnel and employment practices that governs relations between a company and its employees; (2) a system of internal decision-making practices; (3) a system of intercompany relationships such as those based on *keiretsu* (conglomerations of business firms linked by cross-shareholding—details will be discussed in Chapter 3); and (4) a system of corporate governance practices. These four systems mutually support one another and as a whole form what is seen as Japanese-style corporate management. They are closely connected to the various distinctively Japanese institutions of the economy to be discussed in Chapter 3. As a whole, all these systems depend to a significant extent on social capital, founded on trust. This will be discussed in Chapter 4.

In a narrower sense, "Japanese-style management" is often used to refer to the personnel and employment system typical of Japanese companies. This is characterized by lifetime employment, seniority-based promotion and pay, and a system of enterprise-based welfare (in which the company is responsible for looking after many aspects of employees' lives outside work, including health, housing, and children's education). This personnel and employment system is the core of Japanese-style management and operates in close tandem with the other three systems.

The practices regarded as characteristic of Japanese management are not unique to Japanese companies. Many of them can be found in organizations in other countries. Long-term stable employment, seniority, and the internal labor market[3] can be found in Europe and the United States in central and local governments, as well as within such bureaucratic organizations as the military forces.[4] In the private corporations of many Western countries, seniority (length of service) is a major determinant of promotion in blue-collar union jobs (blue-collar jobs in

which employees belong to a union). In Japan, however, these practices have been conducted much more broadly and systematically across the entire organization of private-sector companies. This is not the case in other countries.

The system of enterprise-based welfare is not entirely unique, either. As will be shown in Chapter 5, paternalistic employers in the United States and the United Kingdom attempted to introduce enterprise-based welfare measures between the late nineteenth and early twentieth centuries. Such progressive employers were always a minority, however, and many of their pioneering efforts ended in failure or were later abandoned. They never succeeded in changing the character of the employment system as a whole in their country. In Japan, however, systems like these were standard in many large companies and became one of the defining characteristics of the Japanese employment system.

As I explain below, some aspects of Japanese-style management can be traced back to the feudal system that was in place during the Tokugawa period (1603–1867). The origins of the individual practices that make up the systems are diverse. What we know today as Japanese-style management was formed when practices deriving from a variety of origins were incorporated into modern, large-scale organizations in the years following World War II. This style of management reached its apogee—when it was practiced most widely and functioned most effectively—between the postwar economic boom and the 1980s.

Beginning in the 1990s, however, as Japan entered a prolonged period of stagnation following the collapse of the bubble economy, the drawbacks of these systems of Japanese-style management became increasingly apparent. Many companies implemented restructuring measures and job cuts, and one by one the systems that make up the Japanese style of management became the targets of reform and gradually the practices that had been typical in the past came under review. Some of the new systems introduced at this time proved effective and helped to improve performance, but in other cases, they failed to bring the anticipated results, and in many cases gave rise to new problems. As a result, in the early years of the 2000s companies began to shift their practices again. Feeling that reforms had gone too far, many began to shift some of the systems back to what they had previously abandoned. The performance-based system of evaluation that is the focus of this chapter is one example of practices that many companies have begun to rethink in recent years.

In the following section, I discuss the origins and historical background of Japanese management and the various institutions it comprises. I then focus on several of its most important elements, namely the personnel and employment system and patterns of internal decision-making. I examine the chief characteristics of these systems and how they are put into practice in Japanese companies today, and give a view of what they will be like in the future.

Origins and Historical Background

Japanese-style management consists of practices with diverse origins. While a number of practices can be traced back to the feudal Tokugawa period, others came into being during the early period of modern industrialization in Japan between the late nineteenth and early twentieth centuries. Others were not established until after World War II. The origins of the most important elements are outlined below.

1. Elements that can be traced back to the Tokugawa period

Although they make up only a small proportion of the whole, several important elements of Japanese-style management were inherited directly from customs common during the feudal Tokugawa period—in particular, from those practiced in merchant houses. Several customs deriving from the apprentice systems common in merchant houses and the craft industries survived more or less intact into the modern period. These include the practice of paying bonuses twice a year—in midsummer and at the end of the year. Apprentices were allowed to return to their homes twice a year: for the Obon holidays in midsummer and at New Year. It was customary for apprentices to receive a "bonus" at these times (generally known as the "shikise," which originally meant "clothes provided by the employer"). This custom continues today, and most Japanese companies still pay a bonus to permanent employees (*seishain*) twice a year. The amount varies depending on the company's results, but payments of 1.5–2.5 times the regular monthly salary are common.

2. Aspects dating from early industrialization

Many of the practices now thought of as typical of Japanese corporate and bureaucratic systems—including lifetime employment, seniority-based promotion and pay, and enterprise-based welfare—came into being during the period between the late nineteenth and early twentieth centuries. They were incorporated into large, modern organizations after World War II and thus became an integral part of the management methods used in many Japanese corporations. A number of these

elements were survivals from the Tokugawa period that were deliberately adjusted to the needs of large, modern organizations, as outlined below:

(1) Customs deriving from merchant and farming houses.
   (a) Organization as a large "family-like" unit
   The concept of an extended family as a management unit prevalent in the Tokugawa period was later applied to industry and helped to form large-scale enterprises consisting of nonfamily members yet operating on the basis of family-like relationships. (This will be discussed in detail in Chapter 4.)
   (b) Distinction within the "family" between employees hired on a temporary basis and permanent, lifetime employees.
   (c) Wages determined by length of service.
   (d) Emphasis on paternalistic relations premised on the idea of the parent–child relationship.

(2) The idea of collective responsibility and group supervision: Creation of the work-group system in late nineteenth century workplaces was a modification of the *gonin-gumi* or "five household" collective responsibility system institutionalized in seventeenth-century Tokugawa Japan. The *gonin-gumi* system derives from an old method of political control long familiar in China and Japan where any misconduct or breaking of the regulations by any member of the group is considered the responsibility not only of the individual concerned, but the group as a whole. Such institutions of collective responsibility and group supervision are linked with the groupism characteristic of contemporary workshop organization, for instance, the work teams in the Japanese auto industry.[5]

3. Aspects formed during the postwar reconstruction period

Immediately after the end of World War II, in-house labor unions were established in most large companies to support relations between labor and management. With the enactment of the Labor Union Act in 1945, labor unions were legally permitted for the first time in Japan, guaranteeing workers' right to organize, collective bargaining, and the right to strike. Unions were organized within individual companies. Facing a context in which military-related demand had suddenly been abolished, the unions demanded that saving jobs should be management's number one priority. As the union membership rate grew, employees gained a greater say in how companies were run. In the 1950s, massive labor

disputes arose over job cuts. It was the lessons of this sequence of major disputes that established the practice of lifetime employment. In return for guaranteeing workers' jobs, companies demanded cooperation from the unions. Both sides began to prioritize a relationship of trust between labor and management, and strong resistance to the idea of job cuts took root. Layoffs became taboo. At the same time, the idea that the organizational unit of the unions was the individual company became firmly established as the norm, and enterprise-based unions became entrenched in the corporate culture.

The practice of promoting employees internally to managerial positions also dates from the immediate postwar years. After the war, the government encouraged worker involvement in "joint management councils" (*keiei kyōgikai*), and made it clear that workers had an important role to play in rebuilding the economy. The aim was that management personnel who had risen through the ranks would make decisions affecting the company following consultation with permanent employees.

This trend was given a boost by the "purge" that took place in 1947, when senior officials and top executives involved in the conduct of the war and those related to the *zaibatsu* conglomerates were barred from public office. Even today, there is a strong tendency for managerial positions in large Japanese companies to be filled by people who have risen through the ranks. According to a survey carried out by Paul Sheard, around three-fourths of the executives in companies listed on the Tokyo stock exchange were internally appointed.[6] A majority of managers at Japanese companies are therefore former rank-and-file employees who worked their way up from an entry-level position. This is one of the most conspicuous differences between Japanese companies and companies in Europe and North America.

Above we looked at a number of practices whose origins date back to the Tokugawa period. It is important to note that in none of these cases did traditional practices simply continue intact and unchanged as a matter of course. They were deliberately and consciously selected and adapted to make them suitable to the needs of a modern, large-scale organization. Nevertheless, it is possible to discern certain historical continuities in terms of the values, ideologies, and patterns of behavior that lie behind these practices. Many such practices come from the distinctly Japanese *ie* system that I will discuss in Chapter 4. They contributed to the formation of organizations as *ie*-like communities. In particular, the Confucian

doctrine that formed the basis of the *samurai* warrior code continued to provide the foundation for core social norms in Japan even after the Meiji Restoration (1868) and had a major influence on behavioral norms in organizations. The Confucian virtue of loyalty (*chū*) that warriors were expected to show toward their lords is often said to have survived into the modern age; salaried employees are held to feel a similar kind of loyalty toward their superiors or toward the company as a whole. The basic approach of Japanese management practices, which rests on the idea that human nature is inherently good, is often said to derive from the Confucian concept of "virtue" (Jp. *toku*; Ch. *de*). These and other similar values and ideologies have had a significant influence on the principles of Japanese business management.

Organizational Management: Ideal Types and Current Practice

Personnel and Employment

The classic model of Japanese management in large firms is based on a personnel and employment system consisting of lifetime employment, seniority-based pay, and related practices, but the model has not necessarily been implemented in all its aspects in small- and medium-sized enterprises. Particularly, very small concerns lack the capital reserves necessary to support such a system in the long term. In 2014, 99.7% of the 3.82 million companies in Japan were small- or medium-sized enterprises (SMEs) with 300 employees or fewer. Only 0.3% counted as large companies.[7]

Around 70% of Japan's working population is employed in SMEs; only 30% work for the large companies. Nevertheless, for half a century after the end of the war, the classic model of Japanese management as I have sketched it above was regarded as the ideal for all companies to aspire to—including SMEs. In that sense, the Japanese style of management has had a major impact not only on the relatively small proportion of the population that works in large companies, but on Japanese society as a whole.

Lifetime Employment

The most distinctive feature of the personnel and employment system, which lies at the very heart of Japanese-style management, is lifetime employment. A company hires employees who have just graduated

from high school or university and continues to provide stable, long-term employment until they reach retirement age, barring extraordinary circumstances. This system is at the core of the management of human resources. The promise of lifetime employment is not something set down formally in writing. Rather, it is an ongoing unspoken agreement between company and employees. Often, it is a shared assumption that comes into being without any particular conscious decision on either side.

Even at companies that have practiced lifetime employment for many years, however, pressure to trim superfluous personnel from the payroll has been mounting since restructuring began in the 1980s. Nevertheless, the tendency for Japanese companies to prioritize employment security remains strong. As a general rule, companies will do their utmost to avoid dismissing a permanent employee (*seishain*). When a company's results are suffering and changes are unavoidable, the standard option is to terminate the contracts of nonpermanent employees. When it comes to permanent employees, although a company may resort to other options to balance its workforce (including encouraging early retirement with preferential conditions, sending employees to a subsidiary or otherwise affiliated company, or reassigning them to a different department), as a rule, companies will avoid terminating the employment of a permanent employee as much as possible.

Since the global economic recession that was triggered by the American subprime mortgage crisis, increasing numbers of companies have had no choice but to terminate the employment of permanent employees as companies have failed and departments have closed. These include some companies that had practiced lifetime employment for decades. Even so, Japanese managers remain much more reluctant to dismiss an employee than managers in US or European firms, and no such decision can be made without careful consideration and thorough deliberation. The same policy applies to the overseas branches of Japanese companies. This will be discussed in more detail in Chapter 5.

In surveys, the proportion of companies answering that they intended to continue the policy of lifetime employment into the future declined during the 1990s, for example, down to 56.2% in 1998 and 33.8% in 1999. Since then, however, the numbers have risen, forming a v-shaped curve. According to a survey carried out in 2005 by the Japan Institute for Labour Policy and Training, 95% or more of companies in manufacturing, and around 90% of companies in wholesale, retail, food and drink industries, and other service industries responded that long-term

employment was a priority. This tendency was particularly pronounced in manufacturing, followed by the wholesale, retail, food and drink service industries, and the service industry, in that order.[8] Large companies tend to prioritize long-term employment more than SMEs.[9]

Among employees, too, the idea of lifetime employment is becoming more popular. In a survey carried out by the Sanno Institute of Management on entry-level employees who joined their companies in 2009, as many as 73.5% responded that they thought a lifetime employment system was "desirable," the highest level ever.[10] According to a survey carried out in 2008 by the Japan Institute for Labour Policy and Training, 86.1% supported lifetime employment. In the context of a difficult climate for job seekers, anxiety about unstable employment is clearly rising among employees, bringing about a revived sentiment in favor of stability.

Viewed together, these and other statistics reveal that at present the majority of companies value the advantages of lifetime employment: namely, that it encourages loyalty and commitment, and makes it possible to provide employees with long-term training over the course of their careers. Many companies want to continue the system of lifetime employment, and in these companies, as long as company performance continues to hold steady, the idea that permanent employees should be employed on a stable, long-term basis is unlikely to be discarded anytime soon. Even at companies that are struggling, managers are likely to feel that abandoning the idea of lifetime employment altogether would be too drastic a step to take. It is likely that companies like these will continue to implement long-term employment to the limits of their ability to do so, even if it means reducing their pay scale.

Seniority-Based Promotion and Pay

In traditional Japanese management, promotions and pay raises are based on seniority system (*nenkō-joretsu*; order determined by the number of years an employee has been with a company). Seniority-based pay (*nenkō-kyū*) is at the heart of the Japanese employment system, originating during the postwar period of poverty and austerity, when the aim was to provide wages that would be sufficient to support employees' livelihoods. The system was designed to provide all employees with adequate means to provide for their daily needs, while keeping a cap on total wage costs. It minimizes the gap in wages between occupational strata, while increasing pay in accordance with the needs relevant to various life stages.

In some respects, it might be described as a "communal" or "socialist" system. In order to raise the pay of employees in their 40s, who are likely to have expensive school tuition fees to pay for their children, the wages of younger workers must unavoidably be kept within a certain amount. Such factors are taken into account when determining salary levels.

The standard compensation structure in Japanese companies has been a joint system combining seniority-based and managerial position-based pay (*nenkō-gata shokunōkyū*). An employee's pay is calculated by combining these two elements according to a given ratio: for example, 65% seniority-based pay combined with 35% based on managerial position. The term *shokunokyū* originally referred to that part of an employee's wages that was determined according to ability, but the reality is that in most Japanese companies it refers to pay allocated to a certain managerial position within the company. Since managerial posts are often tied to seniority, the managerial position-based pay is also largely determined by seniority, especially for the first ten to fifteen years of their careers. In consequence, the extent to which the entire salary is determined by seniority is certainly high.

Under this system, job performance is not directly reflected in an employee's pay package at all. Under the classical model, all new recruits who enter the company after graduation in the same year will receive almost exactly the same salary and bonuses for the first ten to fifteen years of their careers.

Even in companies that use seniority-based pay, however, ability and performance are important factors in deciding promotion after a certain age, and differences in pay among an age cohort, therefore, do arise depending on their position. The exact duration of seniority-based pay varies from company to company. Normally, by the time employees are in their 40s, considerable differences in pay exist depending on position, even among employees who entered the company at the same time.[11]

Under the seniority system, job performance is scarcely reflected in pay and promotion until an employee reaches a certain age. Accordingly, there is little need for formal performance evaluations of employees. Evaluations and promotions thus take place infrequently. As described below, a number of reforms have been made in personnel management system over the past twenty years, and many companies have made changes in their seniority-based pay systems. Even today, however, some companies continue to use conventional seniority- and position-based pay system, and in these companies, the framework described above still determines employees' pay.

In contrast to Japanese companies, most companies in the United States use a formal, points-based system to evaluate employee performance and decide promotions and pay raises on merit according to these evaluations.[12] In the vast majority of American firms, line managers evaluate the employees under their direct supervision on a regular basis (often every six months or once a year). These evaluations determine compensation and promotions and other aspects of an employee's remuneration package.

In Japanese organizations, it is the vertical, seniority-based order (*nenkō joretsu*) and the vertical chain of responsibility based on it that represent the path to advancement. Most employees are hired as generalists, and the likelihood of being shifted horizontally to a different section or department within the organization regardless of their expertise is much higher than in European and American firms. Professional positions are less specialized, and there is often no system in place by which an employee can be promoted as a specialist in a certain field. Moving between companies as a specialist is not common.

As mentioned earlier, many Japanese companies have reformed their personnel management practices since the bubble economy collapsed in 1990. Between the 1990s and the beginning of the new millennium, increasing numbers of companies adopted job-based pay systems (*shokumu-kyū*), in which remuneration is determined by the nature and value of the work performed in a given position. This was often introduced in addition to the seniority- and position-based pay system that had previously been the standard. As discussed in detail in the section "Performance-Based Management" below, this generally did not involve the introduction of a job-based system across the whole company. Rather, using the concept of job-related pay, albeit partially, allowed companies to offer results-based rewards to employees with specialist skills who do not aspire to be promoted as generalists.

The stagnation that followed the collapse of the bubble in 1990 brought home to many people the disadvantages of the conventional Japanese personnel management system. Companies began to introduce performance-based personnel system to supplement seniority-based system. Since 2000, however, many companies that introduced performance-based evaluations and treatment have found that they did not achieve the anticipated results, and many have subsequently reexamined their systems and decided to change tack again. I will discuss performance-based promotion and pay and the problems associated with these practices in more detail in the section below on "Performance-Based Management."

Recruitment

One feature above all others distinguishes traditional hiring practices in large Japanese companies: The great majority of permanent employees are hired en masse at regular intervals. Annual cohorts of fresh employees are hired when they graduate from high school or university and enter the company as new graduates (*shinsotsu*) in April each year. The general practice has been that these employees spend their whole careers, under ordinary circumstances, with the same company until they reach retirement age.

Recently, however, a certain percentage of newly recruited freshman employees have been leaving the company within a year or two of joining. This phenomenon has been observed for more than fifty years, but the proportion of new hires quitting within three years has steadily increased. For the past twenty years or so, the general rule has been that around 30% of employees leave the company within three years of joining.

Various explanations have been suggested for this increase: Young people today are said to prize self-fulfillment more than previous generations, to be choosier about the kind of work they want to do, and to value more highly the freedom to decide how they live their lives. It is often said that they lack perseverance compared to previous generations. Aside from these early leavers, the majority of the rest of each annual cohort of new recruits generally stays with the company until retirement.

Previously, employees who left their company one or two years after joining as new graduates were required to apply for their next job as "old-graduates" (*kisotsu*), or under non-regular recruitment for mid-career level hires, and could not apply under the regular recruitment of new graduates. In recent years, however, companies have started to allow these applicants to apply again under the annual regular recruitment as if they were "new graduates." These applicants are known as "second-time new graduates" (*daini shinsotsu*).

Many companies struggled to balance their books during the slump that lasted from the bubble collapse through the early 2000s, and job stability decreased as a result. But for companies, few things are more important than hiring and training the human resources responsible for the company's competitiveness. From a long-term perspective, it is likely that many Japanese companies will continue to follow the basic strategy that has prevailed until now, and will continue to hire the bulk of

their workforce in annual batches as new graduates and then develop the resources they need by training new hires on-the-job and assigning them to the appropriate departments within the organization.

Meanwhile, the changing structure of the economy has brought increasing demand for jobs requiring highly specialized qualifications and skills. Many companies have been filling these positions in recent years through mid-career level hires. A survey conducted in 2005 by the Japan Institute for Labour Policy and Training showed that while companies in manufacturing, wholesale and retail, and the food and drink service industries strongly prioritized new graduate hires, in the service sector many companies actively look to hire mid-career employees.

According to this survey, when the percentage of companies answering that they "prioritized mid-career hires" was subtracted from the percentage answering that they "prioritized new-graduate hires," the highest scores were recorded for manufacturing, followed by "wholesale, retail, and the food and drink service industries."[13] In the services industries, many companies actively look to recruit mid-career hires as ready-trained assets ready to work as permanent employees with specialist knowledge and skills.

Enterprise-Based Welfare

Japanese companies have traditionally provided a wide range of welfare services to employees, including pensions, medical insurance, retirement payments (*taishokukin*), housing allowances (or provision of company housing), family allowance, and recreation and welfare facilities. This system took shape in postwar Japan when companies, particularly large companies, put active efforts into providing full welfare packages to their employees. In Japan, social welfare provision by the state has tended to lag behind Europe and North America and the government came to depend on the "family-style" of company management to provide adequate social welfare.

Japanese companies have played an important role in providing social welfare. But generally, this implies a framework in which many welfare benefits are paid to individuals as members of an organization. Furthermore, these benefits are generally reserved for permanent employees only. This means that people who do not belong to large organizations, along with the unemployed, nonpermanent employees, and the underemployed, find it difficult to obtain adequate social welfare benefits.

In Western welfare states, the norm has been for the government to provide welfare services on the level of the individual citizen. In Japan too, the role required of the state has increased in recent years for a number of reasons, among them the diversification of types of employment, the increasing population of people who do not belong to large organizations, and the fact that many companies can no longer continue to support lifetime employment.

Many companies still maintain the original enterprise-based welfare system. At the same time, many are carrying out reforms as they introduce performance-based promotion and pay. These innovations include advance payment in monthly installments of retirement payments (traditionally paid as a one-off payment on retirement) and changes in the allowance for dependents.

Over the past ten-plus years, many developed countries have passed "family-friendly" labor legislation designed to help employees achieve a better work–life balance. This legislation has required companies to make it easier for employees with young children to work flexible hours, and to take paid sick leave and maternity and childcare leave. The Japanese government has pressed companies to fall in line with these developments, and in recent years Japanese companies have been working to improve the practices they have in place for maternity and childcare leave.

Since the Child Care and Family Care Leave Law was revised in 2005, employees have been able to take up to 18 months of childcare leave (previously the maximum was one year). In 2001, the percentage of employees taking their childcare leave was 49.1% for women and 0.12% for men, but these figures have been rising. In 2005, it was 72.3% for women and 0.50% for men; in 2012, 83.6% for women and 1.89% for men.[14]

Enterprise Unions

Labor unions in Japan are in-house enterprise-based unions with the company as the organizing unit and the company's permanent employees forming the membership. In the West, unions normally bring together workers in the same profession or industry outside the company framework.

This difference has a profound influence on how unions act. Japanese unions are much more cooperative in their relationship with management. In his book *The Japanese Factory*, James Abegglen, one of the first scholars to look at Japanese management, described enterprise unions as one of the main characteristics of the system, along with lifetime

employment and seniority. For Western researchers, Japan's enterprise unions were a unique system that seemed to be at the center of a cooperative and nonconfrontational relationship between labor and management that did not exist in the United States or in Europe.[15]

As mentioned above, unions were legally recognized in Japan in 1945, immediately after the end of the war, and unions were organized in many companies. At the time, the union membership rate (the percentage of all workers who were members of a union) reached over 60%. However, this percentage gradually declined; in the 1960s it was 30-odd percent, in the 1990s less than 25%, and by 2012 just 18%.[16] A similar decline in union membership can be seen in other developed countries.[17]

Several factors suggest themselves as reasons for this drop-off in union membership. From the end of the war through the period of rapid growth in the 1950s, when Japanese living standards were low, the struggles of the unions to win pay rises for their members helped considerably to improve workers' standard of living. These struggles were therefore highly significant to workers. But eventually, pay scales at Japanese companies rose and people's lives became more comfortable. At the same time, the Japanese economy reached maturity. In many industrial sectors, the market reached saturation point and the economic growth rate dropped. The kind of regular wage increases that workers had previously expected now became more difficult, and unions could no longer obtain satisfactory results through their annual rounds of wage negotiations each spring (known as *shuntō*, or "spring campaigns"). The role of the labor unions began to shrink as the social security provisions offered by the government and regional bodies improved.

Because of these factors, employees became increasingly reluctant to spend time on union activities. More people disliked being pressed to lend electoral support to a given political party. The long economic slump has also had an effect; mergers of companies and departments, along with personnel cuts, have forced many unions to fold.

As noted above, the percentage of permanent employees who are members of a union has been decreasing steadily. The same is not true of nonpermanent workers. The percentage of nonpermanent workers joining a union has been increasing steadily year by year, from 3.3% in 2005 to 6.3% in 2012.[18] Increasing numbers of companies are allowing nonpermanent workers who work a certain number of hours to join unions, and it seems likely that the increasing membership of unions among these employees will help to improve their working conditions.

Internal Decision-Making

The Ringi *System, Consensus and Collective Responsibility, and "Bottom-Up" Decision-Making*

The classic model for decision-making in Japanese organizations is characterized by consensus and group responsibility. In many organizations, this takes place via a process known as the *ringi* system, which is a means of reaching decisions with unanimous agreement. Proposals are submitted by employees in a particular department and then approved at each level as they pass up the organizational hierarchy, before being finally adopted. The historic origins of the *ringi* system can be found in the bureaucratic methods used in traditional government administration. Proposals relating to the organization's business and management are drawn up by subordinate divisions, and circulated in writing to all relevant departments and managers for approval.

This method of decision-making is distinctive to Japan. In the bureaucratic pyramid of Western countries, a decision is made at the highest level and then communicated to subordinates for implementation. Subordinates provide relevant information such as feedback from employees and consumers and details regarding government regulations and the state of the competition. Decisions are made at the top level on the basis of this information. In the Japanese *ringi* system, by contrast, an initial decision is made by a group of people involved with the issue at hand. The decision-making process goes forward as follows.[19]

(1) A person with ideas or concerns regarding an issue related to the company's business or management gathers other concerned individuals together and holds meetings to discuss the issue. The necessary information is collected and an initial decision is reached by consent after careful consideration.
(2) The proposal agreed in this way then makes its way up the hierarchy of the organization in the form of a written document known as a *ringi-sho*. This document is passed to senior figures in the organization for consultation until final approval is given. Meanwhile, the written proposal is also submitted to people in other positions and departments whose role within the organization is relevant to the content of the proposal. Provided the proposal does not clash with other decisions and conflicts with

the circumstances of other departments are not detected, top management normally approves the *ringi-sho* without further comment. Once a proposal has been approved, the decision is returned to the subordinate divisions for implementation.

The extent to which the *ringi* system is implemented differs according to industrial sector and individual company, but it is said that between 80 and 90% of Japanese companies use it in some form. It has both merits and demerits.

1. Merits

Circulating a written document rather than holding meetings makes it possible for the people involved to reach a decision on the basis of a full acquaintance with the relevant background. Once a decision has been reached the process of communicating the decision and acting on it normally happens very quickly. Also, because employees at each level of the hierarchy share information and reach an understanding of the proposal in advance, mobilizing people and implementing the decision normally goes smoothly.

Being involved in the consultation process and working on a proposal does not mean involvement in decision-making at a managerial level. Nevertheless, the *ringi* system does give employees a sense that they have made a contribution to the decision-making process of the organization as a whole. This helps to improve motivation and can make employees more likely to exert themselves once a decision has been reached.

The *ringi* system also allows "bottom-up" decision-making, in the sense that the people responsible for a particular work function within the company can, in practice, initiate the process, without depending on the formal relationships of authority and responsibility. In many companies in Japan, it is normal for an employee with frontline responsibility but little far-reaching authority (normally a middle manager) to point out problems and propose solutions. After consultation with his group, a written document (*ringi-sho*) is drawn up and submitted to all related sections and departments for consultation—each person of responsibility affixing his or her seal to the document—before being sent for approval at the highest level of management. The written document allows superiors to confirm the consensus opinion of employees before deciding whether to approve the proposal. If the proposal is approved, it is returned to the relevant department and work begins on implementing

the decision. This process makes bottom-up decision-making possible. One effect of this is to increase the motivation of middle managers and other employees directly in charge of a certain task.

2. Drawbacks

The first disadvantage of the *ringi* system is the length of time required to reach a final decision. Regulations regarding delegation of authority and budget to departments vary from one company to another, but in many Japanese companies relatively little authority has been delegated or transferred to lower-level management. In these companies, lower-level managers on the level of department head (*buchō*) or division manager (*honbuchō*) lack the authority to take decisions even on matters that would be considered relatively minor from a global perspective. They are unable to get approval for decisions without going through the *ringi* procedure.

In the case of a proposal for a new project, for example, many different departments are likely to take part in the deliberations: the management department, which is concerned with management; the investigation department, responsible for assessing the trustworthiness of partner companies; the finance department, which allocates funding; the personnel department responsible for the assignment of personnel; the accounting department, which will handle the accounts of the new project; and the legal department, which will need to consider the legal implications. All these departments play important roles in considering the project. Unlike the employees directly involved in the proposed business, these departments are third parties. The jobsite employees must, therefore, compile materials and explanations to persuade these departments that the proposal has merit. Within the department directly concerned, most of the explanations beyond the basic reference materials can be done verbally, but as soon as other departments are involved, a huge volume of paper and other materials becomes necessary. Within each department, four or five people will examine the documents—one person delegated to act as coordinator with other departments, one person responsible for studying the content, and the section chief (*kachō*), department head (*buchō*), and division manager (*honbuchō*), who will approve it. After this, the documents will either be stamped for approval or, if there are problems, returned to the person who submitted them with a request for clarification.

Only after the documents have passed through four or five different departments, in turn, are they finally submitted for approval by

the directors of the committee concerned, for instance, the Investment Committee. Depending on the nature of the proposal, it may be necessary to obtain the approval of the board of directors, in which case the proposal may have to wait another month until the next board meeting. During this time, anywhere from 20 to 30 people may read the documents and add their stamp of approval.

As a consequence, it is not unusual for it to take several months to prepare the necessary documents and several more before a decision is reached—even for relatively minor proposals. In today's world of rapid technological advancement and a constantly shifting business environment, there is a real danger that unless decisions are made promptly a firm may miss the opportunity to launch new projects at the most appropriate moment. Companies risk being overtaken by competitors or finding that their new product or service is already out of date by the time it appears.

Another criticism of the *ringi* system is that group responsibility and consensus mean that it is often unclear where the responsibility for a decision lies. This can lead to evasion of responsibility.[20] If a proposal results in failure, there is a tendency for everyone involved to "share the pain." This creates an ideal environment for collective avoidance of responsibility. It has been suggested that a widespread desire to avoid personal responsibility is, in fact, part of the reason why the *ringi* system is still used in so many companies.

In a case where a decision goes all the way up to the company president, for example, it is in the president's interests to be able to say: "I put my seal on the proposal because the senior managing director had approved it." The same system allows the senior managing director and others to dodge responsibility by arguing that the company president also approved the ultimately unsuccessful idea. The *ringi* system often makes it unclear where the responsibility for failure lies, and the system is, therefore, open to abuse as a way of avoiding responsibility.

Making the System More Efficient

A large number of people who participate in the decision-making process is a problem inherent in the *ringi* system. Although some people argue that the merits of the system justify this unavoidable drawback, many consider the time-consuming aspects of the system and its ambiguity of responsibility to be serious disadvantages. Many companies have made efforts to improve the situation. In many cases, this involves reducing the

number of people involved in the *ringi* process in order to make quicker decisions possible. Itōchū Corporation, for example, achieved a significant reduction in the number of sections and departments to which a *ringi-sho* is circulated, and cut the number of approvals required to under a third of previous levels.[21] As part of their reforms, many companies are trying to "flatten" their organizations in terms of authority. Even after a company has equipped itself with an efficient in-house E-mail communications network, the situation will not change and there will be little improvement in the amount of time required to reach a decision if the number of managerial positions remains high and numerous people need to be consulted on every decision. Simplifying and streamlining the organization makes it possible to speed up decision-making and communication.

Nippon Sheet Glass Company, a glassmaker, eliminated a number of managerial positions as part of reforms designed to introduce a "flat" system with a clear relationship between responsibilities and authority. This involved getting rid of positions including department deputy head (*jichō*), section chief (*kachō*), and subsection chief (*kakarichō*) and taking away the management-level titles of some 250 employees.[22]

At the same time, others point to the advantages of the system: If used appropriately, it can be effective at allowing ideas to percolate from the bottom of a company to the top. It is also a rational system that allows specialists within the company to give their opinion on proposals submitted from below before a decision is made. Of course, this assumes a clear definition of responsibility and authority. Let us assume that the company president holds all responsibility and authority as the ultimate decision-maker within a company and delegates a part of that authority to the general manager and various division managers. These people are then allowed to make decisions within the remit of the responsibility delegated to them. They report the content of each of their decisions to the president, who retains ultimate authority. Establishing a clear structure of this kind allows the group decision-making system to function more effectively.

Performance-Based Management

As observed earlier in this chapter, the traditional practices of Japanese-style management have drawbacks as well as merits. During the period of rapid economic growth, the advantages of the system were more readily

apparent than its weaknesses and the system functioned effectively. Once that growth ceased, however, the drawbacks of the system became manifest and started to hinder company management. Particularly following the collapse of the bubble economy in the early 1990s, companies have become aware of the problems inherent in Japanese-style management and begun to reexamine their established practices. Along with restructuring, many companies carried out reforms of their personnel and employment systems. In the process, they introduced many elements of Western business management. One of the elements introduced most widely was performance-based evaluation and remuneration for employees.

Beginning in the early 2000s, however, many companies that had introduced performance-based systems ten or twenty years earlier changed their approach again as problems arose, including lowered motivation, lowered interest in developing subordinates' skills and capabilities, and deterioration in teamwork. This section looks at the introduction of merit-based systems into Japanese companies, some of the problems that followed, and in addition, some of the steps that companies took to remedy these problems.

Introduction of the Concept of Job-Based Pay

Following the collapse of the bubble in the early 1990s, many Japanese companies attempted management reforms. It was at this time that the term "job-based pay" (*shokumu-kyū*) began to be heard in many Japanese companies. The standard pay system in most Japanese companies is a joint system combining seniority-based and managerial position-based pay (*nenkō-gata shokunōkyū*), as described in "Seniority-Based Promotion and Pay" above. Since the position an employee occupies is generally determined by length of service for at least the first ten to fifteen years of the employee's career, the reality is that in fact "managerial-position-based" pay is also largely determined by seniority. Both seniority-based pay and position-based pay are paid to individuals on the basis of the personal attributes of the employee.

Job-based pay (*shokumu-kyū*), by contrast, is determined by the content and worth of the work performed in a particular job. This approach to remuneration is widely used in European and American companies, and forms a contrast with the "person-based" system of seniority- and position-based pay normal in Japanese companies. Somewhere between

60 and 70% of European and American firms are said to use job-based pay. In the West, pay is determined according to job description and a quantitative evaluation of the job. Although each organization employs a somewhat different method to formulate job evaluation system, the typical procedure can be outlined as follows.

The first step, called "job description," is one in which all jobs considered necessary for a company to operate are described with regard to content of the work and the demands the work job makes upon the employee, such as skill, effort, job knowledge, responsibility, know-how, and problem-solving ability. Next, these job descriptions, or definitions, are analyzed, evaluated and ranked in order of difficulty and importance of the job performed. This is known as the job analysis and evaluation process. This ordering is then organized into a pyramidal structure on the basis of the vertical chain of command within the organization to form the internal job hierarchy. This is known as the job classification system. The pay structure is then determined by assigning the job classifications to basic hourly wage rates or basic annual salaries, thus creating a ranked system of job-based pay. Job evaluation provides a systematic method of appraising the worth of each job in relation to other jobs in the organization and comprises the basis of compensation and promotion policies.

The concept of "job-based pay" (*shokumu-kyū*) was introduced in many Japanese companies in the 1990s. But in almost all cases companies did not adopt a systematic company-wide job-based pay plan like those commonly used in Europe and North America.

Some aspects of job-based pay in the true sense of the word proved resistant to adaptation in Japan, where job rotation is common and a culture of cooperation and teamwork is highly valued. Instead, the concept of setting employees' compensation and benefits depending on the content of their work gradually became widespread, and companies increasingly established a category of positions, typically for some specialist positions, eligible for a job-based pay system in which salary was based not on the position per se but on the content of the work performed.

"Company C," for example, a major manufacturer of office equipment, printers, and cameras, introduced the concept of job-based pay for some job categories in the second half of the 1990s.[23] Seniority- and position-based pay used in the past was premised on a typical employee—a generalist who sought to climb the ladder within the organization and perhaps aspired to a managerial position. But in today's

world, job content and employee attitudes to their work are more diverse than was once the case. Some employees are specialists who are less interested in climbing the promotional ladder than in doing a job they find personally rewarding. One of the personnel managers at the company said: "As a company, we do not expect that all employees will aspire to climb up through the ranks." Job-based pay made it possible for companies to provide incentives to such employees by raising pay to reward an employee whose performance improves, even if that employee does not advance in terms of the organizational hierarchy. In other words, companies can apply the performance-based system for those specialist categories that are suitable to job-based pay.

It is said that most large companies had introduced the concept of job-based pay in some shape or form in some part of their compensation plan by 2003–2004.

Introduction of Performance-Based Management

Surfacing of Seniority-Based System Disadvantages

As I have already noted, the standard pay system in Japanese companies for many years was a joint system that combined seniority-based and position-based pay. Under this system, an extremely large portion of an individual's pay package was determined by seniority. The Japanese personnel system results in relatively small ability-based differentials in pay and has several advantages lacking in European and American systems. It was particularly effective at maintaining high levels of motivation and a strong sense of belonging among the lower-level employees, particularly the blue-collar workers engaged in manufacturing jobs. Low levels of wage disparity help to build cohesiveness and togetherness within the organization. However, this kind of equality also brings difficulties, particularly in terms of motivating talented employees who would otherwise belong to the upper echelons of the organization on the basis of their ability. This kind of system makes it difficult to make the best use of employees with high levels of creativity and leadership. Many people also suggest that the system allows less motivated employees to free-load with impunity, while also eroding the motivation of harder-working employees.

Also, under the increasing pressure of global competition, many companies found it harder to support the cost burden involved in running a

system of seniority-based pay and lifetime employment, especially given the high levels of pay that had become established during the period of rapid growth and had to be maintained despite the economic slowdown. Various methods were introduced from overseas in an attempt to reform Japanese-style management. The introduction of Western-style performance-based management was particularly important, since it brought about a fundamental change in the personnel system at the heart of traditional Japanese management.

Many Japanese companies adopted the concept of performance-based management as a means of making the best use of the talent available within the company and thus improving the performance of the organization as a whole. The idea that personnel management should be based on the principle of fairly evaluating employees' performance and rewarding them on the basis of this evaluation became widely accepted. More and more Japanese companies introduced performance-based systems to replace the traditional approach whose drawbacks had become increasingly apparent. A "follow-the-crowd" mentality also played a part, and eventually, some form of performance-based system was introduced in the majority of companies. According to a survey carried out in 2009, over 80% of listed companies were using some form of that system.[24] In many companies performance was reflected in bonuses; there were also some at which performance was reflected in basic pay as well. The introduction of performance-based management led to improved results at a number of companies. Nissan Motors, for example, introduced a commitment-led "Revival Plan" under new CEO Carlos Ghosn during a period of management crisis in 1999. The plan was instrumental in restoring Nissan to profitability after a period of poor results.

But success was far from universal. Many companies did not see the results they had hoped for; in many cases, the negative aspects of performance-based management were more obvious than the benefits.[25] In 2008, even Ghosn announced plans to move away from his "commitment-driven" method of management.

Problems Arising from the Introduction of Performance-Based Management

Ideally, performance-based management improves employee motivation and injects energy into an organization by tying results to remuneration—but not all companies achieved the results they hoped for, and indeed in many cases, the new practices caused new problems. The chief problems that resulted are outlined below.

1. Loss of long-term perspective

First, in many of the performance-based systems introduced in Japanese companies, an management-by-objectives (MBO) method is adopted whereby performance is evaluated on the basis of results achieved within a given time period. But because these systems demand results within relatively short periods—often a year—there is a tendency for long-term projects to suffer. It becomes harder to improve long-term productivity or to develop products that might require long-term support by the company. An employee who develops a new product or technology that might have positive effects in the future will not be positively evaluated for that work if immediate targets are missed or sales are low. Employees therefore naturally tend to choose short-term tasks or targets that can be easily achieved when setting their own goals. This leads to a tendency to set low targets that can be easily achieved in order to receive a higher evaluation. There is a possibility that employees' willingness to take up new challenges will diminish as a result.[26]

Another problem is that as employees start to avoid responsibility for the risks involved in creating new products, there is a tendency for employees to clump together on already popular or otherwise dependable products where steady high sales can be expected. Even if some employees are willing to take on the challenge of a high-risk project, the atmosphere in the company can easily become dominated by a caution-first mindset as people seek to avoid having their own evaluations brought down by association with an unsuccessful project. Negative opinions become dominant, and it becomes difficult for possibly high-risk products or projects to get a hearing.

As a result, a company's lineup may be dominated by popular products and steady sellers, and it becomes difficult to create exciting new products. This hinders long-term growth. It has been reported that Namco, for example, a company that designs, develops, and sells video game consoles and content, experienced problems of this kind after introducing performance-based system in 2003.

2. Unfair Evaluations and Falling Motivation

The second problem concerns fairness. Fair evaluations are essential for performance-based management to function effectively. But in fact, in many cases evaluation criteria are vague, and the evaluations themselves tend to be subjective or arbitrary, leading to dissatisfaction among the employees being assessed. The personal results of any employee are frequently influenced by factors beyond the individual's control—such as the

performance of the industry or market as a whole—and when an employee's evaluation suffers as a result of factors like these discontent rises.[27]

In a *Nikkei Business* readers' survey carried out in 2009, a total of 944 respondents who worked at companies with performance-based evaluations were asked to say whether they were satisfied or dissatisfied with their personal evaluations: 43.3% described themselves as "dissatisfied," while only 16.2% were "satisfied."[28] In response to a question about the negative aspects of performance-based management, the most common response was that "evaluations were unreasonable" (63.5%). The next most popular responses were that it was "difficult to focus on long-term work" (49.7%), that "teamwork has diminished" (39.0%), and that "training of subordinates and new recruits has been neglected" (36.0%).[29]

Dissatisfaction with evaluations frequently leads to a loss of motivation. *Nikkei Business Online* conducted a survey in 2007 that received 1082 responses. In answer to the question: "Does performance-based evaluation have an effect on your enthusiasm for your work?" 18% of respondents said it had increased their motivation, while 41.4% said it had lowered their motivation and 40.6% said it had no particular effect.[30]

In the aforementioned *Nikkei Business* survey carried out in 2009, in response to the question, "Has your enthusiasm for work increased since the introduction of a performance-based system?" 36.3% of respondents answered "No," while only 16.1% said their motivation had increased.[31]

3. Deterioration in Teamwork

A third concern is the negative impact on solidarity and cohesion within the organization, and a decline in teamwork. Employees increasingly tend to prioritize their individual work, and it becomes difficult to make progress with large projects on a company-wide basis. Employees come to feel that their responsibility is merely to ensure that their own results improve. They become less likely to help others and horizontal connections within the company weaken. People grow reluctant to share tips with coworkers or other departments for fear that this might improve a rival's evaluation and cause their own evaluation to drop in relative terms. This can interfere with the handing down of techniques and technology among coworkers and from senior to junior employees.[32]

4. Neglect of Training

A fourth problem is that because managers concentrate on improving their own evaluations, they tend to neglect training of the employees who work under them. McDonald's Japan, for example, introduced

a performance-based personnel and remuneration system in 2006. The aim was to build a corporate culture that would encourage young employees and create a culture of merit in the company. At the same time, the company carried out fundamental changes in its personnel and employment system that included doing away with mandatory retirement and seniority-based promotion and pay. Once the new system was actually implemented, however, veteran employees started to give priority to their own evaluations and no longer made an effort to train younger colleagues. Eventually, the company decided that its decision had been premature, and reverted to the old system in 2012.[33]

5. Resistance to Widening the Pay Gaps

Normally when a company introduces performance-based management, the total amount of money available for personnel costs per department or team is fixed. This means that in order to raise the reward for those members whose results have improved, it is necessary to lower the remuneration of other employees since the total amount cannot be increased. The more generously a company rewards employees who perform well, the wider the pay differential becomes with employees who received a negative evaluation. Managers in Japan who are used to the seniority-based system tend to feel a resistance to imposing this kind of difference on employees, and it frequently happens that even after a performance-based system is introduced, the system is not used as intended. Often companies end up with a kind of half-hearted system in place, with no significant gap in pay based on results and performance.[34]

Course Correction: The Move to Multilayered and Selective Use of Performance-Based Management

Reevaluating Introduced Systems and Shifting Back to Original Systems

By the early years of the twenty-first century, there were signs of a shift taking place. A number of companies that had introduced performance-based management and tried it for ten or twenty years began to revise their approach and correct course in response to in-house confusion or falling morale caused by the kinds of problems discussed above. Some companies went back to traditional seniority-based system, while others stayed with performance-based system but imposed limits on the range and extent of its applicability in an attempt to address the issues. Fujitsu received widespread attention when it introduced performance-based system in 1993 as

one of the first Japanese companies to adopt it. But the company's results diminished, and by the beginning of the 2000s it was forced to reverse course.[35] Mitsui & Co., Ltd. also introduced performance-based management in the second half of the 1990s but shifted back early in the new millennium after experiencing a host of problems.

At Q&A, a company that provides IT support services, a performance-based management system had been in place since the company's founding in 1997. Results were at first impressive, but around 2000 it became clear that a striking number of employees were being hospitalized or quitting because of illness. The company concluded that performance-based management was causing employees stress and that the company needed to change the system that was putting too much pressure on its employees. Accordingly, seniority-based pay was introduced.[36] Under the new system, basic pay was fixed according to seniority at a level designed to support employees' livelihoods. At the same time, however, bonuses were decided entirely by performance. The company arrived at the conclusion that a working environment in which employees could feel at ease and a corporate culture that placed a high value on colleagues and teamwork were particularly important in the service industry, and opted to design its personnel system along those lines.[37]

A 2009 survey carried out by the Ministry of Health, Labour, and Welfare revealed that the number of companies where results or performance were the main criteria deciding basic pay was in marked decline. Companies were definitely starting to take another look at the performance-based systems they had introduced a few years earlier. The questionnaire was sent out to 6147 companies employing at least 30 employees; responses were obtained from 4321 companies.[38] Regarding the criteria used to determine basic pay, those who said "results/performance" decreased considerably, accounting for less than half of answers in the cases of both managerial and nonmanagerial groups. By contrast, more than half of employees cited "results/performance" as the factor determining bonuses. The ministry analyzed the results as follows, "Companies are reexamining the idea of performance-based systems for basic pay, but performance-based systems seem more deeply established as far as bonuses are concerned." A tendency was developing for companies to move away from determining basic pay according to the previous year's results and return to the long-standing seniority practices; bonuses, however, continued to reflect performance over the past year in most cases. On promotions and appointments, many companies base

decisions on long-term results. It seems likely that most companies will settle down into a system along these lines.

Fair Evaluations

As noted above, the response given most frequently to a questionnaire regarding problems resulting from performance-based management was that evaluations were "unreasonable." Ensuring fairness in evaluations is a vital issue in any performance-based management system. Performance-based management is widely used as standard in European and American companies, and there too, the fairness of evaluations is considered crucial, and companies use a variety of measures to try to ensure fairness. Training exercises involving role-playing in small groups and discussions about issues arising are standard. Also, to make evaluations fairer and more objective, many companies incorporate feedback from team members and external customers in addition to evaluations by the immediate supervisor. This process of taking soundings and gathering objective information requires huge amounts of time. In some cases, reward specialists in the company will devote a month of every year to this task.[39]

One thing that makes it difficult to implement performance-based management effectively in Japanese companies is a problem with the personnel management system itself. In Japan line managers are not given authority over personnel decisions, including hiring and firing. In European and American companies, immediate supervising line managers, who are in the best position to observe the work of each individual employee, generally carry out the evaluations. Under this system, the direct, first-level supervisor reviews each employee under him and evaluates his performance through a formal rating system. Although the company also draws on relevant information from various sources, as a general rule the immediate supervisor takes responsibility for deciding each employee's evaluation. The supervisor has the authority to make personnel decisions, including hiring and firing. These authorities go hand in hand with responsibilities. Because supervisors are also subject to evaluations, if the evaluations they give to their subordinates are unfair, their subordinates will lose motivation and the manager's own reputation among his superiors and others in the company will fall. There is even the possibility of a pay cut or dismissal. In American and European companies, employees are highly sensitive to the matter of workplace fairness, and they will often approach a manager with a complaint if they feel

their evaluations are unfair.[40] A supervisor needs to be always prepared to defend his or her decisions. These factors tend to put significant pressure on supervisors to ensure fair evaluations.

Supervisors' lack of authority to hire or fire workers is a major difference between European and American systems and those in place in Japan. Some experts have even argued that implementing true performance-based personnel management is almost impossible in a context where line supervisors do not have sufficient authority over personnel decisions.

Moving Toward Mix-and-Match System

If a company is unable to guarantee fair evaluations under performance-based system and is likely to give rise to dissatisfaction and feelings of unfairness among employees, a seniority-based system that decides treatment of employees on the number of years of service presents fewer problems. The fact that years accumulate for everyone, in the same way, makes everyone equal. And evaluations are not the only stumbling point. Companies experience various other unforeseen problems after introducing performance-based systems, prompting many to reexamine and modify their policies, as noted.

However, there are also major drawbacks to the traditional seniority-based system. After all, it was to escape these drawbacks that many companies switched to a performance-based system in the first place. One major problem with the seniority system is that because length of service decides an employee's position and salary, it is difficult to reward performance. Young employees who work hard to improve results or hardworking enthusiastic and talented employees who achieve great things for a company will not be rewarded for their performance under a traditional system. This means that such employees tend to be less motivated than might otherwise be the case. One of the merits of a performance-based system is that an employee who works hard and produces results will receive a positive evaluation and see that performance rewarded in the form of a promotion or pay rise. Effective use of performance-based management is essential in order to bring out the intellectual energy and creativity of resourceful employees. Management can also keep overall personnel costs low by giving poor evaluations to employees who fail to produce results.

Considerations like this make a combination of the best elements of the performance-based system and the seniority system an attractive

option for many companies. As noted, surveys carried out by the Ministry of Health, Labour, and Welfare and other organizations suggest that a new standard is emerging among Japanese companies that previously adopted performance-based systems. Today many of these companies determine base salary on the conventional criteria of seniority and position and allocate bonuses by the results over the past year. In many cases, companies that previously introduced performance-based systems at all levels throughout the organization, including basic pay, have revised their policies and settled down to something similar to the system described above.

The most effective combination of performance-based management with seniority-based systems will vary according to the type and level of the position. In other words, performance-based methods are best introduced selectively depending on the position level within the organization, as will be discussed in detail in Chapter 6. The roles expected of employees naturally differ according to position level and so do the nature of the results expected of them. Therefore, some position levels within the company will need results to be more closely reflected in remuneration than others. An employee's needs and expectations regarding work also depend on the person's level within the company and specific life stage. Different employees will, therefore, react differently to the introduction of performance-based management.

The first thing that needs to be considered is that the correlation between results and remuneration should correspond to the amount of authority invested in an employee. This authority defines the sphere within which an employee can achieve results. In the case of a senior manager with a great deal of authority, a failure to improve results can fairly be blamed on the fault of the individual. This is not the case for a lower-level employee, however, with only a limited amount of authority; in this case, poor results may not be the individual employee's fault. Even in a system where basic pay is determined by seniority and bonuses are determined wholly or partially by results, it is appropriate to make the performance-dependent part of the pay larger for senior employees, imposing them higher standards, and make it smaller for the employees of lesser rank.

Many companies follow a scheme along these lines, with results deciding a relatively low proportion of the performance-based bonus paid on top of basic pay for junior positions and a considerably larger proportion for more senior posts.[41] Few Japanese companies use performance-based

systems for determining the pay of blue-collar employees. In European and American companies, too, the proportion of pay dependent on results is normally very low for blue-collar workers. Most unions are opposed to performance-dependent pay on an individual level, and demand the same pay for all workers in the same position.

Operational Measures to Improve Japanese-Style Personnel Management

Over the past twenty years, many companies have reexamined the practices of traditional Japanese-style management, and numerous reforms have been made to employment practices. At the same time, other companies have stuck firm to the basic fundamentals of traditional Japanese practices, including lifetime employment and seniority-based pay. Even these companies, however, have had to make adjustments and adaptations to allow them to confront fierce global competition and a rapidly changing market.

Demotion

Companies have implemented a number of measures in order to reduce the impact of the drawbacks of Japanese-style management without giving up what is positive about it. One of these is demotion of employees. Demotion makes it possible to introduce a partial merit-based system while maintaining lifetime employment and the seniority- and position-based pay. By demoting underperforming employees, management can bring remuneration into line with results and ability.

In the Japanese system, dismissing an employee, even one whose performance has failed to improve over a number of years, is extremely difficult. Because companies lack the ultimate sanction of dismissal, employees' sense of responsibility can be impaired and people can become complacent. As a way of dealing with these drawbacks, while maintaining the lifetime employment and seniority system, a number of companies have introduced the abovementioned policy on demotion. In other words, employees whose appraisal scores remain low for several evaluations are subject to demotion, and those with high scores are considered for promotions and salary increases. Because downgrading means being moved to a lower-ranked position, it also entails a reduction in salary. This makes it possible to maintain discipline while also allowing a company to reward productive employees with treatment that matches positive results.

Company "C" mentioned earlier, for example, maintains a mostly traditional Japanese-style approach to management, but has introduced a performance-based system for a certain number of positions and ranks by carrying out selective downgrading. In the following passages, I will introduce the system as it is used at Company C.[42]

The company's approach is to maintain lifetime employment and seniority-based pay, while aiming to reward ability and performance in the long term with promotions. The personnel managers at the company believe that lifetime employment is a rational system that has the merit of encouraging a sense of unity and commitment within the organization. However, for managerial positions, remuneration and promotion are decided without regard to seniority. Instead, results and ability are reflected in pay and promotion (at Company "C" this is known as *jitsuryoku-shugi*, or "merit system"). The company also downgrades employees for poor performance shown on appraisals.

Around 5000 out of a total of approximately 25,000 employees are in managerial positions. Of these, around 150 are demoted each year. Because this means a move to a lower-ranked position, it entails a reduction in salary. Demoted employees may seek another position by applying to advertised vacancies within the company. This practice also applies to 200 senior managers (department head [*buchō*] and above).

Demotion following a poor performance evaluation is not an option for nonmanagerial, rank-and-file employees who are union members. The company regards the first ten years as a training period and remuneration until the end of this period is based on seniority and position. There is no remuneration based on results. The merit-based system applies starting ten years after an employee enters the company. In fact, some differences in pay start to appear around three years after employees join. Employees undergo aptitude tests (consisting of a written essay, work simulations, interviews, etc.), and may be promoted to a higher rank depending on the results of these tests, so that annual pay may differ among employees who entered in the same recruitment year by as much as a million yen, even during the initial ten-year period.

Real merit-based evaluation begins ten years after employees join the company, when they are normally in their early 30s. The C company's business involves large amounts of research and development work, making it well suited to a merit-based approach. Managers can evaluate employees using clear criteria, such as whether or not they were able to develop a product by a certain date. An MBO system was introduced for

a time, but subsequently abandoned for three main reasons: (1) Much of the company's work being in the area of research and development, it was difficult to set numeric values for objectives; (2) The difficulty of achieving objectives in one year; and (3) Because work is done in teams, it is hard to draw a line between individual achievements and those of the team.

Evaluations are carried out on both an absolute basis and relative basis in each section, and the data adjusted after examining the data from all sections at a meeting of section chiefs. Relative assessment is used to decide remuneration, while absolute assessment is used to decide the direction of the employee's training. Employees are urged not to overreact to a single positive or negative evaluation. Instead, employees whose assessments are low are encouraged to work harder to improve their performance in their next evaluations.

Company C says that it wants to maintain a corporate culture that values teamwork. For this reason, if there are some business divisions performed better than others, management uses an average for the whole of divisions rather than simply increasing the performance-based pay of those divisions that did well.

Promotion of Nonpermanent Employees to Permanent Status and a Shift in Emphasis from Hiring Nonpermanent to Permanent Employees

Another way in which companies adapt their practices to a changing business environment while remaining inside the framework of Japanese-style personnel system, relates to treatment for nonpermanent employees (*hi-seishain*). This involves systematic promotion of nonpermanent employees to permanent (*seishain*) status, or a switch to hiring permanent rather than nonpermanent employees to fill a particular position. Both of these bring nonpermanent employees, not covered by the practices of Japanese-style management, into the realm of permanent employees. Companies hope that these reforms will help to increase commitment and motivation.

Promotion to Permanent Employee Status

One of the biggest changes in the Japanese labor market has been the vast increase in the number of nonpermanent employees. The number of nonpermanent employees (fixed-term contract employees and part-time employees) in advanced countries has continued to increase over the past

three decades. In Japan, too, there has been a significant increase in the number of these nonpermanent employees, who do not receive the same benefits as permanent employees, from 8.7 million in 1990 to 12.58 million in 2000 and 19.6 million in 2014, by which time they made up 37.4% of the total employed population.[43]

For companies that have come to rely on nonpermanent employees for a substantial part of essential work, management of these employees, who now form a substantial part of the workforce, is an important issue. One measure taken by these companies is to try to shrink the gap in pay and other treatment between permanent and nonpermanent employees; another is to open up a path for employees to be promoted from nonpermanent to permanent status. In a survey carried out in 2013, employees in nonpermanent positions were asked why they were in their present position; 31.1% of male employees responded that they would have preferred a permanent position, but had been unable to find one. This was the most popular response. Among women, 27% (the highest percentage) said they were working to help out with household expenses. Only 14.8% of women said they wanted a position as a permanent employee.[44]

This shows that the population of nonpermanent employees includes people with diverse lifestyles at different stages of their lives; not all of them want the same working pattern. Although many would eagerly become full permanent employees given the chance, others are satisfied with a more flexible style of work, and do not want to be tied down to the time commitments expected of permanent employees. Consequently, as part of reforms of personnel system for nonpermanent employees, in addition to reducing the gap in treatment (pay, etc.) between permanent and nonpermanent employees and offering opportunities for promotion from nonpermanent to permanent status, it is also important to present employees with a variety of employment patterns.

At Company A, for example, a major retail company, as at most Japanese companies, until the 1980s the bulk of the company's work was done by permanent employees, and the work performed by nonpermanent employees was less than 50% of all hours worked. Until this period, the roles were clearly divided; permanent employees did the "main" work and the nonpermanent workers (mostly women) helped out. The permanent employees represented the core of the workforce, and the role of nonpermanent employees was limited to peripheral tasks. Within the company, there was a prejudice that saw the nonpermanent workforce as being of limited ability, which made it difficult for a nonpermanent employee to ascend to permanent status.

In the 1990s, however, the proportion of nonpermanent employees increased rapidly, and by 2003 nonpermanent employees accounted for 80% of all hours worked. The company had no choice but to take the motivation of nonpermanent employees into account when formulating its human resource policies. The company, therefore, decided to streamline various employment patterns developed over several decades and to show employees a clarified division of patterns according to employment conditions.[45] To this end, permanent employees were divided into two status categories and nonpermanent employees into three, employment conditions were presented for each category, and individual employees were given the opportunity to choose the category according to their needs.

The two categories for permanent employees are (1) national members and (2) regional members. The former can work full-time until the retirement age of 60, are transferred nationwide and abroad, and are paid monthly. The latter can work full-time until the retirement age of 60, are transferred only within one of four areas into which the nation is divided, and are paid monthly.

The three categories for nonpermanent employees are (1) community members, (2) expert members, and (3) part-time members. Community members are full-time or part-time fixed-term employees, are transferred only within a range where it is not necessary to change their place of residence, and are paid monthly or hourly. Expert members are professionals who work full-time for a fixed term, are transferred only within a range where it is not necessary to change their place of residence, and are paid monthly. Part-time members include students employed for a short-term and part-time employees aged 60 or over. They are paid hourly, and their contracts are not renewed.

In addition to explicitly showing the employment conditions by status category, Company A decided to establish a new, "community member system" that would enable the promotion of nonpermanent employees to core members. Those who joined the company as a community member can be promoted to a certain level if they receive on-the-job training. Further promotion requires passing the qualifying examination (written and oral) that permanent employees are required to take. If community members pass the examination, they can be promoted to managerial posts such as general store manager, vice store manager, or store manager of a medium-sized or small store. Community members can become permanent employees (national or regional members) after being promoted to a specific rank (floor manager, etc.).

New systems are often introduced when a new store is set up because it is difficult to integrate a new system into an existing store. To take an instance, in opening a new store, Company A hires 600 permanent employees and 600 community members instead of 1200 permanent employees. The hourly wage for lower-level jobs, such as Duty I, is the same as in the past, but the salary for community members at the level of store manager is increased. However, there is a difference in working conditions between permanent employees and community members: The former are transferred, while the latter are not. Thus, it is necessary to attain a proper balance that reflects this difference. Although improved treatment of community members is important, permanent employees will complain if their salaries are the same as community members. Therefore, the annual salary of community members is fixed at a rate between that of permanent and part-time employees. To quote the actual figures, the annual salary of community members, part-time employees, and permanent employees are, respectively, 3 million and 800 thousand yen, 2 million and 700 thousand yen, and 4 million and 500 thousand yen.

These new systems apply merit-based evaluations to some nonpermanent employees, making it possible for them to be promoted and get pay raises, and reducing the gap between them and permanent employees on salary, fringe benefits, and other aspects of compensation. Also, by introducing a systematic path by which they can make the switch to permanent status, the company aims to reduce the gap in status between different types of employees. The community member system has had a positive effect; it has provided community members with more opportunities for promotion and brought them awareness and a sense of responsibility.

Q&A, another company mentioned earlier, also divides employees into a total of seven different categories: two categories of permanent employees to whom lifetime employment and seniority-based pay apply, and five categories of nonpermanent employees to whom lifetime employment and seniority-based pay do not apply. The seven categories are: (1) Visiting staff, (2) Temporary employees (dispatched from outside the company), (3) Nonpermanent staff (short hours), (4) Nonpermanent staff (long hours), (5) Contract employees, (6) Specialist and management-track positions, and (7) Upper-level specialists and senior management.[46] ((1) through (5) are nonpermanent employees, (6) and (7), permanent employees.)

The company's aim is that employees can choose the status category that best suits their lifestyle choices. It is also normally possible to move from one category to another. One woman worked as a Type (3) and (4) nonpermanent employee while she was looking after young children, but later became a permanent employee and now works in a managerial position.

Greater Priority to Hiring Permanent Employees

Another change that has accompanied restructuring over the past twenty years has been a movement on the part of companies to have nonpermanent employees do some of the roles that had been performed by permanent employees. Recently, however, a number of companies are changing their policies and recruiting permanent employees again for these roles. These companies assume that commitment has a significant impact on performance and productivity in carrying out these roles. The switch to a permanent employee position is designed to achieve the necessary level of commitment.

All Nippon Airways, for example, started hiring its cabin attendants as permanent employees from the recruitment in spring 2014; previously these roles had been filled by contract employee hires.[47] ANA used to hire cabin staff as permanent employees, until the airline decided in 1995 to cut personnel costs by hiring contract employees from that spring. Under this system, employees could attain permanent status after working three years as a contract employee, but around 10% of employees continued to leave the company to get married or for other reasons before becoming permanent employees. The company decided to revert to hiring staff as permanent employees beginning in 2014 in order to secure a regular supply of high-caliber personnel. The company also makes it possible for staff currently employed as contract employees to become permanent employees. This marks a reversion to hiring cabin staff as permanent employees after a gap of twenty years for ANA. Part of the reason behind this decision was apparently the television footage shown following an accident involving an Asiana Airlines plane at San Francisco in July 2013, when a senior female cabin attendant was seen carrying passengers on her back to safety. These images are said to have reminded airline managers of the importance of cabin staff in ensuring safety.

Hiring cabin staff as permanent employees will mean an increase in personnel costs due to the need to pay retirement payments

(*taishokukin*) and other benefits, but the company says it hopes to reduce costs by reducing the number of employees who quit after short terms of service. The switch from contract to permanent employee will do away with the need for annual contract renewal, and employees will benefit from improved treatment, including an increase from 10 to 20 days paid annual leave. Employees will be able to set their careers to suit their lifestyles, incorporating events like marriage and childcare.

Japan Airlines, which had decided in 1994 to switch from hiring cabin staff as permanent employees to relying on contract workers, also reverted to permanent staff hires from the recruitment in spring 2016.[48]

First Retailing, the parent company of Uniqlo, a producer, and retailer of casual clothing, converted 90% of nonpermanent staff to permanent employee status in April 2014. This was apparently to secure a high-quality workforce and respond to a personnel shortage. Personnel costs will increase by 20%, but the company says it hopes to reduce the time and money spent training new hires and avoid wasted investment in short-term employment.[49]

This chapter has looked at personnel and employment systems and practices and the internal decision-making structure of Japanese companies, tracing the historic origins of what is known as "Japanese-style management," defining its ideal types, and showing how it is being practiced today. By analyzing the current situation, I have shown what has changed in Japanese management and what is likely to survive into the future. I also considered likely changes in the years to come. The next chapter examines intercompany networks—i.e., a company's relationships with other companies, and its corporate governance system. It analyzes the current state of these systems and gives a view of what they will be like in the future.

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CHAPTER 3

Intercorporate Networks and Corporate Governance: The Present and Future

This chapter analyzes Japanese systems of intercorporate networks centered on "keiretsu" and corporate governance practices, and assesses the future directions they will take. In Japan, intercorporate networks and corporate governance system are closely associated with the practices of internal organizational management—those concerning personnel, employment, and internal decision-making dealt with in Chapter 2. As mentioned in Chapter 2, the Japanese-style corporate management is made up of four systems, i.e., personnel and employment, internal decision-making, intercorporate networks, and corporate governance. Supporting one another, these four systems form what is known as distinctly Japanese corporate management. How does this Japanese corporate management differ from that of other countries? And where does the Japanese economic system built around these practices stand in terms of the framework of the comparative analysis of capitalist systems?

Since the demise of socialism in Eastern Europe in 1989–1990, debate on institutional diversity in different capitalist economies has gained increasing attention. As discussed in detail in the following section, the standard approach was to organize the various capitalist economies of the world according to how closely they adhered to the principles of free-competition and free-market liberalism. This made it possible to arrange countries on a spectrum according to the extent to which the principles of market competition operate. As explained below, however, in practice capitalist countries of the world can be sorted into

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two main groups: countries where market principles operate to a relatively large extent and those in which they operate to a relatively small extent. The former group includes the "Anglo-Saxon" countries such as the United States, the United Kingdom, Canada, and Australia. The second consists of countries like Germany, Japan, Switzerland, the Netherlands, Sweden, and Denmark. In this book, the economic systems of countries in the first group—capitalist systems more faithful to the laissez-faire principle—are referred to as the "Anglo-Saxon model." I will refer to the second type of capitalist system, in which market principles play a less important role, as the "coordinative model."

Although the countries assigned to these two categories share certain core characteristics of respective categories, they nevertheless differ considerably on numerous points of detail. Let us take the Japanese system discussed in this chapter, for example, including the keiretsu and corporate governance. Although the system does have certain characteristics in common with the coordinative model, many aspects are unique to Japan and stem from the country's historical and cultural background. This chapter begins with a discussion of recent contributions to the comparative study of capitalist economies and looks at the main characteristics of the Anglo-Saxon and the coordinative model. Next, I analyze the Japanese system, which has its own distinctive qualities in addition to those it shares with the coordinative model, focusing on the keiretsu and corporate governance. I look at how these systems have changed over the past twenty-five years and try to discern the likely direction in which they will develop in the future.

The Diversity of Capitalism and Comparative Institutional Analysis

Historically, most of the countries that are now considered "advanced nations" passed through stages of development that are in many respects universal, developing the various institutions of modern capitalism and becoming members of today's global market economy. These countries share the common factors such as market mechanism, corporate organization, and technology. But there are many differences too, particularly with regard to their institutional foundations and the ways in which these institutions are managed. The fall of the Berlin Wall in 1989 and the collapse of socialism that followed marked a major turning point in the comparative study of economic and social systems focusing on the institutional diversity among countries.

Classifying Different Types of Capitalism

Since 1990, as the former socialist countries of Eastern Europe and other regions have entered the capitalist economy, more and more countries have come to participate in the globalized market economy. Today, in almost all the developed countries, a market economy operating on the principles of free competition is accepted as the most realistic and reasonable system. The collapse of socialism rendered meaningless the debate over the comparative advantages of capitalism versus socialism. Instead, economists turned their attention to differences within the capitalist camp. Now that socialism has more or less disappeared and capitalism enjoys a position of almost undisputed precedence, the distinctions between the economic systems of various countries are mostly matters of degree. Economies differ in how thoroughly they pursue profit maximization, or in the extent to which they leave the market to its own devices on laissez-faire principles. Both these issues are linked to the question of how much the state should interfere with and coordinate the economy.

Since the 1990s, in response to these circumstances, cross-national studies that compare capitalist institutions of different countries have been at the core of the economic debate in Europe and the United States. Among these studies, some use an elaborate theoretical framework to analyze various dimensions of social and economic systems, and others are based on empirical verification using statistical data and quantitative analysis. Let me provide a brief summary of a few of the more important contributions to the field of comparative institutional analysis since the 1990s.

One of the first studies to compare the various systems in the capitalist countries was *Capitalism Against Capitalism* by Michel Albert, published in 1991. Albert argued that economic policies fall into two basic approaches, which he named the "Anglo-Saxon" or "neo-American" model and the "Rhine" model.[1] Albert characterized the Anglo-Saxon model practiced in the United States and the United Kingdom as being focused on individual achievement, short-term profits, and laissez-faire government. By contrast, the Rhine model followed in Germany, Switzerland, the Scandinavian countries, and partially in Japan, values collective achievement and public consensus and, according to Albert, has the long-term success of the society as a whole as its aim.

Albert compared countries according to three criteria: (1) security of civic life (protection from illness, unemployment, family breakdown, etc.); (2) reduction of social inequalities; and (3) openness of society and

socioeconomic mobility.[2] He rated the Rhine model higher on the first two criteria and the neo-American model higher on the third. Overall, he believed that the Rhine model worked better both in terms of efficiency and fairness. Despite this, he felt with some alarm that most capitalist countries, as well as most of the former socialist states, were moving rapidly not toward the Rhine model but in the direction of the Anglo-Saxon model.

In *Varieties of Capitalism* published in 2000, Peter Hall and David Soskice presented an elaborate study to analyze the major capitalist political economies in terms of their institutional foundations. Drawing on the core distinction between "liberal" and "coordinated" market economies, they employed a broad spectrum of data to compare the OECD countries and categorize them as either "liberal market economies" (LMEs) or "coordinated market economies" (CMEs). These two models are used as ideal types placed at the poles of a scale, as it were; the various economic systems actually in use are positioned between the two forms according to institutional variations.[3]

In his 2003 book, *The Diversity of Modern Capitalism,* French economist Bruno Amable sorted the OECD countries into five types based on the features of the following five "institutional areas": product-market competition; labor relations and labor-market institutions; financial intermediation sector and corporate governance; social protection and the welfare state; and education. Amable's five models of capitalism are: (1) the market-based (Anglo-Saxon) model, (2) the social democratic model, (3) the Continental European model, (4) the Mediterranean model, and (5) the Asian model.[4] Amable argued that previous studies had tended to give too central a place to the United States as the representative form of capitalism, and that this tendency had led many scholars into dichotomization of the United States and other countries and toward oversimplified comparisons between them. Previous studies, he argued, had limited their purview to a small number of institutional areas in a handful of countries. Amable's response was an empirical analysis of the economic institutions functioning in 21 OECD countries, presenting a corrective to previous studies that had looked at different economies from an Anglo-Saxon market-based perspective.

Amable's comparison of economic systems was organized around the extent of laissez-faire in each country, the extent to which the market was left to its own devices, and the degree of leeway the government had to intervene in the market for coordination purposes and impose regulations. In this respect, his analysis does not differ markedly from that

of Hall and Soskice. However, Amable divides the CMEs put forward in Hall and Soskice's work into two categories: a "social democratic" model (Sweden, Finland, Denmark, etc.) and a "Continental European" model (France, Germany, Austria, Belgium, etc.).[5] In general, countries belonging to the "social democratic" group have a more developed welfare state and a higher level of social protection, and they are characterized by more coordinated wage bargaining system.[6]

Although Amable's five models also includes an "Asian" and a "Mediterranean" model, these are residual categories, as it were. Given that he discusses his social democratic and continental models as examples of "coordinated market" economies, his five-part categorization does not differ widely in terms of the core classifying principle from Hall and Soskice's division of the developed economies into LMEs and CMEs.

All three of these studies—Albert's two-way contrast between an "Anglo-Saxon" and a "Rhine" model, Hall and Soskice's division into LMEs and CMEs, and Amable's grouping of economies into "liberal market" and "coordinated market" types (the latter type including the "social democratic" and "Continental European" model)—can be said to use the same basic approach, for all three of them compare developed countries according to the relative extent to which the principles of the free market and coordination function in the economy. Although the ideal types presented in the studies differ in a number of ways in their details, their main characteristics nevertheless have a good deal in common.

Two Models of the Market Economy

The Anglo-Saxon model of capitalism developed in the United Kingdom and the United States, where the industrial revolution first took place and capitalist market economy first developed and became widely established. Compared to other forms of capitalism, the Anglo-Saxon model is marked by a more thoroughgoing adherence to market principles and a more uncompromising implementation of the laissez-faire principle. The coordinative model, by contrast, is a significantly modified form of market capitalism. In the attempt to correct the inequities that can result from adhering too closely to market principles, it allows the state to intervene and coordinate the markets to a greater extent than the Anglo-Saxon model, and protect citizens through the development of social welfare systems.

As we have seen, Albert, Hall and Soskice, and Amable all base their comparisons of the developed world's economic systems on the extent to which each adheres to market principles. They categorize capitalist economies into two main groups, which I refer to as the Anglo-Saxon and the coordinative models. In comparing and analyzing the ideal types of these two forms of capitalism, I will focus on the companies that are at the center of all capitalist systems in order to make the terms of the discussion more concrete.

A company is an economic entity that exists to profit from economic activity, which may include developing, producing, distributing, and selling goods or services. A company develops relationships internally with its employees. Externally, it has relationships with such stakeholders as clients, the companies it does business with, affiliates, suppliers, trade associations, local community, and government agencies, as well as a variety of other actors. Insofar as a company's ability to achieve its aims depends to a great extent on the relationships it can establish with these actors, it is vital that the company coordinates these relationships in a wide variety of ways. A company needs to manage its relationships with various actors—labor relations, corporate governance, relationships with other companies, vocational training, and relations with its own employees. The solutions a company finds to the challenge of coordinating and managing these relationships are of crucial importance. A key factor determining whether or not a corporation succeeds or fails is the quality of the relationships it builds with these various actors.

In the Anglo-Saxon model, free competition and market relationships are prioritized in the coordinating process. In the coordinative model, on the other hand, the coordination problems are resolved through state intervention and the legal system, or by following the practices of coordination and cooperation established by them. The two economic models, therefore, use two quite different approaches to address the coordination problems. In what follows I compare the Anglo-Saxon and the coordinative model, focusing on corporate behavior, and explain the characteristics of the two systems.

The Anglo-Saxon Model

In the Anglo-Saxon model, companies rely heavily on arm's length market relationships to solve coordination problems. Companies coordinate their activities primarily through arrangements based on corporate hierarchies and the principle of market competition. Within the Anglo-Saxon

model, market relationships are characterized by competition and formal contracts that regulate the exchange of goods and services. The market provides effective means of coordinating many aspects of the activities of economic actors.[7]

The labor market is quite flexible and is characterized by a low level of regulation. Companies are able to hire and fire employees with relative ease in order to take advantage of new opportunities. It is normal for workers to move between companies, and short-term employment contracts are common. Workers are often headhunted for high salaries to fill an immediate need. Companies often rely on the fluidity and flexibility of the labor market to absorb the adverse shock they cannot fully absorb by price adjustments. To a considerable extent, competitiveness depends on this labor market flexibility.

In the Anglo-Saxon model of a liberal market economy, companies depend on short-term funds centering on the stock market for the bulk of their financing. External oversight of companies through the market is stronger than in other models, and shareholders frequently exert a controlling influence over companies through the stock market. This system of corporate governance is known as the "outsider," "external monitoring," or "open" model of corporate governance. Since companies rely on the stock market for financing and shareholders exert a powerful influence over corporate behavior, they need to constantly pay close attention to their revenue and profits and their latest share price on the stock market. Laws on mergers and acquisitions are fairly relaxed and companies can be bought and sold with relative ease. If a company's market value drops, the possibility of a hostile takeover arises. A company's ability to raise funds depends on the market valuation of the company, and individual investors judge companies by making use of publicly available information. Compared to the bank-derived financing that is the mainstream in the coordinative model, financing through the stock market is less patient but more responsive.[8] Pension funds and other institutional investors have a significant influence, and the stock market and venture capital market tend to be active and well developed.

The leading examples of the Anglo-Saxon model of market economies are the United States and the United Kingdom; other examples among the OECD countries include Canada, Australia, New Zealand, and Ireland.[9] In these countries, it is common even for professional employees and managers to change companies, and employees with skills in high demand are headhunted for high salaries and dropped into

particular positions immediately. Because of this, there is generally little company-led training or education of employees. New ideas and technology spread when engineers and scientists are headhunted or otherwise move jobs. The sale of new technology through licensing and patent agreements also plays an important role. Because in theory opportunity is available equally to all in an ideal free-market economy, there is a strong tendency to regard success and failure as largely due to individual effort.[10]

The Coordinative Model

In a coordinative market economy, companies rely to a much greater extent on nonmarket, noncompetitive, cooperative relationships to coordinate their activities with other actors. Compared to market-based coordination, this model requires a wider-ranging, interdependent contract, or a more incomplete contract, as well as network monitoring based on exchanges of private information within networks.[11]

Financing and corporate governance work quite differently from the norms that prevail under the Anglo-Saxon model. Corporate financing comes largely from banks. In many cases, companies can obtain "patient capital," and do not have to rely only on access to financing that is dependent on publicly available financial data and current revenue. This makes it possible for companies to retain skilled labor without the need for layoffs during an economic downturn. It also allows them to invest in projects likely to generate a profit only in the long term. As global competition intensifies, however, the reality is that even in coordinative markets labor market regulations are reasonably relaxed, and labor is much more flexible than it once was.[12] In general, coordinative market economies traditionally place a higher value on employee training than the Anglo-Saxon model. And on the premise that misfortunes can happen to anyone, a priority is given to coordination through nonmarket channels, in the belief that society needs to provide relief to its weakest members.[13]

Under this kind of system, financing and investment are not dependent on published data or information available on the company's balance sheet. In many cases, prospective investors obtain information on the performance of a company and its current projects through another method. Unpublished internal information plays an important role—normally obtained via the close-knit networks that exist between organizations.

These networks link the managers and professional personnel of one company with the managers and professional personnel of other

companies, with the aim of sharing reliable information about potential investments. Investors also obtain information about companies via their close relationships with suppliers and clients, cross-shareholding networks, and by joining trade associations that gather information on companies in a given industry. In the coordinative model, wide-ranging systems generally exist for monitoring based on reputation and evaluations within the networks, securing the reliability of the information.[14] Investors use this information to take decisions and monitor company performance to ensure the value of their investments.

Representative examples of the coordinative model are Germany and Japan. Other examples among the OECD countries include Switzerland, Austria, the Netherlands, Belgium, Sweden, Norway, and Denmark.[15]

The overall structure of the market as a whole also affects corporate governance. In the coordinative market economy, the "insider" model or "internal monitoring" is the most commonly practiced style of corporate governance. Under this system, monitoring of a company from within the network plays an important role. This monitoring is performed by stakeholders with a close relationship to the company and a concern in its long-term survival and interests.

In this type of system, companies frequently finance their activities from retained earnings. This means that they do not have to rely entirely on external financers, and therefore are not as sensitive to the matters of their own profitability or financial data which, if they were obtaining loans from outside, would have a decisive influence on the terms of financing. But if there is a risk of a hostile takeover from outsiders promising to extract more value, the company will be forced to concentrate on current returns and shareholder value. From the company's point of view, along with cross-shareholding networks, regulations, and legal measures that restrict hostile takeovers and mergers are therefore of great significance.[16]

In many coordinative market economies, an internal decision-making mechanism based on consensus encourages sharing of information, makes network monitoring easier, and thus facilitates the functioning of insider-model corporate governance. For example, the Japanese practice of consensus decision-making and collective responsibility, discussed in Chapter 2, as well as the intercorporate networks and corporate governance discussed later in this chapter, work together to form an overall system that values consensus and agreement.

In a coordinative economy, industrial relations are adjusted in the framework of an institutionalized balance of power. In other words,

bargaining patterns are established so as to make it possible to attain compromise acceptable to both sides.[17] In Germany, for example, cooperation is organized between labor and management and between companies in order to secure and maintain skilled workforce. Wage levels are determined through negotiations between industry-wide labor unions and employer associations. Generally, wage levels are set up for an entire industrial sector following a "leading" agreement, in which the unions are in a strong position and are able to extract favorable conditions.[18] This system equalizes wages at the same skill level across an industry and makes it harder for companies to headhunt workers. It allows workers to obtain the highest practicable level of pay, but requires of them a commensurate commitment to their company. It also helps to keep wage inflation down by coordinating labor relations on a nationwide level across the economy.[19]

In Germany, this coordination of the labor relations is supplemented at the company level by the *Betriebsrat*, or "works council." The *Betriebsrat* is a labor–management consultation body made up of elected employee representatives that holds considerable authority over personnel matters and working conditions. Together with the industry-wide labor unions, it makes up a two-dimensional system for coordinating labor–management relations.

Japanese Capitalism: Its Characteristics and Relationship to Other Types of Market Economy

As we have seen, the various models of capitalism found in the developed economies can be broadly divided into two categories according to the extent to which they allow the principles of a competitive free market to operate: the Anglo-Saxon and the coordinative model. Japanese capitalism fits the second of these models. Most of the comparative studies I have mentioned focus on examples drawn from Europe and North America and do not contain detailed discussions of the situation in Japan. In all cases, however, Japan is classified as an example of an economy in which adherence to free-market principles is comparatively weak and in which there is a relatively high degree of state intervention and coordination. The Japanese economic system does share many characteristics in common with the coordinative model, leaving little room to refute that categorization. Nevertheless, as already mentioned, the Japanese economic system is also characterized by a number

of distinctive features arising from the country's particular historical and cultural background.

At the Opposite Pole from the Anglo-Saxon Model

In some ways, the Japanese model of capitalism can be seen to depart even further from the basic principles of capitalism than the social democratic version of the coordinative model, given that the government significantly interferes to limit free competition. The system has pronounced communal and even socialistic tendencies. These can be found in many aspects of Japanese society, and together they make up the Japanese system as a whole. In the Japanese system, large companies coordinate wages and labor relations as they maintain cooperation and communication with other companies within meso-level organizations and groups, including the keiretsu, trade associations, and employer associations. These intercorporate networks operating at the meso level occupy an intermediate position between the management practices of individual companies and the national and international forces that shape the macroeconomy and industrial policy, and serve to link these two. Along with the state, these networks perform an important role in coordination.

This is the reason why some Western scholars use phrases like "alliance capitalism" to describe Japanese-style capitalism.[20] Some scholars previously used the phrase "state capitalism" to refer to the Japanese model, but today that phrase generally refers to the economic systems of former communist countries, Russia, in particular, where state control of the economy is incomparably stronger than in Japan.

Table 3.1 (Classification of Capitalist Systems) shows a variety of capitalist systems classified to illustrate the characteristics of the Japanese model from an international perspective. The horizontal axis shows the degree of state intervention in the economy, or the degree to which country's economy is market-principle-oriented. The vertical axis shows the extent to which market principles operate in the management of individual organizations.

In the Anglo-Saxon model, free-market principles operate powerfully in both the market as a whole and within individual companies. In the social democratic welfare states, free-market principles operate at the level of individual companies though not to the extent of the Anglo-Saxon model. But here, unlike the Anglo-Saxon model, the state intervenes significantly at the level of the wider society. In the Japanese model, market

Table 3.1 Classification of capitalist systems

		Market		
		Small ←	*State intervention*	*→ Large*
		Liberal market capitalism	*Coordinative market capitalism*	*State-controlled capitalism*
Firm	Market-oriented	Anglo-Saxon model market capitalism (US, UK)	Social democratic welfare-state capitalism (Germany, France, Sweden, Denmark)	
	Organization-oriented		Japanese model community-oriented capitalism (Japan)	State capitalism (China, Russia)

principles function to a much smaller degree than in the Anglo-Saxon model both in corporate organizations and in the market. The countries where there is still more state intervention than Japan are state-controlled capitalist countries such as China and Russia. In discussing institutional variations of capitalist economies, scholars in the United States and Europe normally focus on the OECD countries, and generally do not consider China and Russia in their comparisons. However, I have put them in a category of their own in this table for the sake of comparison. These state-controlled economic systems differ significantly from the coordinative model of capitalism, lacking the coordination mechanisms established in OECD countries that employ the coordinative model. In state capitalism of this kind, there is an extremely high degree of state intervention both in the markets and in corporate organizations. This distinctive characteristic makes it appropriate for these countries to be placed in a separate category of their own.

The classification in Table 3.1 is simplified for the purpose of comparison, and the arrangement strictly relative. And as mentioned in Chapter 2, the Japanese system has changed significantly as a result of the restructuring and economic turbulence of the past twenty-five years. The transformation of the Japanese system over time in the spheres of intercorporate networks and corporate governance will be discussed later in this chapter. Nevertheless, when we compare the Japanese case with other countries, the influence of the traditional system continues to be significant.

Mechanisms Limiting Free Competition

As we have seen, most scholars see the Japanese economic system as a version of the coordinative model similar to the social democratic economies of some European countries. The Japanese model of community-oriented capitalism does indeed share certain similarities with the modified capitalism of the social democratic countries, insofar as it places high value on equality and limits the working of market principles to achieve this. One major difference is how this is done. In Europe and North America, these adjustments or "modifications" of capitalism are carried out through systems in the social sphere, chiefly by means of the social welfare system. In Japan, on the other hand, the modifications of capitalism based on socialistic concepts are made through organizations in all spheres, including those of the economy.

"'Yes' to market economy, 'no' to market society." These words of the Socialist Party prime minister of France Lionel Jospin became famous. In Europe and North America, it is generally assumed that economic activities primarily operate according to market principles. In order to minimize the problems generated by a market economy and maintain social unity, a separate public mechanism is thought to be required. This is the welfare system, built on community-oriented thinking, which is entirely different from market principles. The political right and left differ on how much the government ought to intervene to "correct" the market. But the idea that although a degree of social regulation is necessary economic regulation should be kept to a minimum in order to encourage free competition, is generally accepted across the political spectrum. In Japan, however, there has been a tendency to restrict market principles in all spheres—political, economic, and social—and for the principles of community to operate in their place. This is closely related to the important role played throughout Japanese society by intermediate "pseudo-*ie* (family)" organizations, including private corporations, which exist between the municipality or state level and the family. I will discuss this in more detail in Chapter 4. These intermediate pseudo-*ie* organizations have had a decisive influence on the characteristics of Japanese social structure as a whole.

What follows is an analysis of Japanese-style intercorporate networks and systems of corporate governance. Focusing on their distinctive characteristics, I trace some of the ways in which these systems have changed over the past twenty-five years and look ahead to how they are likely to develop in the future.

The Fate of the Keiretsu

Many scholars and policymakers in Japan and other countries have been interested in the uniquely Japanese corporation networks, of which the keiretsu are the most distinctive institutions. These conglomerates occupy an intermediary position between the internal managerial practices of individual companies and the wider forces that designate the macroeconomy and industrial policy at the national or international level, and bind the two together. The networks function as elaborately structured institutional frameworks that plug the primary decision-making units into complex networks of cooperation and competition. Of course, such networks are not limited to the keiretsu. Groups of small enterprises (*shōkigyō shūdan*) and strategic tie-ups also play a role. Nevertheless, it is the keiretsu that have played the most important role in the system of intercorporate relationships in Japan.

Characteristics of Japanese Keiretsu

Similar relationships exist to a certain extent in other countries. Particularly since the 1980s, various types of complex networks known as "strategic alliances" have been proliferating in the United States, the EU, and other regions. Nevertheless, the keiretsu differ markedly from this pattern of intercorporate network of cooperation in the nature of the relationship between the companies involved.

Strategic alliances provide a framework within which corporations can cooperate in specific areas of corporate activities—developing new technology, for example. Except in rare cases, they do not significantly change the relationship between the participating companies, such as by changing the companies' ownership structure or basic conditions of operation. In Japan, however, in most major keiretsu groupings, the direct and indirect ties between the companies within the keiretsu group are deeply enmeshed with the complex interests of the group as a whole. Most importantly, companies define one another's ownership structure through cross-shareholdings and reciprocal equity investment. Many Japanese companies are in a cross-shareholding relationship with keiretsu companies or affiliates or with their main banks. These corporate shareholders do not hold these shares for reasons of genuine investment; rather, the purpose is to strengthen the relationship and exclude outside interference. A company in a keiretsu relationship with another

is able to exert final control over that company's decision-making process by means of formal governance mechanisms based on ownership rights. In other words, the pattern of intercorporate networks in Japan is closely related to the characteristically Japanese governance structure.

A Japanese-style keiretsu relationship is more comprehensive and stable, and longer lasting than the types of corporate alliances that are often seen in the United States, Europe, and elsewhere. Companies in a keiretsu relationship are tied together by three types of connections.

1. First, all companies in a keiretsu have some kind of business relationship. This relationship can be one between lenders and borrowers of capital, suppliers and users of goods or raw materials, distributors and vendors of finished products, and so on.
2. The second connection involves cross-ownership through reciprocal holding of shares. There are two types of cross-shareholdings, which differ in function. In the first, companies within the keiretsu typically hold several percents of one another's shares, and function reciprocally as stable shareholders. They cooperate to provide one another with steady shareholders who can guard against hostile takeovers and outside pressure to remove board members. The second is when a parent company holds a block of shares (for instance, 12, 33, 51%) in its subsidiaries and other affiliated companies with which it has a vertical relationship. The parent company exerts control in proportion to the amount of shares it holds. In this type of relationship, the parent company tends to be more directly involved in the management of its subsidiaries. In some cases, the subsidiaries or affiliated companies also hold shares in the parent company and help it to build a block of stable shareholders.
3. The third type of tie involves directors who are dispatched from one company to another. In Europe and North America it is common for directors to hold interlocking directorships in several companies at once, but normally this involves a full-time executive director who serves as an unaffiliated outside director in other companies. The situation with keiretsu companies is different. In Japan, the appointment of directors to the board of another company is more than a temporary reassignment and should be seen as part of a wider exchange of personnel between affiliated companies. Directors who move from one company to another do not serve as unaffiliated outside directors but take up a full-time

post at the place to which they are assigned. In Europe and North America unaffiliated outside directors assume broad responsibility for playing the role of observers who help a company to respond to changes in the business climate, for improving the running of the company as a whole, and so forth. In the Japanese case, the main role of a director appointed from the outside is to strengthen the company's relationships with the company that is dispatching the director or between the company and the government. If the company dispatching the director finances the receiving company, the director's job will be to monitor the company he is assigned to. In other cases, the director may be expected to use his personal network of contacts to win new business for the receiving company.

Keiretsu: Changes Since the Bubble

Keiretsu are of two types, horizontal and vertical, according to their functions and structure. The following sections discuss the nature and functions of respective types of keiretsu, their changes since the bubble and their current state.

Horizontal Keiretsu

A horizontal keiretsu (also known as financial keiretsu) is a corporate group centered on a core bank and built up from the loosely formed relationships between companies linked by cross-shareholdings. Although the *zaibatsu* that dominated the Japanese economy from the late nineteenth through the early twentieth century was dismantled after World War II, the companies that had been at their heart soon formed new loosely affiliated groups and developed new corporate relationships. These later formed the horizontal keiretsu. Until the 1990s, each of the six major banks (Mitsubishi, Mitsui, Sumitomo, Fuji, Dai-ichi Kangyo, and Sanwa), all of them descended from zaibatsu groups, was at the center of its own corporate group. These were known as the Big Six. But Japan's banking sector underwent dramatic upheavals when the bubble economy collapsed in the early 1990s. A series of mergers and consolidations followed Japan's version of "Big Bang" deregulation in 1999. Of the six major "megabanks" only three remain in 2017 (Tokyo-Mitsubishi UFJ, Sumitomo Mitsui, and Mizuho).

The former zaibatsu are not the only examples of horizontal keiretsu. There are numerous examples of non-zaibatsu corporate groups built around other city banks and regional banks. Nevertheless, it is the mammoth keiretsu centered on the former zaibatsu banks that have had the most profound influence on industrial organizations in Japan.

The typical form of a horizontal keiretsu is often compared to a fleet of ships. In their book *Keiretsu*, Kenichi Miyashita and David Russell describe a keiretsu as a corporate convoy, a large group of companies that sail together and keep an eye on each other.[21] Dominant at the center of the convoy is the flagship, widely recognized by insiders and outsiders alike. This is the city bank. But the bank is often accompanied by another large ship at the center of the fleet. This is the *shōsha*, or general trading company. The *shōsha* maintains a position next to the bank, and has almost as much influence. The third great ship at the center of the fleet is a giant manufacturer. Around these two or three huge companies are the secondary core members—normally insurance companies, trust banks, and other financial service providers, along with one or two large manufacturing firms. Together the financial firms, the general trading company, and the core manufacturers form the brand image and identity of the keiretsu.

These core companies are surrounded by large numbers of smaller ships. Sometimes a number of these band together; at other times they sail alone. Many more companies are to be found on the fringes of the convoy, far from the center. Normally these tend to be rather small, but there are also some large companies that choose to maintain a certain distance from the central group. Many large companies prefer to maintain an image that they are "independent" and these companies often do not have formal ties with any of the other companies in the group. Nevertheless, although they make efforts to maintain their independence from the keiretsu, normally these companies sustain a business relationship with at least one of the major banks that form the center of the keiretsu.[22]

The reorganization of the financial sector that followed the collapse of the bubble economy in the early 1990s had a major impact on the horizontal keiretsu conglomerates. Already in the 1980s, the number of commercial banks was starting to decline, but the situation changed rapidly after the bubble burst. Some of the banks facing nonperforming loan problems began to go bankrupt, and mergers and

consolidations became common. Between 1996 and 2001 the sector underwent a period of major deregulation known as the Big Bang. Barriers were torn down that had previously kept the various types of financial institutions—banks, trusts, and securities companies—apart. For instance, the boundary between banking and securities services was removed, the dividing line between life and nonlife insurance business was taken away, and entry into banking industry from other industries was liberalized. This gave impetus to a comprehensive reorganization of the financial world. Liberalization made it easier for companies to fund their projects through direct financing, releasing them from their dependence on the banks.

As mentioned above, relationships within the keiretsu had long been upheld by the tradition of cross-shareholding. Starting in the 1990s, however, many struggling companies and financial institutions started to divest themselves of underperforming stock in their portfolio, and the proportion of cross-held stock began to decline.[23] This will be discussed in more detail in the section on "Corporate Governance" below.

Although a number of major companies do maintain the same kind of close-knit relationship they traditionally had with their main bank, the relationships between most large companies and their banks have become less binding since the wave of deregulation. For the banks, too, the changing economy made the risks involved in lending large amounts to a single company or corporate group difficult to ignore, and this was another reason why the extremely close relationships between companies and their main bank tended to fade. Small- and medium-sized enterprises (SMEs), however, still find it difficult to raise finance through corporate bonds, and a majority of SMEs still have a close relationship with the main bank.

Vertical Keiretsu

The preceding section has discussed the horizontal keiretsu. But another type of conglomerate exists, known as the vertical keiretsu (also called industrial keiretsu). In the simplest terms, a vertical keiretsu resembles a pyramid made up of a layered network of subcontracting relationships. There are two types: production keiretsu and distribution keiretsu. The first forms a system of industrial production, while the second makes up a distribution system that sells the products produced by the parent company.

There is considerable overlap between the horizontal and vertical keiretsu; this is one reason for the confusion that tends to surround the

subject. In many cases, vertical keiretsu are contained within horizontal keiretsu. Most important companies that belong to one of the horizontal keiretsu also stand at the head of their own vertical keiretsu. Companies like Mitsubishi Heavy Industries, Sumitomo Chemical, Mitsui & Co., Toray, and Asahi Glass each have hundreds or thousands of smaller companies under their umbrella. Within these vertical keiretsu, these important companies stand at the summit of a huge pyramid, on top of layer upon layer of smaller companies underneath. The horizontal keiretsu bring together several of these major companies that head the vertical keiretsu groups; below each of them is a massive collection of smaller and medium-sized companies that together make up a vertical keiretsu. Figure 3.1 shows the relationship between these horizontal and vertical keiretsu groupings, taking the Mitsubishi Group as a typical example.

Many of the companies listed in the first and second sections of the Tokyo Stock Exchange head a vertical keiretsu. As this suggests, a huge number of vertical keiretsu exist. Together, they make up the Japanese industrial sector. There are currently something over 2000 companies listed in Section One of the TSE (2032 companies as of September 2017). These companies are considered the largest and most influential in Japanese industry. Each of the companies listed in this section of the stock market has dozens, hundreds, or in some cases thousands, of subsidiary or otherwise affiliated companies under its umbrella. Most industries have vertical keiretsu, including nonmanufacturing sectors of the economy such as information services, communications, advertising, and

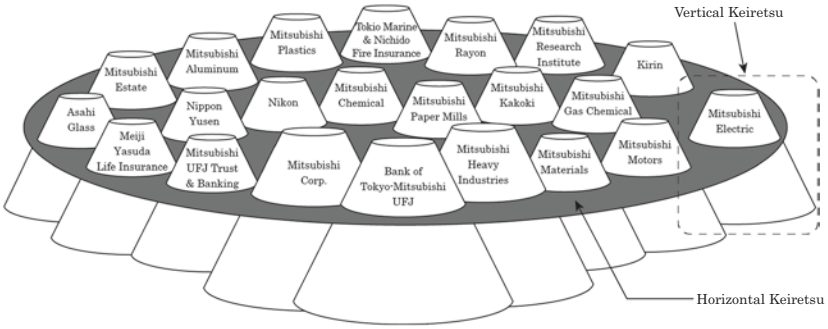

Fig. 3.1 Relationship between horizontal and vertical keiretsu groupings (the Mitsubishi Group)

publishing. But it is in the manufacturing sector that companies are most thoroughly and systematically organized in large-scale keiretsu. This tendency is particularly pronounced in the automotive, electronics, and computer industries. Giant manufacturers like Toyota, NEC, and Hitachi offer good examples for understanding the structure of a typical Japanese keiretsu.

As already noted, a vertical keiretsu resembles a vast pyramid with numerous companies arranged in layers under the head company. In a production keiretsu in the manufacturing industry, the companies lower down in the pyramid make parts and carry out partial assembly for the company or companies above them in the pyramid. These parts are delivered step by step up the supply pipeline, following the chain of the keiretsu relationship. Ultimately, they are put together at the parent company at the top of the pyramid, and become the finished products. The companies at the very bottom of the structure are normally small. Some of them are tiny outfits almost too small to deserve the name of the company. These include small factories in low-rise urban areas with just a few employees, as well as family businesses where family members assemble electronic parts in a room of their home. These workshops accept orders from slightly larger companies on the next level in the pyramid. The slightly larger companies, in turn, receive their orders from companies that are slightly larger again and one level further up the pyramid. These are normally small companies with between 100 and 200 employees. These and smaller companies constitute the bottom half of the keiretsu pyramid, and make up a large part of Japanese industry. Above these small companies are the medium-sized firms located roughly in the middle of the pyramid. These are normally subsidiaries of the parent company at the top of the pyramid.

As is well known, the most highly valued qualities in a traditional keiretsu relationship are loyalty and reliability. Relationships built on these values contribute greatly to keeping "transaction costs" low. Subcontracting companies tend to work for one parent company only; it is very difficult for them to accept work from other companies. This kind of relationship is distinctive to Japanese keiretsu. In Europe and North America, it is common for a subcontractor to do contract work for several companies at once. A company producing parts for Ford, for example, will often supply parts to competitors like GM and Chrysler as well.

In recent years, however, such exclusive relationship in Japanese production keiretsu has begun to change. In an increasingly competitive

international environment, Japanese companies, just as the companies in other countries, are being pressed harder than ever to reduce production and labor costs and improve quality at the same time. Many Japanese companies have begun to reexamine the way they have done business in the past. In a search for ways to obtain better quality at a lower price on a global level, some are starting to look at alternatives to the keiretsu system through which they are supplied with parts. In the automotive industry, for example, long-standing keiretsu relationships are gradually being pulled apart as the supply network for components becomes increasingly globalized. Particularly striking examples are Mazda, now under the Ford umbrella, and Nissan, which has allowed Renault into management at the top level. Under the banner of greater efficiency, these companies have been taking the previously unthinkable step of severing their contracts with the Japanese subcontractors that used to supply their parts. Japanese parts manufacturers also began to look for customers outside their keiretsu, realizing that domestic demand is undoubtedly shrinking, and an increasing number of them are supplying parts to automakers overseas.

One risk of the keiretsu system is that it can give rise to cartel-like behavior, obstructing free competition and making it difficult for new companies to enter the market. The exclusive nature of the keiretsu system has often come in for criticism from overseas. On the plus side, however, because of the shared assumption that a business relationship will be stable, ongoing, and based on trust, there is no need to build a fresh relationship with every new transaction. This helps to reduce the transaction costs, and in that respect, the keiretsu system is economically "rational."

If the parent company and the affiliate who supplies it with components are geographically close, other benefits can accrue. If an assembly manufacturer has its component suppliers close by, it is possible to make effective use of "just-in-time" manufacturing. With a guarantee of long-term business relationship, it makes sense for a subcontractor to establish its factory close to the manufacturer whose components it supplies. This reduces transportation costs and makes it possible to supply the necessary parts when needed to match with assembly line production, helping to cut down on warehousing costs. Toyota and its affiliated keiretsu companies enjoy the advantages of the just-in-time method to the maximum degree by positioning the component factories close to Toyota's assembly plant in Toyota city.

Another merit claimed for the keiretsu relationship is that it speeds up research and development. If the assembly manufacturer has a long-term relationship with a subcontractor that supplies its components, it is possible for the two to cooperate on developing new products together. Affiliated companies within the keiretsu network can be involved in a project from the initial planning stage, making it possible to confirm the quality and suitability of the component parts. A stable relationship of this kind gives the component manufacturer the incentive to develop technology or invest in facilities that would be unlikely to be financially viable except within its relationship with the parent company. This too helps to reduce transaction costs in a broader sense.

The keiretsu relationship helps both the parent company and its subsidiaries and affiliates to keep transaction costs low. In this respect, the relationship contributes to the competitiveness of all the companies involved. The advantages of the keiretsu relationship, however, are not necessarily equally enjoyed by all the companies in the group. The advantage to each company depends on its relative position within the pyramid. It goes without saying that the higher a company is on the pyramid, the more it will benefit from the relationship. The parent company holds shares in the companies below it in the pyramid and is able to exert control over them in proportion to its share of the company's stock. The parent company also has an incentive to oversee its subsidiaries and intervene if necessary. If it holds 33% or more of the stock, commercial law gives the parent company the right to block the dismissal of directors, allowing it to exert ultimate control over management.

The strengths of production keiretsu came to the fore during the global recession triggered by the Lehmann Brothers collapse in 2008. Firms making components on a subcontracting basis struggled to make ends meet after production dropped at the major companies, and many faced the prospect of collapse. Production cuts at Toyota affected many of the subcontractors situated near the company's main factory in Aichi Prefecture, some of which began to fail. Toyota worked to support the subcontractors on a group-wide basis and minimize bankruptcies. It was thus able to preserve the strong supply chain that had always been one of the company's strengths. Toyota was afraid that if a component manufacturer with its own unique technology collapsed because of cash flow problems, Toyota itself would struggle to cope after the economy recovered and production picked up again. If Toyota had been forced to purchase more of its components from suppliers outside its keiretsu because

one of its regular subcontracted suppliers had gone bankrupt, it would have led to an increase in overall production costs.

What the Future Holds

Until recently, most observers have believed that by emphasizing long-term relationships built on trust and preventing free competition, the Japanese system functioned quite effectively for companies that were already part of the system, although it put outsiders and newcomers at a disadvantage. But lately, their beliefs have been shaken. Rapid globalization of the world economy and gradual deregulation of the Japanese economy are making it more difficult to shut out free competition—something that was an indispensable part of what made the Japanese system effective. Increasingly, companies are realizing that they themselves can no longer consider the advantages of the system without reservation. Many feel a sense of urgency that in the severely competitive environment of today they can no longer afford to remain complacently settled in the system that has supported them in the past. Also, three interrelated structural factors—changes in company financing, the attenuation of cross-shareholding, and an increase in the number of foreign shareholders—are altering companies' ownership structures and concurrently the keiretsu relationship. These factors are discussed below in the section on "Corporate Governance."

There is no settled opinion at present on how Japanese industrial organizations will change in the future. One possibility is a shift toward oligarchy, with markets increasingly dominated by a smaller number of large companies. In most sectors of industry today there are more companies of significance in Japan than is the case in Europe and North America. In banking, as we have seen, a wide-ranging reorganization, including cross-keiretsu mergers, is underway. Similar reorganization is taking place in other sectors as a result of mergers and consolidations. The aim of mergers and consolidations is to take advantage of efficiencies of scale, and bring improvements to a high-cost structure. Reorganization on this scale involves not only the companies within the same keiretsu groups. The legalization of holding companies as part of the Big Bang deregulation makes greater concentrations of economic strength possible.

Even if the number of conglomerate groups decreases as a result of oligopoly and consolidation, relationships among companies will

probably not change dramatically as long as each firm continues to feel that the keiretsu system makes economic sense. But as competition becomes tougher companies will need to assess more carefully than ever whether keiretsu-based relationships are still in their best interests economically, and as a result of this, keiretsu relationships are likely to become more fluid and flexible. As globalization continues and Japanese companies develop wider networks with foreign companies, inter-company relationships are likely to become more complex and intertwined and will no longer fit any single simple pattern.

The economic merits of long-lasting, stable business relationships have been well argued by institutional economists and those economic sociologists who advocate the idea of "embeddedness." However, Brian Uzzi's study on the US apparel industry contends that although embeddedness produces the best results up to a certain level, excessive amounts can lead to decreased efficiency.[24] The same seems to apply to keiretsu relationships in Japan. Although companies are not about to discard the advantage of stable business relationships entirely, nevertheless it is likely that there will be moves to correct the excessively rigid embeddedness that can damage economic rationality, and that firms will look to develop more flexible network relationships. The importance of mutual trust and social capital in intercorporate relationships, however, is unlikely to change. On social capital, it will be necessary to move away from the "inward-oriented" type that can easily exclude outsiders, developing instead an "outward-oriented" type of social capital that can encourage a wider, more inclusive identity and a broader system of reciprocity. These functions of social capital will be discussed in Chapter 4.

Corporate Governance

Japanese-Style "Insider" Corporate Governance

"Insider" and "Outsider" Model of Governance

In Japan, "insider governance" is the most widespread form of corporate governance. In this system, stakeholders with a close relationship to the company and an interest in its long-term survival and well-being play an important role in monitoring management from the inside. Other characteristics of this system are: (1) Financing is primarily bank-based, and a company's main bank plays an important monitoring role;

(2) Employees and labor unions are influential agents who play an important role in watching over the company from within; and (3) The majority of the company's stock is held by stable shareholders; the stock market is relatively underdeveloped and less active, and shareholders have less influence as investors. These characteristics are not unique to Japan; they can also be seen in the corporate governance systems of continental European countries including Germany, France, Austria, Italy, Portugal, and Spain.[25]

The chief advantage of an insider system of corporate governance is that it allows monitoring to be carried out by an extremely limited number of institutional investors, making it possible to minimize the costs of monitoring and intervention. However, because employees have a considerable say in how the company is run, it is difficult for management to carry out employment adjustments. This gives rise to problems such as redundant employees who are retained on the payroll despite having no role to perform and a tendency to expect companies to absorb social costs internally. And because company executives assume that their management rights are secure and their positions are unassailable, there is a risk that the company may be run in a nontransparent and arbitrary manner.

In general, economists agree that insider governance is effective when a fairly certain and predictable business environment is in place, but that it becomes less effective when uncertainty in the business environment increases. In Japan, this negative aspect of the system came to the surface in the 1990s after the bubble economy collapsed and many companies began to consider ways to reform the system. This will be discussed in more detail later.

In countries like the United States and the United Kingdom, by contrast, the outsider system of corporate governance is prevalent. Companies are monitored predominantly from outside through market, and shareholders frequently exert control over a company through the stock market. Under the outsider governance system, the stock market is highly developed, and companies depend on the financial markets for funding. As a corollary, the behavior of pension funds and other institutional investors has a major impact on corporate governance. Under this system, companies can be bought and sold with relative ease and mergers and acquisitions are frequent. Corporate buyouts also help to encourage restructuring of the companies involved. Market opinion has a powerful influence on the behavior of executives, and since part

of their remuneration often consists of stock options, the company's share price is directly tied to their compensation package, providing a strong incentive. On the downside, because a company is monitored by a large number of investors, monitoring activities are often redundant and involve higher costs. Outsider model of corporate governance is also used in Canada, Australia, Ireland, and other countries.[26]

As we have seen, systems of corporate governance differ significantly from country to country and most of them have changed significantly over time. The system of insider governance that was dominant in Japan for fifty years after World War II was unique in terms of its formation process as it came into being as the result of wartime economic policy.

Wartime Economic Policy and the Beginnings of the Japanese Model of Corporate Governance

Historically, for a period after the joint-stock company came into being, shareholders were able to exert control over a company and a governance system close to the classic shareholder control model was most widely practiced in the United States, Europe, and Japan. In time, however, control moved away from shareholders and into the hands of the company's executives. The direction of this shift of control was the same in all these countries, but the historical background and details were different in each case. In Japan, the immediate cause was the establishment of a controlled wartime economy, and this historical background makes its case unique.

Until the 1930s, corporate governance in Japan was close to the classic shareholder control model, and similar to that used in US companies from the late nineteenth into the early twentieth century. The holding company system played an important role in corporate governance in Japanese companies in the early years of the twentieth century.[27] In both zaibatsu and non-zaibatsu companies, stock tended to be concentrated in the hands of holding companies. As the major shareholders, the holding companies took on risk and invested heavily in group companies; this meant they had a strong interest in monitoring and controlling the way in which these companies were managed. In this model, increasing shareholder returns was a priority, and the discretion and authority of company executives were comparatively restricted. Because the system needed to provide an incentive for executives to boost shareholder returns, executive compensation was more closely linked to company profits than it is today. In the prewar system, the banks were less

important than shareholders as providers of capital, and the influence of employees as stakeholders was insignificant.[28]

This system changed dramatically with the establishment of the wartime economy in 1937, when the foundations of the postwar system were laid down. The establishment of a wartime economy system stripped shareholders of their controlling power and limited the influence of the stock market. Laws were enacted to control share dividends, and the government placed a limit on dividend increases. Once the government embarked on full intervention in the stock market, the market lost its function as a mechanism for determining stock prices. Shareholders lost their ability to influence companies through the stock market, and the idea of holding stock for investment purposes lost its appeal.

As direct financing from the stock market lost its status as the main way for companies to raise funds, indirect funding from banks became more important. At the same time, shareholder control over companies declined and banks came to take on a more significant role in corporate governance. It was also during this time that the foundations were laid for the "main bank" system that provided the backbone of the corporate governance system that was to maintain dominance over the Japanese economy for half a century after the war. Joint financing, in which several banks invested in a single company together, created a systematized framework for efficiently using the savings of ordinary investors for industrial purposes. Joint financing meant that a bank was able to spread the risk involved in lending large amounts of capital to a single company, and also made it possible to reduce the screening costs of each bank. In 1941 an emergency cooperative lending consortium was formed, consisting of 12 banks headed by the Industrial Bank of Japan, and the main bank system was established in which banks took on a central role in assessing the companies they invested in and carried out joint financing based on these assessments.

Laws were passed to bring procurement of materials and manpower under unified central control and strengthen the wartime system, and in 1940 the Imperial Rule Assistance Association (*Taisei Yokusankai*) was launched. The government realized that it was important to stabilize labor–management relations and improve workers' motivation if it was to mobilize labor effectively and improve productivity. Accordingly, branches of the Industrial Patriotic Society (*Sangyō Hōkoku Kai*) were established in each workplace to encourage dialogue and communication between labor and management and to improve employee welfare.

In order to encourage wholehearted involvement on the part of executives and employees, it was necessary to increase incentives by making pay reflect evaluations. In an illustration of the government's understanding that employees' contributions were of the utmost importance to achieve state aims, profits, already declining because of price controls, came to be used to provide incentives not for shareholders but for employees.

In this way, the prewar system of corporate governance, which had been close to the classical shareholder control model, changed dramatically under the wartime controlled economy. Shareholder control declined and was replaced by a larger role for banks; incentives for executives and employees were given priority over shareholder income. This wartime system was to have a major influence on the structure of corporate governance in Japan for half a century after the war. The structure of corporate governance introduced during the war as a temporary measure was strengthened further by the policies enacted by the Occupation forces during the postwar reconstruction period.[29]

The Beginnings of the Postwar System: The Main Bank System and Japanese-Style Corporate Governance

Shareholder power, already considerably weakened during the war, was further reduced by the decision of the Allied Occupation to break up the zaibatsu immediately after the war. GHQ (General Headquarters, the Supreme Commander for the Allied Powers) took the view that the zaibatsu had provided a fertile breeding ground for militarism and in 1945 gave orders to break up and freeze the assets of 15 of the largest zaibatsu, among them Mitsui, Mitsubishi, Sumitomo, and Yasuda. The following year the holding companies were broken up. Stock held by the main zaibatsu companies and the families that ran them, as well as the bulk of the shares in both zaibatsu and non-zaibatsu major companies, was transferred to the Holding Company Liquidity Committee and other government bodies. These policies more or less destroyed the groups of major shareholders that had exercised strong control over the prewar corporations. This was followed in 1947 by a purge of executives who had been involved in the war or associated with the zaibatsu. This and the legislation that followed did away with the system that had been the norm until the war, in which companies had outside directors who represented major shareholders and executives who were dispatched from the zaibatsu headquarters. As already mentioned in Chapter 2, most of these vacated posts were filled by promotions from within the companies.

The major shareholders were replaced as providers of capital by the banks. The capital for reconstruction was supplied by joint financing through the main banks, with the Bank of Japan acting in an intermediary and coordinating role. This put a company's main bank in a position to monitor the companies it was financing as an investor.

The banks imposed conditions on the borrower companies whose business had deteriorated due to surplus workers they had retained from the immediate postwar period of the controlled economy. The conditions focused on reduction of excess workforce. Banks checked to see that companies carried out their rebuilding plans, and when necessary demanded a change of management. This intervention imposed sound management on companies, and when profitability surged due to the economic boom propelled by the Korean War (1950–1953), institutional investors such as banks, trust banks, and life insurance companies bought up large amounts of stock and came to occupy a position as major shareholders. The main bank, which had both the ability and the incentive to screen and monitor companies in which it invested, played an exclusive role in ex post monitoring, with other corporate shareholders holding stock as stable shareholders and relying on the main bank's monitoring. This framework of corporate governance was established in the 1950s.

Under this system, the main banks had exclusive and comprehensive responsibility for carrying out thorough monitoring of companies. This consisted of three stages: ex ante, interim, and ex post monitoring. This system was one of the characteristics of governance under the main bank system, and is one of the major points of difference with the Anglo-Saxon system, under which the three stages of monitoring are kept separate and are the responsibility of different specialized institutions.[30]

The type of close relationship that exists in Japan between a main bank and the companies it invests in is not completely unknown in other countries, but it is very much the exception. In the United States and European countries banks generally do not get involved in rescuing companies from financial difficulties, and have little incentive to do so. The normal course of action taken by banks in Europe and North America when a company they invest in falls into difficulties is to pull out. Likewise, the job of coming up with a restructuring plan is often left to consulting firms, while assistance from the banks is generally limited to measures such as slightly more lenient loan repayment terms.[31]

In the Japanese system, the financial institutions that monitor the companies they finance are themselves overseen by financial authorities including the Financial Services Agency's Supervisory Bureau (until 2001 the Banking Bureau in the former Ministry of Finance) and the Financial System and Bank Examination Department of the Bank of Japan. As well as setting regulations, these authorities stand at the summit of supervision system, providing administrative guidance as well as monitoring, intervention, and protection. This is often called the "convoy" style of financial administration.

The power of the financial authorities to decide and act is essential to the proper functioning of the system. The same banks that are monitored and protected by the financial authorities, in turn, monitor individual companies by providing loans and holding stock. Banks (particularly a company's main bank) and the company that is financed hold substantial amounts of each other's shares and thus serve each other as stable shareholders, enabling them to avoid outside interference and ensure stable management. Monitoring and intervention are carried out exclusively by the main bank, with which the company is in a reciprocal relationship of cross-shareholding, as previously noted.

In most cases, monitoring of subsidiary and affiliated companies is normally done not by the banks but by the parent company. The system forms a pyramid-like hierarchy, with organizations higher in the pyramid controlling those below. The tacit understanding that the main bank will take final responsibility for the survival of a company provides an incentive for the company to provide accurate information during interim monitoring and to follow the advice and feedback provided. By complying with monitoring, a company acts in its own best interests, since by doing so it can ensure more generous treatment from the bank if it ever needs financial help in the future.

The main advantage of the Japanese model of insider corporate governance is that it minimizes transaction and monitoring costs. As noted, the system is generally held to be most effective when a relatively high degree of certainty exists in the business environment, and it produced the best results during the period of high growth from the 1950s to the 1970s. After the collapse of the bubble economy in 1990, however, as the management climate became more uncertain, this distinctively Japanese main bank system and Japanese-style insider governance began to encounter a number of problems.

Changes Since the 1990s and Future Changes in Boards of Directors

Since the 1990s, the Japanese model of insider corporate governance has failed to function the way it previously did. The main reasons for this are as follows.

1. First, as a result of deregulation, companies have come to avail themselves of a more diverse range of options. Companies can get more of their funds from shares, corporate bonds, and other forms of direct financing, making them less dependent on banks. In consequence, the relationship between companies and banks has shifted, and the influence of the banks has waned. An increasing number of companies are no longer closely monitored by their main banks.
2. Second, following the collapse of the bubble, cross-held shares that had not previously been sold began to be released onto the market, leading to a decline in the number of stable shareholders. Underperforming Japanese companies were forced to carry out restructuring and began to sell off stock that provided low returns, leading to a gradual decrease in cross-shareholding. The proportion of bank stock held by business corporations declined, along with the proportion of cross-held shares as a percentage of the total market. Starting around 1999, banks too began to sell off their own holdings of companies' stock and the system of cross-shareholding between companies and banks began to erode.

   At the end of fiscal 1992, cross-shareholding accounted for 49.6% of all the shares on the market.[32] This proportion has fallen steadily in the years since then. Despite a temporary rally caused by fear of hostile takeovers, since 2009 the proportion has declined again steadily, and by the end of fiscal 2012 cross-shareholding made up only 16.8% of the market.[33] A significant proportion of banks and companies that held each other's stock are no longer honoring the tacit agreement that they would not take opportunistic action against each another. This agreement was an essential part of the insider governance system.

   Market investors, including a considerable number of foreign shareholders, acquired these released shares. The decline of

cross-shareholding has affected the ownership structure of different listed companies in different ways. On the one hand, some companies attracted attention from large numbers of foreign investors and have come to rely almost entirely on the market for their financing. On the other hand, a substantial number of companies have maintained cross-shareholding with banks and continue to depend on banks for their financing.

3. The third factor was the increasing influence of ordinary shareholders, who had hardly spoken up in the past. As capital markets have become more globalized, the number of foreign shareholders has increased, and foreign investors now make up a considerable proportion of shareholders at many Japanese companies, including Sony, NEC, Canon, and Fujifilm. As part of this globalization of the capital side, companies have increasingly been coming under pressure to raise return on equity (ROE) in order to boost share prices and provide a higher dividend for shareholders. This shift in the makeup of a company's main shareholders—from stable shareholders belonging to the same keiretsu or other business partners to outsider market investors who buy or sell stock depending on business performance—compels executives to change their patterns of behavior and consider shareholder interests.

In the traditional main bank system, banks, as shareholders and major creditors of a company, were able to impose discipline on executives of the borrower company. This meant that problems were normally dealt with before they came to the surface. In the traditional system, when cross-shareholding and stable shareholders were the norms, the pressure of the stock market on companies was minimal. And because boards of directors were composed of people who had been promoted from within companies, executives tended to prioritize the interests of employees above all else. Together, these factors constituted a risk that shareholder interests might be ignored altogether. However, this risk was avoided to some extent as a result of the monitoring of the main bank.

As main banks have ceased to monitor companies and their management operations as closely as before, the question of how best to monitor businesses and management has become a serious issue.

One measure adopted at several companies is to separate the board of directors and the executive board as is done in the United States and establish places for outside directors on the board of directors.

The board of directors would accept outside directors with executive powers (particularly over personnel) and would exert ultimate control over the company. Implementing policy would be the responsibility of a separate team of executive officers. This would separate the roles of management and monitoring more clearly, and make it easier for a board of directors to fulfill its original function of supervising senior management. The presence of outside directors provides an opportunity to ensure that the decision-making process conforms to social norms; many people believe that this would be effective in preventing scandals.

One factor that spurred the introduction of outside directors was a revision to the Securities Listing Regulations of the Tokyo Stock Exchange in 2009, to the effect that "In order to protect the interests of general shareholders, listed companies are required to secure among their outside directors and outside auditors at least one independent director unlikely to have conflicts of interests with general shareholders." The appointment of one independent director is a minimum standard for listed companies; the TSE says that having several independent directors is preferable for most companies. As of 2013, more than half of Japanese listed companies had appointed outside directors.[34] Recent studies have shown, however, that in many of the advanced countries appointing outside directors does not necessarily help to strengthen the governance of a company. One reason for this, according to the British economist Colin Mayer, is that the advisory and disciplinary roles of outside directors conflict with each other.[35] It is likely that further reforms will be necessary to ensure that the outside director system actually strengthens and improves governance.

Another movement underway involves changes in the makeup of boards of directors and directors' remuneration. As already noted, in Japanese companies many key managers have risen through the ranks within the companies and a senior management post is used as a reward within the system of lifetime employment and seniority-based advancement. As a result, companies tend to hold more directors than they need. Such companies are likely to be pressed to restructure their boards and cut the number of directors in the future. In order to increase the motivation of executives and to make the best use of human resources with creative ability or leadership or bring them in from outside, companies will need to shift to an incentive system in which pay and promotion reflect performance more closely. This will be discussed in more detail in Chapter 6.

Conclusion

The insider corporate governance that had worked so effectively during the rapid economic growth period, ceased to function from around the time of the collapse of the bubble economy in 1990. In this governance system, stakeholders with a close relationship to the company and an interest in its long-term survival and well-being had played an important role in monitoring management from the inside. The stakeholders that played the most important role in this system had been the corporations' main banks. But as mentioned in the preceding section, diversification of the means by which businesses procured funds, increased sales of cross-held stocks and decrease in the number of stable shareholders, as well as increase in the number of foreign shareholders, led to a slacking off of the main banks' function of monitoring the corporations they financed. The management of corporations was no longer under close supervision. Today, when the main bank system no longer functions effectively in Japan, a major issue corporations face is how to assure proper supervision of management and practice effective corporate governance.

Now that the practice of cross-shareholding is steadily declining, there is a growing concern that the replacement of long-term stable shareholders by short-term investors might have a negative effect on company management. Shareholders bring various kinds of pressure to bear on a company in an attempt to improve its short-term results, and managers sometimes lose long-term perspective in their attempts to respond to every incidence of market pressure. Japanese companies need to work to ensure that they avoid the harmful effects of excessive market pressure that the Anglo-Saxon-type stock market often generates.

Stock market pressure is essential from the perspective of monitoring company management, and excessive cross-shareholding needs to be corrected. Short-term investors play an important role in bringing fluidity to the market. But a situation in which speculative shareholders become a majority and start to have an undue influence on management should also be avoided. For a company, both short-term and long-term investors are necessary. Achieving the right balance between them is vital.

From now on, however, market-based funds procurement is sure to become more active in Japan as well, and the influence of individual shareholders, investors, and especially pension fund and other institutional investors is likely to increase. Under these circumstances, mergers and acquisitions will be more frequent, and corporate buyouts will

encourage restructuring of the companies involved. Market opinion will have a stronger influence on the behavior of executives since the company's share price would be more directly tied to their compensation through stock options and other long-term rewards.

When endeavoring to respond to these changes, Japanese companies can learn much from what American companies experienced during the late 1980s and early 1990s. During that period investor pressures transformed the internal structures of many US corporations, increasingly realigning them to match shareholder interests. American scholar of management Michael Useem, in his 1993 book *Executive Defense: Shareholder Power and Corporate Reorganization*, reveals how US companies changed their organization, compensation, and governance during this period in response to the investor pressures.[36] Japanese companies now faced with new institutional pressures will have to channel more resources into building effective relations with shareholders and focus more attention on shareholder interests. Also, Japanese managers will have to seek legal safeguards against takeovers. Of course, American-style corporate governance has a number of problems of its own and ways have to be found to resolve them. But US businesses are always ready to recognize their problems, discuss what can be done to deal with them, and respond to them promptly. The most important point that Japanese corporations can learn from their American counterparts is that active posture vis-a-vis improvement and change.

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27. In Japan, the holding companies disappeared after World War II along with the dismantling of the zaibatsu. However, in 1997 they were legalized after a gap of half a century, and this has led increasing numbers of companies to reorganize using the new system. Watanabe Satoko, "Mein banku shihonshugi no hōkai to atarashii kigyō tōchi shisutemu no kōchiku" [The Decline of Main Bank Capitalism and Changes in Corporate Governance in Japan], *Shakaigaku ronshū* 26 (March 2002), pp. 19–43.
28. Watanabe, "Mein banku shihonshugi."
29. Morikawa Hidemasa, *Zaibatsu no keieishi-teki kenkyū* [A Managerial History of the Zaibatsu] (Tokyo: Tōyō Keizai, 1980); Asajima Shōichi, *Senkanteki Sumitomo zaibatsu keieishi* [A Managerial History of the Sumitomo Zaibatsu in the Interwar Period] (Tokyo: University of Tokyo Press, 1983).
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32. "Kabushiki mochiai, kaishō no ugoki susumu, 12-nendo-matsu 16.8%, yonen renzoku saitei kōshin" [Cross-Shareholding Relationships Continue to Break Apart: Just 16.8 Percent at End of FY2000, Lowest-Ever Level for Four Years Running], *Sankei Biz*, September 5, 2013, www.sankeibiz.jp/macro/news/130905/eca1309050600002-n1.htm.
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CHAPTER 4

Japanese Management: Strengths to Preserve

Global interest in Japanese management reached its height during Japan's high-growth years and then waned as the Japanese economy stagnated in the early 1990s. Until recently, emerging economies like China and India attracted more attention internationally. Recently, however, economists and management specialists in the United States and Europe have once again begun to look at the positive aspects of Japanese corporate management.[1] Interest in Japanese management is also growing in Asian countries, and many Chinese managers are starting to study Japanese management methods and philosophy.[2]

Behind this renewed interest in Japanese management is a growing feeling around the world that corporate management has put too much emphasis on American free-market liberalism. Apparently, many companies have been driven in this direction under the ever-increasing pressure of global competition. The financial crisis triggered by the Lehmann Brothers collapse in 2008 and the ensuing global recession opened many people's eyes to the excesses of the liberal free-market model. This has led to reevaluation of the Japanese approach as a feasible alternative to the Anglo-Saxon model. Naturally, not all aspects of Japanese management deserve emulation. As I point out throughout this book, there is much room for improvement and many areas in which Japanese corporations can learn from their counterparts in Europe and North America.

If the strengths of the Japanese-style management are to be utilized, the traditional management practices of Japanese companies need to be

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reviewed and efforts made to draw upon their comparative advantages. This chapter analyzes the management principles that form the foundation of the strengths of Japanese corporations and identifies ideas and principles of behavior that deserve to be maintained into the future. I also consider how to make effective use of these strengths, particularly those relating to the human aspects of organizations, looking at several specific examples.

Social Capital and Japanese Management

Japanese Organizations and the "Ie" System[3]

The traditional Japanese approach to management has been widely studied and debated and many books have been written on the subject. There is general agreement that many elements of Japanese management as it was practiced until the end of the 1980s had their origins in *ie* system, Japan's traditional household organization.[4] According to this consensus, large modern corporations in Japan were organized on the basis of the concept of the "extended family as a management body" that developed under Tokugawa feudalism (1603–1868); and these corporations consisting of non-kin members operated on the basis of family-like social relationships. Just as in traditional *ie* households, the organizing principles and behavioral norms in these corporations were heavily influenced by Confucian doctrine. I have already touched on these aspects in Chapter 2.

How did Japanese-style management, with its origins in the traditional family system, help to drive the development of large corporations and the overall economy? Understanding this point is crucial for analyzing the strengths of Japanese management. There are several key reasons why the traditional *ie* system became linked to the development of modern corporations and provided a source of their strengths.

1. Elements of Rationalism and Voluntarism

The first point to understand is that although the traditional *ie* system is often regarded as inherently premodern, in fact a number of its characteristics are quite compatible with the management of modern organizations. These elements played an important role in the development of Japanese corporations. The first of these elements relates to the practice of inheritance by the eldest son in the traditional family

system. During the Tokugawa period (1603–1867), there were no clear inheritance laws in Japan. In the early Meiji era (1868–1912), however, the new government decided to adopt a system of inheritance by the eldest son, and this became law with the enactment of the 1898 Civil Code.[5] Under this system, the norm was for the eldest son to inherit the entire family estate. A consequence of this was that there was often no room for any other adult children to remain in the family. This created a steady population of people going out into the wider world in search of jobs. In terms of management of the *ie*, however, blood relationships were often relatively unimportant. In order to continue the *ie* lineage and the family name along with the family estate and business it was not unusual for families to adopt an "eldest son" to inherit the *ie* and family headship. In some cases, the adopted son would inherit the business in preference to the owner's actual son if the original heir was considered unsuitable. People cannot choose their parents or children. But as the *ie* system allowed families to adopt an adult son to whom they are not related, they had a much higher chance of recruiting a suitable heir. This increased the likelihood that the *ie* would be well run and thereby sustained through the generations. These traditions of *ie* management were inherited by modern organizations and brought into corporate management.

From this viewpoint, anthropologist Francis Hsu has claimed that the Japanese *ie* system differed from the Chinese equivalents of *jia* (family) and *tsu* (clan) in having "a degree of voluntary association of human beings." Japanese companies are often described as "family-like," but there are striking differences with the situation in China, where many companies are literally families. Although authority structures and moral obligations similar to those found in families do exist in Japanese companies, these have always been marked by a degree of rationality and voluntarism free from the constraints of kinship considerations.[6] In this sense, traditional Japanese organizations were closer to the voluntary associations found in Europe and the United States than to Chinese companies and clans. From an early stage in Japan's industrialization, company management transcended family ties and management of companies was in the hands of specialists. In other words, there was a clear separation of ownership and management. In many cases, companies that had started as family firms began to promote outsiders to management roles as they reached a certain size. In many cases, this adaptability brought positive gains.

2. Trust Transferred from Family to Business Organization

A second point to note regarding the relationship between Japanese corporations and the *ie* system is that the structure of human relationships derived from the *ie* system went beyond the actual family and was transferred to modern non-kinship-based organizations.

In this way, the relationships of trust and reciprocity that existed within the family were replicated in private companies made up of individuals who were in most cases not related. As discussed later in this chapter, the existence of intermediate organizations situated between the family and the administrative organs of local- and state-level government indispensable for fostering trust that does not depend on family ties. Companies in Japan have played an important role as such intermediate organizations where the members can develop pseudo-familial relationships of trust without depending on kinship relations. *Ie*-like social organizations exist in many other areas of society in Japan besides private corporations. Perhaps the best-known example is the *iemoto* system common in the traditional arts, such as tea ceremony, flower arrangement, classical Japanese dance, and *kabuki* drama. These *ie*-like social organizations are characterized by what is often referred to as the "vertical structure" in the literature on Japanese society.[7] Application of the ideology and institutions derived from the *ie* system to the management of modern private companies had a particularly pronounced effect on the structure of Japanese society as a whole, since these companies played the leading role in the development of the Japanese economy.

3. Modified Confucianism

The third point to bear in mind when considering the influence of the *ie* system on Japanese corporations concerns Confucianism, which provided the philosophical and moral underpinnings of the *ie* system. We have already seen how the quasi-*ie* principles of the Japanese corporation were profoundly influenced by Confucian doctrines. Many of these doctrines were adaptations made to Japanese social conditions when Confucianism was imported from China. The teachings of Confucius, for example, recommend several virtues, whose relative weight has an important influence on real-life social relationships. In orthodox Chinese Confucianism, the most esteemed of the Five Constant Virtues are benevolence (*jin*), and filial piety (*kō*). However, when Confucianism was transmitted to Japan, the relatively minor virtue of loyalty (*chū*) was given a more

prominent position in the hierarchy of virtues, while filial piety was reduced in importance.[8] In other words, the positions of filial piety and loyalty were deliberately reversed so as to support the Japanese political apparatus and social structure. Particularly, under the Tokugawa shogunate, which designated Neo-Confucianism (*Shushigaku* or the teachings of *Chu Hsi*, a school of Confucianism) as the state orthodoxy, the modified Confucianism played an important role in sustaining political control.

The precedence given to loyalty over filial piety in Japanese Confucianism continued to play a major role in modern business organizations, encouraging the loyalty of Japanese employees toward their companies. The influence of this reversal can also be seen in numerous aspects of society, as can be illustrated by imagining the moral dilemma of a person's social responsibilities. In traditional Chinese Confucianism, family bonds are considered stronger than ties to political authority (including the emperor). Consequently, if a father breaks the law it is generally agreed that his son is not duty-bound to report him to the police.[9] In Japan, by contrast, it is normally thought that a son in this dilemma has a duty to inform the police.[10] For the *samurai* of the warrior class in the feudal period, the bond of loyalty to the lord was stronger than the ties to his family. The continuity of this attitude can be seen in the modern-day salaryman's loyalty to his superiors or the company. These armies of highly motivated corporate warriors, prepared to sacrifice their own interests for the greater good, played a crucial role in Japan's rapid economic growth. For this reason, although Confucianism did not help the development of large nonfamily private companies in China, the same ethical teachings played a key role in driving the development of corporations in Japan.

Social Capital and the Development of Corporations

As we have seen, in Japan organizational principles and social structures that originated in the *ie* system moved beyond the level of the actual family and were transferred into modern corporate organizations, where they contributed to the formation of many of the most important managerial practices of private companies. In this process, trust was cultivated and reproduced on a daily basis within a pseudo-familial group made up of unrelated individuals, and accumulated as a form of what might be called "capital." The trust and reciprocal relationships thus accumulated

helped to form the foundation for the growth and development of private corporations in Japan. The concept of social capital as developed in economics and sociology in recent years enables us to gain a good understanding of these social relationships.

The phrase "social capital" has been in use since the early years of the twentieth century. An article published by the American sociologist James Coleman in 1988 was the first to present this concept as an important idea in academic discourse. The work of the American political scientist Robert Putnam, particularly *Making Democracy Work* (1993) and *Bowling Alone* (2000), helped to bring the idea to wider prominence.[11]

Social capital consists of social relationships and social networks that link individuals, and the trust and norms of reciprocity that arise from these relationships. It is what creates people's ability to associate with each other, which is essential for virtually every kind of social or economic activity.[12] This collaborative ability depends on the extent to which people share the values and norms of the community, and the extent to which the interests of the individual can be subordinated to the interests of the group. Social capital consists of the connections and relationships between individuals, and the networks arising from them. It is therefore different from "human capital," which is formed by the properties of the individuals involved.

"Trust" can be defined as an expectation within a community that its members will abide by rules based on shared norms and that they will act sincerely and cooperatively in working with other members of the community. Managers and business scholars have often cited the important role of trust-based networks in business, and many people have argued that long-term relationships with customers, clients, employees, trading partners, and shareholders represent a company's most valuable asset.[13]

American political scientist Francis Fukuyama has defined social capital as the capabilities that emerge once a certain level of trust has permeated a society, and argues that social capital is vital for a country's economy to develop and for its companies to grow.[14] Fukuyama published a comparative analysis of the different processes by which large companies emerged in the United States, Japan, Germany, France, China, Italy, and South Korea, focusing on how social capital was accumulated as the result of unique historical processes in each of these societies. Countries like Japan, the United States, and Germany, where large companies are relatively common, are home to large numbers of intermediate organizations that allow people to cultivate trust without depending on family ties. Social

capital built up within these intermediate organizations made it possible for corporations to grow rapidly. In Germany, for example, it was the guilds that provided this early foundation. In the United States, a similar role was played by voluntary associations such as charitable organizations and civic groups, making possible the accumulation of social capital that allowed companies to develop and expand, according to Fukuyama.[15] It was in these "high-trust societies" that today's large corporations developed, with their management structures that transcend family ties.

In other countries, including France, Italy, and China control was concentrated in a powerful central authority—either an autocratic government under an emperor or sovereign or the one-party dictatorship of the Communist Party. The result of this central authority was to impede or destroy intermediate social organizations. This, in turn, led to the development of "low-trust societies" in which people were reluctant to trust anyone other than their own family consisting of people related by blood or marriage. This belief that "only family members can be trusted" had a pervasive influence throughout society, and led to a lack of willingness to cooperate with strangers (i.e., non-kin) to launch new economic ventures. This, Fukuyama argues, made it more difficult for large corporations to develop.

Inward- and Outward-Oriented Social Capital

Several studies have shown that social capital and the trust on which it is built can have a positive effect on economic results.[16] Studies have also suggested that building relationships of trust can directly contribute to improving a company's profits. Frederick Reichheld, for example, has drawn on examples of many successful companies to show that relationships of trust are ultimately linked to company profits.[17]

However, as Putnam and others who have studied social capital have shown, there are various dimensions to social capital, not all of them positive. It can also have a negative impact on social development and welfare. In discussing social capital, it is therefore necessary to categorize its effects and identify which ones have a positive effect on helping companies to grow and economies to expand.

Social capital works to the advantage of economy and society when it facilitates cooperation with external resources, mutual support, and information diffusion, and inspires trust and reciprocity on a broader scale. Social capital that produces these positive effects can be referred to

as "expansive" or "outward-oriented" social capital. This type of social capital gives organizations or individuals the energy and drive to move forward and expand. In Japan, the relationships of trust and the norms of reciprocity that developed from the *ie* system went beyond the family unit and became part of the culture of modern corporations, making an important contribution to companies' growth, as we have seen. This is a good example of how outward-oriented social capital can function effectively.

By contrast, we can use the term "inward-oriented social capital" for the type of social capital that serves to strengthen bonds among group members and promotes homogeneity and uniformity within the group. In some circumstances, this type of social capital can have a negative impact on social development and welfare.

Social capital thus can be categorized into outward- and inward-oriented social capital, depending on how it functions. Because these two types of social capital can produce opposite effects, it is vital to differentiate between them. A number of previous studies have discussed appropriate ways of categorizing social capital; Putnam cites a work by Ross Gittel and Avis Vidal as the oldest study known to him to categorize and label the different types of social capital.[18]

Inward-oriented social capital helps to stabilize specific networks of reciprocity that can help enhance solidarity for collective action or mobilize support for unfortunate members of the community who have fallen on hard times. However, its inward-looking orientation tends to reinforce in-group bonds, often producing an exclusive identity that strengthens the homogeneity of the group. Inward-oriented social capital can sometimes be misused for exclusionist or antisocial purposes. Examples include extreme political or nationalist groups, factions, and criminal organizations, which are often kept together by the exclusive bonds and antagonism toward outside groups based on inward-oriented social capital. It is possible that this type of social capital, increasing the cohesiveness of interest groups, can be used to promote particular vested interests and can consequently have a negative effect on society.[19] The negative effects can include ethnocentrism and corruption. Even in groups like trade associations or cooperatives, in which exclusionary tendencies are not normally particularly pronounced, inward-oriented social capital can have the effect of strengthening exclusionary tendencies when a situation arises that makes group members anxious. In some circumstances inward-oriented social capital can also have positive social effects,

but in general it produces a strong sense of loyalty to the group that can be accompanied by a commensurate antipathy toward outside rival groups. This makes it easy for inward-oriented social capital to generate negative effects.

Outward-oriented social capital, by contrast, is effective at linking up with external assets, facilitating communication of information, and giving an organization the strength to engage with the outside world and expand. While inward-oriented social capital tends to narrow people's perspectives and turn them inward, outward-oriented social capital can help to produce a more inclusive identity and more extensive reciprocity. This tends to bring out the positive dimension of social capital, promoting mutual assistance, cooperation, trust, and a positive, proactive attitude. Used effectively, outward-oriented social capital can have a positive effect on economic growth.[20]

The social capital that underpins Japanese-style management functions both as inward- and outward-oriented social capital. In its inward-oriented manifestations, it can often have a damaging effect on the operation and management of organizations. Nakane Chie's *Tateshakai no ningen kankei* (*Human Relations in a Vertical Society*) is a well-known attempt to analyze the Japanese groupism and collective identity as seen in the *ie* system in the context of a comparison with other societies. Nakane's original study was published in 1967. Japanese society has, needless to say, changed considerably in the several decades that have passed since then, but Nakane's observations still contain helpful insights when we look at Japanese society in an international context. Nakane argued that in terms of its basic human relationships, Japanese society was essentially a "village society" that maintained many aspects of the traditional farming communities from which it had evolved.[21] One aspect of human relationships is their strongly regional character, which means that direct contact is important. Because of this, duration of contact is a decisive factor in fixing a person's position within the group. According to Nakane, this is the origin of the Japanese-style seniority system.

Because a person's position is decided by the length of affiliation with the group, other factors such as ability have only secondary importance. Since rank depends on length of affiliation (for example, since entering the company), it follows that two people who entered the group at the same time should receive the same treatment. The tide of postwar democratization distorted this model of equality into "ability egalitarianism" (a view that tends to downplay differences in ability among

individuals) and frequently led to practices of "bad equality" or "misapplied equality." In these cases, ignoring individual differences in ability and treating everybody equally in a uniform manner can, conversely, result in inequality.

In Japan, various systems restrict free competition and a widespread tendency to limit competition can be seen in many areas of society. These can be regarded as the results of inward-oriented social capital. Many distinctly Japanese practices—*keiretsu*, insider corporate governance, promotion of executives from within, factional organization (*habatsu*), and collusive consultation agreements (*dangō*)—all share the merit of reducing the cost of doing business for those inside the group. However, these mechanisms tend to exclude free competition and deny equal opportunities to outsiders. This protects vested interests and can easily stifle economic as well as social vitality. Inward-oriented social capital in Japanese organizations undergirds reciprocity and strengthens bonds within the group, and has the positive effect of reducing transaction costs when doing business within the system. But there is a real risk that it can also produce exclusionism and conservatism, which could have an adverse effect on economic development.

But Japanese social capital frequently acts as outward-oriented social capital. It was these aspects of traditional social capital in Japan that made Japan's economic growth possible. Many aspects of management in private companies in Japan derived from the traditional *ie* system, including patriarchal, paternalistic, and group-oriented aspects. But in several important points their approach to management was also marked by the rationalism characteristic of modern organizations. This rationalism constitutes an extremely important aspect of the outward-oriented social capital accumulated in Japanese corporations.

The Organizing Principles of Japanese Corporations: A Combination of Collectivism and Rationality

Drawing on "*Gemeinschaft-Gesellschaft*" dichotomy developed by the German sociologist Ferdinand Tönnies, the American sociologist Talcott Parsons advanced a system of what he called "pattern variables" to contrast the value orientations typical of the traditional community and those typical of modern society.[22] "Pattern variables" consist of a series of alternatives or dilemmas which every actor faces. One type of

alternative would be selected in a predominantly *Gemeinschaft*-like situation, and the polar opposite in a *Gesellschaft*-like situation.

According to this conceptual framework, the action of an individual in a modern rational organization should be "universalistic" and be based on achievement. The pattern variable "universalism–particularism" represents a choice between action based on universal criteria equally applicable to all and action based on select standards. In a rational organization, universalistic criteria are applied. Selection of candidates for a job or school by means of an examination to assess their ability would be one example of this. Examples of particularistic criteria, on the other hand, would be nepotism or exclusion of certain social groups in recruiting staff members.

The "achievement–ascription" variable represents another choice faced by an actor when he/she relates to others. Does the actor judge another individual according to what he/she is, or what he/she does? That is, the actor considers either the attributes of the other person such as gender and age, or his or her achievements and performance.

In Japan, even companies that began as family firms generally start hiring outsiders and promoting them to executive positions once the firm reaches a certain size. When this happens, the standards used for personnel decisions are based on "universalism." In the traditional model, promotions and pay raises generally depend on length of service, but performance-based considerations apply to a considerable degree in the case of managerial positions above a certain level. These rational and universalistic aspects are part of the social capital that underlies the organizational principles of Japan's large corporations. They have been effective in promoting linkages to external resources, giving companies the energy to actively orient themselves toward the outside, and producing a broader identity and reciprocity. These are the outward-oriented aspects of Japanese-style social capital.

Two factors that are seemingly contradictory actually work together to make up the strengths of Japanese management: relationships of trust and norms of reciprocity that are similar to those commonly found in families, but that are balanced with elements of rationality and universalism unconstrained by kinship considerations. For example, the "bureaucratic flexibility" seen in Japanese corporations is part of the strategy to achieve this kind of balance. As discussed in more detail in Chapter 5, Toyota Motor Corporation gains employees' trust by applying company

rules and procedures flexibly so that they work to the benefit of individual employees.

Outward-oriented social capital that combines the collectivism characteristic of the traditional community and the rationalism characteristic of modern organizations has played an important role in such countries as Japan, the United States, and Germany where innumerable large-scale enterprises have developed. All these countries gave rise to intermediate organizations that were not dependent on family relationships: the pseudo-*ie* organizations in Japan, the guild in Germany, and voluntary associations in the United States. The group mentality and ethics that support these various intermediate organizations spring from different cultural and historical sources, but in all cases the group orientation that results can be differentiated clearly from traditional equivalents (such as the premodern collectivism found in Europe and Japan during their feudal periods). By combining with the rationalism and voluntarism essential to a modern organization, this groupism formed the basis of the organizational principles and behavioral norms of the intermediate organizations. In all these cases, the countries' traditional systems and cultural characteristics can be said to have made a good match with the liberal economic system.

I have argued that social capital derived from the traditional *ie* system, and outward-oriented social capital in particular, gave Japanese corporations a solid foundation and helped them to develop. These positive aspects of social capital can be said to constitute the strengths of Japanese-style management. In the success stories that follow, I focus on four particular strengths: trust and the norms of reciprocity; a human relations approach that meets employees' social needs; egalitarianism and on-site management that prioritizes the experience and input of workers on-site (*genba shugi*); and institutional advantage in the generation of innovations.

The Four Strengths of Japanese Management

Trust and the Norms of Reciprocity

As a general rule, a business environment where reciprocity is the norm is more efficient than one marked by mutual suspicion. By eliminating the need to balance accounts after each and every transaction, reciprocity makes it possible to reduce the costs of doing business and to enable

actors to get more business done. The costs involved in building relationships are much reduced when transactions take place within a close-knit social network where there is the assumption of a stable, long-term business relationship.[23] If the parties in the network believe it is in their future interests to show cooperative and even altruistic behavior now, this type of behavior will become a habit and in the course of time will be established as the norm. In transactions between companies, trust plays an important role by getting rid of doubts and anxiety about the other party's ability to meet expectations in terms of quality and delivery. This makes it possible to do business without needing to run cost calculations for future uncertainty or risk, and thus reduces transaction costs related to gathering information and so on.[24]

The norm of reciprocity is supported by the two-way obligation that, "I will do such-and-such for you, in the expectation that you will do something for me in return." At its simplest, reciprocity involves a relationship of trust between two individuals. In the business world, reciprocity develops into a longer-term relationship when it goes beyond given individuals and is acknowledged at the level of organizations, and the norm of reciprocity begins to function between organizations.

As we have seen, in Japan social capital deriving from the *ie* system went beyond the actual family and was inherited by modern corporations, thus laying the foundations for many of the most important management practices of Japanese private companies. Trust was cultivated and reproduced on a daily basis within a quasi-familial group made up of individuals who were not related by kinship ties. This led to an accumulation of social capital that became the foundation on which Japanese companies grew and developed. To put it another way, companies are intermediate organizations that can cultivate trust without depending on family relationships. High-trust societies were formed within these organizations based on norms of reciprocity similar to those commonly found within families.

The traditional *ie* system had its roots in the patriarchal family system that came into being among the samurai class during the Tokugawa period. The framework of this distinctively Japanese family system was written into law when the Civil Code was enacted in 1898 under the Meiji government. However, as noted previously, it is important in this context to remember that the *ie* system already contained elements of rationality that made it compatible with modern large organizations. It was these qualities that were inherited by large companies. This made it possible

for Japan's private companies to maintain relationships of trust similar to those found among family members and yet engage in rational decision-making and behavior not bound by family considerations.

As previously mentioned, social capital can be divided into two categories depending on the way it functions: outward- and inward-oriented social capital. From the perspective of Japanese society as a whole, inward-oriented social capital has often generated exclusionary and conservative tendencies that can stifle the energy and vitality of society. Restricting our discussion to the area of private corporations, however, outward-oriented social capital has made many important contributions to the success of companies, by encouraging cooperation with outside resources, producing broader reciprocity, and encouraging companies to expand and develop proactively.

The Japanese model of business management, built on the social capital accumulated over the course of the historical process, has provided the organizational framework for management in large private companies ever since Japan started down the road to industrialization. Particularly during the high-growth years of the 1960s, Japanese-style management raised productivity and played an important role in driving the country's rapid economic growth. One system that supported the growth of Japanese companies in this era by providing a steady supply of young labor was the hiring practice known as "group employment," or *shūdan shūshoku*. This system was a good example of how the positive dimension of social capital (trust, mutual assistance, and collaboration with outside resources) functioned effectively.

In the 1950s and 1960s, there was a widespread labor shortage in many industrial sectors in metropolitan areas, including manufacturing, retail, and in the food and drink service industries. Rural areas, predominantly agricultural at that time, had the opposite problem: not enough jobs for the vast population of demobilized soldiers and repatriated civilians. The problem was particularly pronounced for second and third sons, since in many cases only the eldest son who stood to inherit the family farmland was able to make a living. Group employment was an effective way of responding to the situation and resulted in a positive outcome for both companies and workers. Storekeepers' associations and trade associations organized by municipalities in metropolitan areas worked together with public employment offices and junior high schools to recruit young workers en masse. The new recruits were then sent to work in the big cities after graduation. These junior high school-leavers

who took jobs in the cities were what was called the "golden eggs" that drove Japan's remarkable economic growth.

Although a number of the young recruits quit when labor conditions turned out to be different from what they had been led to expect, considerable numbers were lucky to land with a reasonable employer and got a good start to their working lives. The starting pay was around a third of the starting salary paid to university graduates at the time. But unlike nonpermanent employees today, who are often treated as disposable labor, many workplaces retained traditional family-style management practices and would often give assistance to employees who wanted to branch out and set up their own business. These practices made it possible even for junior high school graduates to succeed in becoming independent if they worked hard. It is said that this gave them strong motivation and also hope for the future.

Takemori Kaname (now president of Takemori Industry Co., Ltd.) joined Hikari Manufacture Co., Ltd, a Toyota subcontractor, as part of the *shūdan shūshoku* scheme in 1960. "Looking back on it now, I can see that my experiences there guided me through everything that happened in my life after that," he says.[25] Work in the assembly factory to which he was assigned was hard, but many aspects of the family-style working environment served to encourage him. Senior workers took the time to explain things and the team leader often helped to keep up his spirits, sending goods to his family in the country and generally looking out for him and helping him to adjust to his new life. In particular, on his tours of inspection, the company president would always take the time to come over and give personal advice, such as reminding him of the importance of a positive work attitude and an orderly lifestyle as a young man. Occasionally the president even treated the young man to a steak dinner. Later, Takemori left the company and traveled to Tokyo to attend night classes at a technical school, after which he started working on his own as a welder and established his own company at the age of 23. He says the experience he had at his first job after leaving school had a major influence on his own philosophy and approach as a manager of his own company.

Beginning in the second half of the 1960s, the proportion of people going on to high school increased even in the outlying parts of Japan and the number of young people entering the workforce after graduating from junior high school decreased. The oil shock of 1973 caused a slump in the Japanese economy and made companies increasingly reluctant to

hire employees straight out of junior high school. In 1977 the *shūdan shūshoku* system was abolished. While it lasted, this system was a perfect example of how traditional social capital could achieve positive effects, providing much-needed labor for Japan's rapid economic growth. Networks built on relationships of trust centered on storekeepers' associations and trade associations in urban communities in metropolitan areas, and schools in rural areas produced broad networks of reciprocity, reducing the costs involved in advertising for jobs and recruiting, and making it possible to efficiently transfer surplus labor from rural communities to metropolitan areas where it was desperately needed.

The oil shock brought Japan's rapid economic growth period to an end. Since the 1990s, many companies have been forced to carry out restructuring. Since the early years of the new millennium, deregulation has introduced tougher competition into many areas of business, and as a result cracks have begun to appear in the social capital that formed the foundation of Japanese management. Since the Lehmann Brothers collapse, however, managers have been emphasizing the importance of long-term relationships of trust again and there has been a return to the kinds of long-term relationships that constituted the strengths of Japanese-style management.

The following comments on management priorities were provided by managers in currently successful companies.

Ōshima Industries, Co., based in Munakata, Fukuoka prefecture in the Kyushu region, started as a construction company, working on roads, bridges, and sanitation projects. In 1998 the company expanded into trucking and distribution, and has since achieved impressive growth. Ōshima Yasutomo, the company's representative director and CEO, says the company's success has been built on trust—between the company president and his employees, between the company and its customers and clients, and the ties of trust that bind all these parties together. Trust is something that builds up naturally in the course of doing your work steadily on a daily basis, he says—something that requires hard work and perseverance. It is this day-to-day effort that helps to build trust. Trust is important wherever you are—but it is particularly important in local areas. The Kyushu business world is relatively small. They say "bad news runs a thousand miles" and in Kyushu a bad reputation will be known to the whole business community instantly. You need to make sure you are absolutely honest in everything you do, says Ōshima.[26]

Kyoto Research Park is a business engaged in research and development, support for venture businesses, and providing of event space. "One thing successful companies in Kyoto share is an approach that puts moral principle ahead of profit," says company president Moriuchi Toshiharu. It is an approach that prioritizes doing the right thing on the assumption that profits will follow as a matter of course. This obviously links with the company's ethical values and CSR. "We may be a Kyoto company but our business takes place on a national stage, and looking further afield on an international stage, too." The wider your sphere of activity, he says, the more important it becomes to stay true to your moral sense at the heart of your business philosophy.[27]

Yamato Transport Company, a market leader in door-to-door delivery (*takkyūbin*) services, is currently working to expand its business, exporting the Japanese style of door-to-door delivery service to overseas markets, as well as launching repair services for electronic appliances and computers at its delivery centers by combining distribution and IT. The company prides itself on providing high levels of customer service: an approach summed up in the company motto, "Service before profit." The company president Yamauchi Masaki believes nothing is more important than honesty in business. "That's my personal motto," he says: "Heaven rewards sincerity."[28]

Japanese companies traditionally place a high value on long-lasting relationships, and generally try to get through periods of poor results without laying off employees. It is the relationship of trust between employees and management that makes this possible. During the global recession that followed the Lehmann Brothers collapse in 2009 Suzuki Osamu, at the time CEO and Chairman of Suzuki Motor Corporation, issued instructions for an "all-out battle" to share the pain equally throughout the company. In an auto industry where other companies were making heavy losses, Suzuki made headlines by making a profit of ¥67 billion. The company carried out an exhaustive reappraisal of spending, reducing all unnecessary expenditure and trimming everything to bare necessities. Overtime was banned, and some employees were put on temporary leave to reduce personnel costs. An "emergency management plan" looked for any opportunity to save, searching to reduce costs on the 30,000 parts used by the company by even one yen each. Thanks to long-standing relationships of trust, this exhaustive strategy gained the understanding of employees and everyone involved with the company.[29]

Lean manufacturing, practiced by Toyota Motors and other Japanese automakers, also depends on trust among employees and between employees and management. As discussed in Chapter 5, employees feel confident that the company will not lay them off even during a downturn or in periods when particular employees are no longer useful. It is this belief that allows the company to adopt a lean labor management strategy that assigns the smallest possible workforce to each job. Employees accept the demanding conditions imposed by the need to work with minimal distribution of labor because they are confident that their jobs are secure and long-term. Practices of this kind are supported by the long-term reciprocity shared by employees and management and by relationships of trust. As discussed in Chapter 5, the lean manufacturing method is also practiced in overseas subsidiaries of Japanese automakers.

We have seen that inward-oriented social capital can serve to reinforce the bonds among group members, leading to an exclusionary identity and increasing homogeneity within the group. These inward-looking aspects of social capital can sometimes hinder Japanese companies' efforts when they operate overseas. With team members and stakeholders from different backgrounds, languages, and cultures, clear understanding of intentions is extremely important. In these circumstances, intercultural communication becomes an important issue. In the overseas subsidiaries of Japanese companies, if two groups exist alongside each other made up of people speaking different languages, it can happen that two separate organizations spring up within the same company. A dual communication structure grows up and becomes a part of the company routine. The situation is exacerbated by inward-oriented social capital. As many people have recognized, how to deal with this problem is a major challenge for Japanese companies doing business overseas.[30]

In the years to come, Japanese companies will need to make better use of outward-oriented social capital internationally especially in the sphere of intercultural management. If they can make effective use of the social capital that undergirds the strengths of Japanese organizations, they should be able to achieve greater success in their overseas operation.

Yamato Transport, as mentioned above, is expanding its business in Asia, building on a foundation of trust and outward-oriented social capital. At Yamato Transport Malaysia, the company is introducing the personal delivery service developed in Japan to new customers in Malaysia. The company is working particularly hard on training its local staff. Drivers are sent from Japan to train the local "sales drivers." Work begins

with morning calisthenics, and then Japanese driver rides with the trainee and gives detailed training in the Japanese approach to customer service. Details are important: packages must be treated with the utmost respect and care at all times, and never placed on the ground. The lack of detailed street maps in Malaysia means drivers confirm details by phone during their first delivery to a given location. But they are trained to take careful notes of all their deliveries on a map so that they can find the location quickly the second time they visit. There was no tradition of designated time deliveries before Yamato entered the market, and a system that allows customers to name the time they want their package delivered has proved extremely popular, liberating customers from the need to stay at home all day waiting for their package. The "Cool Ta-Q-bin" service, which delivers chilled and frozen goods, is also popular. Some confectionary shops have apparently doubled their sales since the introduction of the service, which makes it possible to deliver cakes across long distances. The company has also made special efforts to adapt to local customs in the Muslim country by allowing drivers to break at prayer times during their shifts. The company opened for business in 2010; in the space of several years, the Japanese style of personal delivery has already made steady strides toward mainstream acceptance in Malaysia.

In an increasingly uncertain global economy, the priority on trust that lies at the foundation of Japanese management, and the structure by which that trust is developed, reproduced, and accumulated as social capital on a daily basis, is becoming more important than ever.

The Human Relations Approach That Satisfies Employees' Social Needs

People today spend more time than ever before away from home in a factory or office workplace. This separation between workplace and place of residence represents a process that began with the industrial revolution and continues today. White-collar and blue-collar workers and those in specialist and managerial positions all spend the same long hours at their place of work. In many cases people eat meals and travel together, and they clock on early and not go home till late. Growing divorce rates, the collapse of the traditional family, and a tendency for people to postpone marriage until later in life are among the factors that have led to unprecedented numbers of people living alone. For these people, the workplace often represents a "hearth" away from home, a place that assuages their loneliness and helps them avoid feeling alone.[31] And even for people who

live with a spouse and children, the workplace often serves as a refuge from the strains of marriage, children, and housework.

Of course, the workplace is fundamentally a place in which members spend their time and labor to achieve the goals of the organization; any social role the workplace performs is of secondary significance. Nevertheless, gratification of employees' "social needs" and "esteem needs" normally has a positive effect on maintaining and increasing motivation, and thus ultimately contributes to the achievement of the organization's goals. American psychologist Abraham Maslow, author of the well-known "hierarchy of needs" theory, claims that "the basic needs which motivate human beings are organized in a hierarchy of importance." Maslow asserted that human needs could be ranked on five levels, and that people are driven to pursue higher-ranked needs as their lower-ranked needs are satisfied. Maslow ranked the needs as follows: (1) physiological needs (satisfaction of hunger, thirst, etc.), (2) safety needs (protection against danger, threat, and deprivation), (3) social needs (or belongingness and love needs), (4) esteem needs (or egoistic needs) (self-approval and approval by others), and (5) self-actualization needs.[32] It is the social and esteem needs that become important motivators of people's behavior when they have attained a certain material standard of living and their physiological and safety needs are satisfied.

The importance of employees' social needs has been understood from early on. The Hawthorne experiments carried out in 1924–1932 by Elton Mayo and others at the Hawthorne works of the Western Electric Company near Chicago showed that social factors, including a social group at the workplace and adaptation to a peer group, affect employee satisfaction and productivity.[33] The Hawthorne study brought attention to employees' social needs and gave birth to the idea that meeting these needs could help to improve motivation. This is known as the human relations approach to management. The "human relations theory" focuses on the significance of social factors in human resource management, and stresses the importance of catering for employees' social and esteem needs. "Social needs" refer to the needs to belong to a group or organization, to be accepted by peers and colleagues, and to give and receive friendship and affection. "Esteem needs" refers to the needs to find self-esteem based on one's accomplishments, skills, and knowledge, thereby achieving self-confidence, as well as the needs to be acknowledged by others, thereby achieving social status, reputation, and prestige.

Traditional Japanese-style management took a holistic and familistic approach to employee relations, and valued the stability of the group and the organization. There was a belief that the employer should take care of employees not only in the aspects of their work lives but also in the aspects of their private lives. In Japanese companies, the social and human relations aspects were always an important factor in workplace satisfaction on all levels of the organization. It seems likely that this Japanese approach to satisfying employees' social needs is at least partly the reason why Japanese companies expanding overseas have generally been successful in their management of blue-collar workers.

After the bubble economy collapsed in 1990, however, many companies undertook rapid restructuring and introduced a more results-based approach as part of managerial reforms. It seemed that companies no longer placed the same importance on social factors. Over the past ten years or so, however, an increasing number of companies have been worried by the negative effects brought about by excessive reforms along these lines, and companies are making efforts to reintroduce policies that give social factors due importance. At the same time, the population of single people continues to increase as people postpone marriage until they are older or do not marry at all, meaning that social connections in the workplace are more important than ever. In 1970, just 12% of Japanese men in their thirties were single. This has increased rapidly, to 33% in 1990, and 47% by 2010. For women, the equivalent figures were 8% in 1970, 14% in 1990, and 34% in 2010.[34]

In this context, there have been signs of a movement to restore the kind of traditional social ties that had begun to disappear from the workplace. For example, a number of companies in Japan have introduced a new form of quasi-family. The idea is to give new employees a community-like environment and create a quasi-family to help new employees adapt to the organization and reduce stress. Each new employee is put under the mentorship of a "father" or "mother" figure and an elder sibling with whom he or she meets regularly to talk over problems and concerns in an informal atmosphere. I have already mentioned the IT services company Q&A Corporation, which abandoned its trial of results-based pay and reverted to a seniority-based system. The company has also introduced a program whereby employees' families are invited to the company to increase their understanding of the company's work and to provide an opportunity for socializing.[35]

Attempts to create a sense of community within the workplace can also be seen in the United States. Architects who design offices, for example, try to design workplaces that increase a sense of connectivity, creating spaces with names evocative of community such as "watering holes" and "campfires" where employees can come to relax and socialize.[36] As the American sociologist Arlie R. Hochschild has written, "new management techniques so pervasive in corporate life have helped transform the workplace into a more appreciative, personal sort of social world."[37]

In an increasingly competitive global market, many companies are focused on short-term economic returns and have been forced to make even greater demands of their employees and adopt even more flexible employment policies. Despite this tendency, a number of successful companies are making efforts such as those outlined above to create a community-like environment in the workplace. Establishing a sense of community within the company and encouraging mutual assistance and reciprocity leads to greater cooperation on a daily basis and helps teams to work together more effectively, thereby contributing both directly and indirectly to the achievement of the organization's goals.

Egalitarianism and On-site Management

One effective way to cater to the social needs of employees is to establish the organization as a kind of community and demonstrate that all the members of this community are essentially equal. Of course, managing an organization requires a decision-making system, a governing system for implementing decisions, and a hierarchy of authority, as most specialists and managers agree. But today the democratic idea that "all adults are essentially equal" has become widespread around the world and people expect equal rights in society. This has led to a move away from the authoritarian style of management based on a hierarchy of rank and to greater respect for a democratic atmosphere within companies.

Many companies now work to keep the image of "control from above" under the surface, stressing the concept of the company as a "cooperation system" that is sustained by the individual contributions and skills of each member. In companies in the developed economies, the tendency now in personnel management is to ensure equal opportunity, minimizing formal differences based on position, and avoiding a meaningless oppressive climate and unnecessary differentiation of positions.

Increasingly, companies are doing away with differences based on rank in terms of how salaries are paid and in the forms of fringe benefits.

One of the characteristics of Japanese-style management has been the relatively small economic and social differences within a company according to rank. Pay differentials are much smaller than in companies in Europe and North America. In American companies, for example, pay for top executives is reported to be more than 300 times that of the average worker for 2014.[38] In Japanese companies executive pay is generally between five and thirty times the pay of the average employee.[39] In Japan, the gradual internationalization of executive boards has resulted in a number of companies starting to offer higher remuneration for its directors than previously. In 2010, it became a requirement for listed companies to publish the names and pay packages of any directors receiving ¥100 million or more a year. At the end of the fiscal year in March 2010, the names of 289 directors were published, headed by Carlos Ghosn, president and CEO of Nissan Motors. The numbers have gradually increased and was 414 at the end of the fiscal year in March 2016. Slightly over 10% of listed companies pay a salary of ¥100 million or more to their top executive.[40]

Table 4.1 shows the top ten executives at Japanese and American companies in 2014 by amount of pay. A comparison of the figures in the table reveals that top executives in the United States receive about 5–6 times more than their counterparts in Japanese companies. Numerous doubts have been raised about the state of the compensation of senior executives in the United States, and public opinion is generally critical of the tendency for executives to grant themselves huge pay packets. British scholar of management Charles Handy cites a 2002 Gallup poll as showing that 90% of Americans believed that "people running corporations could not be trusted to look after the interests of their employees," and 43% felt that "senior executives were only in it for themselves." Also, 2016 Public Perception Survey on CEO Compensation carried out by Stanford Rock Center for Corporate Governance shows that "74% of Americans believe that CEOs are not paid the correct amount relative to the average worker," and that "there is a clear sense among the American public that CEOs are taking home much more in compensation than they deserve."[41] In another survey carried out in the United Kingdom, 95% of people polled gave a similar answer. Handy points out that the Anglo-Saxon model of corporate governance frequently leads to top executives pursuing their self-interest, with damaging effects.[42]

Table 4.1 The top 10 highest-paid executives: Japan and United States (2014) (*Source* Toyo Keizai, *Kaisha Shikihō, 2015* [Japan Company Handbook, 2015]; Toyo Keizai, *Beikoku Kaisha Shikihō, 2015* [U.S. Company Handbook, 2015])

	Executive name	*Company name*	*Compensation (base salary plus bonus)*
Japan			
1	Carlos Ghosn	Nissan Motors	¥995 M ($8.58 M)
2	Koji Tanabe	U-Shin Ltd.	¥834 M ($7.19 M)
3	Kazuo Okada	Universal Entertainment Corp.	¥810 M ($6.99 M)
4	Jun Fujimoto	Universal Entertainment Corp.	¥676 M ($5.83 M)
5	Hajime Satomi	Sega-Sammy Holdings	¥626 M ($5.40 M)
6	Hiroshi Mitsuhara	Nihon Chouzai Co., Ltd.	¥619 M ($5.33 M)
7	Yoshiharu Inaba	Fanuc Corporation	¥432 M ($3.73 M)
8	Hideyuki Busujima	Sankyo Co., Ltd.	¥420 M ($3.62 M)
9	Masato Matsuura	Avex Group Holdings	¥417 M ($3.60 M)
10	Frank Morich	Takeda Pharmaceutical Co. Ltd.	¥387 M ($3.34 M)
United States			
1	W. Nicholas Howley	TransDigm Group (TDG)	$48.33 M
2	William P. Foley, II	Fidelity National Financial, Inc.	$42.27 M
3	Richard Adkerson	Freeport-McMoRan Copper & Gold Inc.	$40.46 M
4	Stephen Wynn	Wynn Resorts Ltd.	$19.60 M
5	John Wren	Omnicom Group Inc.	$18.07 M
6	Robert Iger	Walt Disney Co.	$17.04 M
7	David Cote	Honeywell International Inc.	$16.56 M
8	Jeffrey Bewkes	Time Warner Inc.	$16.48 M
9	W. James McNerney, Jr.	Boeing Co.	$15.74 M
10	Brian Roberts	Comcast Corp.	$15.72 M

Conversion rate: $1=¥115.94 (closing rate on November 17, 2014)
¥M=million yen $M=million dollars

The remuneration paid to company executives must be sufficient to motivate them, and commensurate with the work they do and the responsibility they bear. But at the same time it also needs to be socially acceptable, given the importance of solidarity within the organization and societal integration.

How does the yearly pay for the Japanese company directors in Table 4.1 compare to that of other employees? An analysis of the data shows that the differential between the top executive's pay and the average employee salary is widest at U-Shin Ltd., the second-highest-paying firm. The average salary for an employee at U-Shin is ¥5.86 million. The compensation of its top executive Tanabe is equivalent to 142 times that figure. At Nissan, the top executive Ghosn gets 128 times the average employee salary ¥7.76 million; at third-placed Universal Entertainment, its top executive Okada gets 119 times the average employee salary ¥6.82 million. In American companies, the ratio between top executive compensation and workers' pay is much greater. The pay for W. Nicholas Howley of TransDigm Group, the highest paying firm, is reckoned to be worth 908 times the median wage for US workers ($53,200). William Foley of Fidelity National Financial, the second-highest-paying firm earns 795 times, and Richard Adkerson of Freeport-McMoRan Copper & Gold earns 760 times the median US worker wage.

As shown by these figures, the pay differential in Japanese companies has been relatively small, and pay has been generally on levels that are considered acceptable within the company and in the wider society. The philosophy of equality is effective in terms of managing blue-collar employees and white-collar clerical staff. This Japanese approach has increased employees' sense of belonging and pride in their place of work, has helped to satisfy their social and esteem needs, and has been useful in improving their motivation. However, as discussed in Chapter 6, this egalitarian approach creates a major problem when it comes to motivating managers and professionals. Growing numbers of Japanese companies are increasing the remuneration they pay to their managers—it seems likely that concerns with motivation lie behind this change. Motivating managers is of course important, and reforms of the system are necessary to allow companies to achieve this better. But the egalitarian approach that has been maintained thus far in Japanese companies has a fundamental importance in ensuring cohesiveness within the organization by keeping pay differentials at acceptable levels.

Unlike in European and American companies, where blue-collar workers rarely assume white-collar office jobs, in Japan it is quite possible for employees to be promoted across these "classes," and it sometimes happens that a worker who started out on the factory floor rises to a managerial role within the head company. This policy is helpful in

impressing on employees that the company is dedicated to the idea of giving everyone a fair chance.

Other aspects of the Japanese approach that are important in encouraging a sense of community, satisfying employees' social needs, and improving morale include the common practice whereby managers enter the factory floor or other place where work is going on and converse with employees directly to see for themselves how work is proceeding. This is known as "human touch management" (*ningen shugi*) or on-site management (*genba shugi*). This approach is common in Japanese companies, and many companies employ it in their overseas subsidiaries as well as at home.

At Toyota UK, for example, as discussed in more detail in Chapter 5, on-site management is an important part of the way things are run. Work teams and quality control circles identify problems as they occur in the work process and work to fix the problems within the production line or to improve the situation. This approach to improving product quality by concentrating on the place where the work is actually done is one of the strengths of Japanese companies. This traditional approach can be further reinforced by incorporating new elements such as IT and software applications. Toyota UK also sets a high store by its philosophy of one "single status" for all employees, and uses a uniform system of pay and benefits for all its employees. As a general principle, the company also treats all employees equally with regard to use of company facilities (see Chapter 5).

Suzuki, another automaker, implements Suzuki management methods at its Indian subsidiary, Maruti Suzuki India, starting each day with a "morning greeting" and having employees eat lunch in the same staff canteen. As the influence of the Hindu caste system still remains, some employees resisted the practice at first, but it was eventually accepted and is now said to run smoothly.[43]

The Marushin Shitaka Construction Company, headquartered in Toyama Prefecture, undertakes contract work building roads in Nepal and Bhutan, where it uses the same approach and practices as in Japan. Making use of its technological and safety expertise, the company uses the traditional "bunkhouse (*hanba*) system" in which local workers are moved in a group to bunkhouses during work on large road construction projects. The bunkhouses, where workers sleep, eat, and rest, are set up close to the worksite. At dinner time the Japanese team leaders and the local workers all sit together around the same table and there is an

opportunity for relaxed conversation and communication. The merits of this approach include improved understanding of the problems on-site and maneuverability.[44]

Innovation Advantage

How a Long-Term Perspective Makes Enduring R&D Possible

The chief priority for European and American companies is shareholder profit. Maximizing return on equity is generally seen as the most important requirement made of a management team. In this context, projects offering little prospect of short-term return find it hard to gain shareholder approval. And because managers are evaluated by short-term results, CEOs tend to be afraid that they might be dismissed unless they produce positive results. And because pay is tied to performance in many companies, there is a tendency for people to concentrate on low-risk projects promising short-term results. This makes it more difficult for long-term projects to succeed. But creative projects often come with commensurate risks and in many cases there is a need for research and development that looks ahead several decades into the future.

Long-term stable employment is often described as one of the aspects of traditional Japanese management that assists R&D (research and development), particularly creative innovation. The assumption that employees will stay with the same company for many years makes the company more likely to invest in developing its employees' skills. Sending employees to study abroad is one such long-term investment in developing employee abilities. Mitarai Fujio, chairman and president of Canon, has said that the ability to make the best long-term use of human resources thanks to the Japanese employment system, together with an environment that allows companies to devote time and money to a long-term project for technological development, are the foundations on which Japanese innovation is built. Mitarai emphasizes the importance of making use of innovative strength that is rooted in Japanese culture.[45] Research findings suggest a correlation between a long-term management perspective and technological competitiveness.[46]

Even in the case of long-term research and development, however, there must obviously be reasonable expectations of marketability and profitability in the future. In these circumstances, the long-term intercompany networks and the relationships of trust they are founded on

help to minimize uncertainty about the future and encourage a positive attitude toward innovation. Below are several examples of companies that have successfully developed new products as a result of long-term R&D supported by long-term stable employment and long-term managerial perspective.

Showa Shell Sekiyu: The CIS Solar Battery Module. It was the oil crisis of 1973 that prompted oil wholesaler Showa Shell Sekiyu to consider developing renewable energies to replace oil. The company started an R&D project on solar energy in 1978, spending nearly thirty years developing a new type of solar cell battery called the CIS. A decision to release the new product commercially was made in 2005 and two years later commercial production began at the company's factory in Miyazaki. The CIS is a thin-film solar module that has copper, indium, and selenium as its key components. It does not contain any silicon or cadmium (a toxic substance). In conventional crystalline silicon solar panels the silicon layer has a thickness of 200–300 μm. With the CIS module it is possible to reduce the thickness to just 2–3 μm, allowing dramatic savings in the use of raw materials and increasing energy-generation efficiency considerably. Since 2010 the company has been expanding production in partnership with Solar Frontier (a wholly owned subsidiary) and has established sales corporations in Germany and the United States.

The person responsible for developing the new product has said that initially the company, which did not reject his proposal, just let him continue doing the research, and thanks to that, he was able to achieve his success.[47]

Toyota Motor Corporation: *Biodegradable Plastic*. In 1998, Toyota launched a new Biotechnology and Afforestation Business Department to work on environmental issues, and started to develop a biodegradable plastic. Biodegradable plastic offers the same qualities as conventional plastic but can be disposed of by burying it in the ground after use. Microorganisms in the soil break it down into water and carbon dioxide. In addition, using plant materials such as sweet potato and sugarcane to replace oil-derived chemical compounds can help to reduce oil consumption and prevent an increase of CO_2 emissions even if the plastic is incinerated after use. The biodegradable plastic is used in spare tire covers and floor mats in Toyota's cars. The company says it hopes the business will be worth several trillion yen in sales in the future. "In the short term, the project requires large amounts of initial investment, but we are looking at this from the long-term perspective," they say, emphasizing the

importance of a long-term strategy that looks ahead ten or twenty years into the future.[48]

Toray: Carbon Fiber and Reverse Osmosis Membrane. Toray's carbon fiber materials have been in increasing demand in recent years, and are used in the fuselage of the Boeing 787 and other leading aircraft. Today, the company is the market leader in carbon fibers, with a 40% share of the global market in 2017. However, for thirty years before Toray could develop its carbon fiber into a profitable commercial product, it took a continuous loss on the project. Toray started research on carbon fiber in 1967. The first trial manufacture had begun in 1957 in the United States, and in 1967, after the British firm Rolls-Royce announced that it would use carbon-fiber reinforced plastics in its jet engines, Toray began its research and in 1971 launched T300, a high-strength carbon fiber. In 1982, the first aircraft using the T300 fiber took to the air, including Boeing's 757 and 767 aircraft and the Airbus A310. The primary reason cited for the use of the Toray fiber was its lightness, which helped to reduce fuel consumption. In 1982 the company set up a joint venture to manufacture carbon fiber in France, and has since expanded its local production facilities around the world, opening production plants in the United States in 1992, in South Korea in 2003, in Germany in 2011 and in Italy in 2015.[49]

A source at the company familiar with the details of the research told the author, "Developing a product like this involves huge costs and massive investment. It would simply be impossible without a stable company culture built on long-term employment. Such a culture is essential to allowing a company to look ahead to results 10 or 15 years down the line with a project that doesn't produce any results in the first year or two. When Toray started its research a number of chemical companies in Europe and the United States were working on similar projects. But most of them gave up along the way, and in the end it was a Japanese company that persevered with its research and made the business the success it is today."[50]

In 1968, Toray began research on reverse osmosis membranes, now widely used in water treatment applications for seawater desalination, water purification, and water purifiers for home use. The company was prompted to start research by the news that the American firm Du Pont had succeeded in developing a reverse osmosis membrane using aramid fibers. In 1972 Kurihara Masaru, newly returned from two years study in the United States, was placed in charge of the development project, and in 1976 Toray announced its first commercial reverse osmosis membrane, a first for a Japanese company. At the end of that year, IBM's

factory in Yasu, Shiga prefecture started to use Toray's reverse osmosis membrane to purify wastewater for reuse. At the time, the market for wastewater treatment applications was extremely small, and this was Toray's first order.

Soon after this, however, the market grew rapidly with the need to supply ultra-pure water for semiconductor factories, and Toray's reverse osmosis membrane business grew in tandem with the growth of the semiconductor business. In 1982 Toray started to develop its product for mass production, and completed a mass production facility at its Ehime factory in 1985. It was discovered that the reverse osmosis membrane was also suited to desalination of seawater. In 1994 Kurihara and his team established a two-stage seawater desalination system that was launched commercially in 1999.[51] In the early 2000s water shortages in many parts of the world led to an increased demand for reverse osmosis membranes, and desalination plants increased in both number and size. The need to replace dirty membranes also helped the market demand to grow. In 2010, Toray was the third-biggest company in the global market for reverse osmosis membranes, with 14% of the market. (In first place was Dow Chemical, with 33% of the market, followed by Nitto Denko with 30%.)

In 2003 Toray received the Ōkōchi Memorial Production Prize for its achievements in developing a high-performance polyamide compound reverse osmosis membrane and a high-efficiency reverse osmosis membrane system.[52] Fully thirty-five years had passed since Toray started to develop these products in 1968. Over the course of that time, most of the companies that had been engaged in similar research either left the market or were taken over. Kurihara, who played a central role in the development of these products, says that Toray was able to continue its research in a competitive field and turn its invention into a successful product, eventually becoming the third-biggest supplier in the market, thanks to two factors: the keen competition on capacity and efficiency with other manufacturers in rapidly growing field and the perseverance and dedication of the research team, supported by the understanding of the company's top management.[53]

Psychological Energy Born from a Commitment That Transcends Duty

Producing innovation is essential to the long-term success of a company, and it is the key challenge of the company to create a climate in which employees volunteer their creativity and expertise. In order to foster

innovation, a company needs a kind of spontaneous cooperation that goes beyond the level of duty, and needs to draw on the sharing of ideas and knowledge that only emerges when people proactively collaborate. A positive commitment that goes beyond work as a simple duty depends on trust in managers and the management system, a sense of community, and the loyalty that these produce. Trust and loyalty make it possible to coax from employees a kind of mental energy that cannot be induced by financial rewards alone. As discussed in Chapter 5, Japanese-style lean manufacturing is said to be effective at bringing out more from employees by fostering trust and loyalty, and delegating authority and autonomy to the workers in the area where they do their work.

In order to bring out employees' latent potential to the fullest extent, it is important to minimize control and create an environment where they can set their minds free to achieve high-level goals. Creating this environment makes it possible to empower each individual employee. Kyocera's "amoeba management" is a well-known attempt to create this kind of environment of "empowerment."

Kyocera and Amoeba Management

The amoeba management implemented at Kyocera was conceived with the aim of encouraging innovation from every employee. The system works by establishing a large number of small units within the company called "amoebas." These serve as the units of management, and are allocated funds by the company that they use to generate profits.[54] The amoeba management system was implemented by the company's founder Inamori Kazuo, now honorary advisor to the company, when he was chairman and CEO. Inamori says that as companies grow in scale there is a tendency for management to become bureaucratic and become dependent on instructions from senior management in order for anything to move. Bottom-up thinking was traditionally one of the strengths of Japanese organizations but that strength was being lost, Inamori says, as companies got bigger.[55]

Dividing a company into smaller groups and running them each on separate budgets encourages individual employees to think about profit margins in their work and encourages them to get involved in management. Top management supervises these amoebas. Amoeba management develops employees' entrepreneurial spirit and mind for management, and encourages people to move spontaneously and autonomously instead of waiting for orders from above. The system, therefore, works

as a whole-team approach to management that aims to bring out the strengths of each individual employee to bolster the company as a whole. This approach has produced numerous innovations and is said to have been fundamental to Kyocera's growth. The amoeba management method has now been introduced at other companies, and reports suggest that it has helped a number of companies successfully energize their organizations.[56]

The long-term employment characteristic of Japanese organizations can sometimes produce complacency and dependency in employees. This causes a company to become listless and conservative and can lead to a loss of creativity and ambition. Perhaps the best way to keep the organization energetic is to utilize the trust typical of Japanese companies as a basis, and create an atmosphere in which employees can proactively challenge themselves to achieve new goals. Inamori says that a trusting relationship among its members is vital to ensure that the organization functions effectively to produce innovation and creativity.[57]

Conclusion

As shown in this chapter, the most important management practices in the private sector in Japan came about by adapting into modern corporations the organizational principles and relationship structures that originated in the *ie* system but went beyond the level of the actual family unit. Through people's daily interactions within and between these pseudo-family organizations, made up of people who were not actually related by kinship ties, trust was generated, reproduced, and accumulated as social capital. The trust and social relations of reciprocity built up in this way formed the foundation on which private companies grew and developed in Japan. The Japanese social capital that was formed in this way also had aspects that were rational and universalistic. These aspects played an important role in enabling this social capital to act in an outward-oriented manner, working effectively to encourage collaboration and exchanges of information with outside resources and to produce a broader system of reciprocity. The collectivism and groupism that originated in the traditional family system therefore combined with rationalism and universalism to provide a strong base for the development of Japanese corporations.

Since the 1990s, as many companies have carried out restructuring and adopted increasingly market-driven policies, there has been a

tendency for managers to introduce competition-oriented ideas into internal management practices. Today, however, in working out future strategy, it is important for Japanese companies to look back on the developments of the past twenty-five or so years, reevaluate the unique strengths of Japanese-style social capital, and apply them effectively in new contexts. This is likely to be an important issue for the development of Japanese companies in the future. As shown, social capital has both positive and negative implications for a company's development. By eliminating the negative aspects and working proactively to maximize the benefits of the positive aspects of outward-oriented social capital, companies can improve their performance, strengthen their international competitiveness, and succeed in developing their businesses in global markets.

In this chapter I have outlined four characteristics of Japanese management born of the positive aspects of Japanese-style social capital: (1) trust and the norms of reciprocity; (2) the human relations approach that satisfies employees' social needs; (3) egalitarianism and on-site management, and (4) innovations created by enduring R&D projects and long-term commitment. I have tried to show through a number of concrete examples how these qualities have brought about the competitive strengths of Japanese companies today. Companies in other countries, too, can learn from the analysis of the strengths of Japanese management presented in this chapter, particularly those relating to the human side of corporations.

The strengths of Japanese-style management described above will not emerge in the American-style hire and fire environment. Of course, there are American companies that emphasize human relations led management, communication with the front lines, and the egalitarian approach, and maintain long-term high performance. Their number, however, is small, and most manage themselves with top priority on the demands of market competition. They are rather quick to reduce their workforce, tend toward short-term hiring, and trusting relationships between management and employees do not necessarily prevail.

Such companies could increase motivation among their employees by adopting from Japanese-style management a human relations approach that satisfies employees' social needs. Such approaches are especially effective in motivating lower-level employees. In fact, companies can require managers to enter the workplace and communicate face-to-face with employees. Making shop floor level employees feel appreciated and trusted can encourage them to put forth even more effort.

As mentioned previously, the innovation strength of Japanese companies derives from a long-term management perspective that looks ahead several decades into the future, along with the ability to develop and utilize human resources on a long-term basis and devote significant resources continuously to long-term R&D projects. Western corporations would be able to enhance the innovation ability they possess, by placing more emphasis on long-term strategies such as adopted by Japanese companies and creating an environment that is more favorable for pursuit of enduring R&D projects.

Western corporations can also learn from the egalitarian approach of Japanese firms. This chapter compared the compensation of top executives and the average employee in US and Japanese companies and demonstrated the extremely large pay disparity that prevails in American firms. Distinctions in rewards are necessary according to the weight of responsibility and to achievement, but such differences must be kept to a level that is accepted both within the organization and by the society as a whole. In that regard, many US companies ought to try to close the pay gap between top executives and the average employee. By making efforts to correct the "excessive" remuneration of senior executives, companies in North America and Europe will be able to restore employee confidence, trust, and commitment. Adoption of these suggested approaches will help firms to steadily build trusting relationships and social capital, and improve their long-term performance.

Notes

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patriarchal household system that developed among the samurai class during the Tokugawa period, the system assigned the right to leadership in family affairs to the head of household. The Civil Code was extensively revised in 1947 to be consistent with the postwar Japanese Constitution, and the *ie* system was abolished. However, customs deriving from the *ie* system continued to have a significant influence on Japanese society, as this chapter shows.

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CHAPTER 5

International Transferability and Adaptability

Japanese companies have globalized dramatically over the past half-century. Although the amount of foreign direct investment by Japanese companies has varied from year to year due to exchange rate fluctuations and other factors, the long-term trend has been consistently upward. Direct investment from Japan surged in the second half of the 1980s following the Plaza Accord, and despite a temporary slump after the collapse of the bubble economy in the early 1990s, it was back on an upward curve by 1994. Investment has continued to increase and in 2013 reached a new peak of ¥13.4 trillion. This trend is expected to continue, with Japanese companies likely to transfer more of their manufacturing overseas in the years to come.

Japanese companies have not always invested most heavily in exactly the same countries, but places like the United States, the United Kingdom, China, and the Netherlands have generally been among the favorite destinations.[1] In recent years, there has been a rapid increase in investment in Asian countries, particularly ASEAN, where wages tend to be lower.[2]

In terms of the past decade or so, the subprime mortgage crisis that emerged in the United States from 2006 to 2007, followed by the Lehmann Brothers collapse and the global financial crisis, brought chaos and depression to the world economy. The American economy has been steadily recovering since then, however, and, with the cheaper yen brought about by the quantitative easing carried out by the Japanese

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government since 2013, the numbers of Japanese companies reporting improving results has increased.

The automotive industry, in particular, has been performing well. In 2013 Toyota posted its first profits in five years and the other six automakers have also reported increased earnings. Automakers are planning to capitalize on these positive results by expanding and strengthening their production facilities overseas. Honda began production in a new factory in Mexico in 2014 and shifted part of the production for its popular minicar Fit to the new facility. Toyota moved part of the production process for its luxury model Lexus to Kentucky in 2015.[3] Fuji Heavy Industries has also announced plans to increase production at its factory in Indiana by roughly 50% from current levels as it looks to boost production capacity for its Subaru cars.[4]

Considerable research has been done on the management practices of Japanese companies overseas. One subject that has attracted particular attention is the extent to which Japanese companies use traditional Japanese methods of organizational management in their overseas subsidiaries, and how these practices function in a foreign setting. Now that several decades have passed since Japanese manufacturers began production overseas, the time has come to look at these questions anew. This chapter considers several examples of Japanese companies operating overseas, examining how Japanese management methods are used and analyzing the types of practices that seem to function most effectively at present. The discussion covers the global transferability of the methods, i.e., the possibility of introducing and successfully using them in new regions of the world. My analysis centers on automotive companies, which have led the way in establishing Japanese systems of production and management overseas.

Lean Production System and Its Expansion Overseas

As we saw in Chapter 2, the Japanese approach to management played an important role in increasing productivity at Japanese companies and accelerating economic growth. In the high-growth period, the non-Western management systems that made Japan's remarkable economic development possible attracted attention from around the world. In particular, many managers in the United States took an active interest in Japanese management methods, hoping to find in them a solution to the problems American companies were experiencing under the system of

scientific management, or the Taylorite model of mass production, with productivity stagnant since the late 1960s and competitiveness dwindling.

Japanese Manufacturers' Experience of Success

As Japanese wages reached parity with European and American levels in the 1970s, it became increasingly evident that the competitive advantage of Japanese firms could not be explained away simply by lower wages. American managers came to realize that the secret to Japanese companies' success was to be found not in automation and other advanced production technology or low wages but in the efficiency achieved from systemizing and organizing the workforce.[5] If a Japanese and an American company produced a product using similar product designs and production technologies, in many cases the Japanese company would come up with a higher quality product at lower cost. It was said that less than one-third of the cost difference between American and Japanese firms were attributable to differences in pay levels.[6] It followed that the rest of the difference could be ascribed to the way in which human resources were managed, particularly in the holistic company strategy with which the entire workforce was organized.

In the finance and other nonmanufacturing industries, Japanese companies operating overseas have been found to suffer from substantial problems in the area of human resource management.[7] In the automotive industry, by contrast, they have been quite successful in managing local blue-collar employees. Most Japanese automakers operating manufacturing plants in the United States and the United Kingdom employ Japanese methods of production and management. In this, they differ from many Japanese companies in other sectors, which tend to use either local management practices or a modified version of them. The employment system used by Japanese companies in the United States and Europe is often described as a mixed system, but in many cases, it is actually quite close to local norms. Several studies including my own have shown that the hiring and employment system in these firms tend to follow the standard practices of local companies, although they may incorporate some of the traditional Japanese practices including subsidized leisure activities and other fringe benefits, bonuses for all employees, a Japanese attitude to layoffs (avoided wherever possible), and a remuneration and incentives system for specialists and managers that are not entirely results-based.[8]

In contrast, many Japanese automakers employ classic Japanese-style production methods and organizational management approaches in their overseas subsidiaries. Central to this approach is the method variously known as "lean production" or "just-in-time manufacturing," first developed by Toyota Motor Corporation and later adopted by other Japanese manufacturers including Honda, Mazda, Fuji Heavy Industries, and Mitsubishi Motors. A number of US automakers including the Ford and the General Motors' Saturn plant in Tennessee have attempted to adopt aspects of Toyota's management style although with differing degrees of success.

The management of Japanese automakers in the United States has had a considerable influence on the management style of American companies too. More than thirty years have passed since Honda started production in the United States in 1982 and nearly as long since Toyota established a factory in Kentucky in 1986. In this time, Japanese automakers have had an immeasurable impact on the industry in the United States. Japanese companies introduced a philosophy and approach that transcended Japanese culture, involving product development, production methods, and quality control that lead to the establishment of new benchmarks. As one manager at an American research company said: "They moved into the American heartland, built non-unionized factories using their own distinctive workplace practices and supply systems, and showed that it's possible to achieve sustained growth for more than 30 years."[9]

The question of how Japanese automakers were able to transplant Japanese management styles effectively to their factories overseas attracted considerable interest from company managers and researchers. The creation of new factories overseas by Japanese automakers provided students and scholars of organization and management a unique opportunity to observe a major social experiment as Japanese automakers transplanted typical Japanese organizations and production methods into an entirely foreign environment. For these reasons, many studies have been conducted on the lean production system that is at the core of the organizational management of Japanese automobile plants. I will look at some of these studies in the following section. In spite of the public and scholarly interest shown in these systems, however, less work has been done on the human aspects of the production floor—how employees work on a daily basis, their attitudes to working in teams, the way they feel about the wider organization, and how they produce high-quality

products. This chapter will examine these aspects of the workplace, helping to elucidate why lean production has been successfully functioning as a sustainable system in the overseas operations of Japanese firms.

The Lean Production System

The lean production approach to production and organization consists of several elements. These include a "just-in-time" production process, inventory control using a "*kanban*" (a card indicating the need to deliver items as they are used up), a "jidōka" system in which automated machinery and the line cease running and workers stop production when a defect or problem is detected, standardization of work processes, and "*kaizen* activities" aimed at constant improvement. "Just-in-time" production is built on the principle of maintaining minimum stocks of parts and finished products and requires suppliers to deliver once a day or several times a day in order to supply "just-in-time" the amount of parts required at each stage of the assembly process. This is the origin of the phrase "just-in-time manufacturing," another name for lean production.

Origin and Functions

Lean production was invented in the 1950s by Ōno Taiichi, a director of production technology and chief production engineer at Toyota. In the United States, the Korean War had created a surge in demand. Automobiles in the United States were mass produced following the Taylorite model of scientific management with a highly specialized workforce organized for the increasingly refined division of labor. Automakers in the United States could afford to purchase specialized machine tools that could be held in place for a long period of time, and they could set aside factory space to keep extensive inventories of stock so as to ensure that production lines were never disrupted. The problem Ōno faced was that Toyota's market was too small to support this sort of system. So he came up with an alternative approach that required lower capital costs and offered higher productivity per unit of capital than the scientific management method.

The essence of lean production was to make it easy to stop the production line wherever a problem occurred at any stage of the production line. Cords were set up within reach of each worker manning workstations at regular intervals along the line. Whenever a problem occurred, a worker could pull the cord and bring the production line to a halt. If a

worker has not finished a given task within the scheduled time, or some parts have not been delivered on time, the entire production line stops. This ensures that all the workers and engineers on the line know there is a problem. The main benefit of this system is that it allows workers to solve the problem where it occurs. This prevents defective parts from being incorporated into the finished product.

In a traditional mass production factory run on the scientific management method, workers are motivated to continue their routine work even when there is a problem with one of the parts. They will continue attaching bolts to a door even if the door plate is bent out of shape. Problems are fixed at the end stage of the assembly line. In lean manufacturing, problems with quality are addressed where they occur—in the case of a problem with a door plate, this would be at the workstation where assembly takes place, or at the level of the factory of the supplier who provided the part. This makes it possible to identify problems with quality before large numbers of defective products start to come off the assembly line.

The initial process of starting a lean production system for the first time is quite difficult, but once the system is up and running it brings considerable improvements in quality. As a result of Ōno's innovations to the die-change process, for example, the amount of time needed to change a die plate was reduced from a day to just three minutes, and the work could be done by production workers themselves instead of requiring die-change specialists.[10] Under the lean production system, decision-making responsibility is delegated to workers on the assembly line. Unlike in scientific management, where workers are given detailed instructions on how to carry out simple, limited tasks, in lean production the entire work team has wide-ranging responsibility and works together to find ways to solve complex problems that arise during the production process. Devolving responsibility upon work teams keeps fragmentation of the work process to a minimum. Workers are trained to perform a wide variety of tasks and can change positions as necessary. Work teams are also given time to discuss assembly line operation and are encouraged to suggest ways to make the production process more efficient. This approach gave rise to the concepts of the "work team" and, later, to the "QC circle."

The QC circle system involves regular meetings in groups of six or seven up to around 20 employees who work together in production. At the meetings, they discuss any problems relating to production,

suggest improvements to the work process and product quality, and submit proposals to management for approval. The idea of the QC circle was proposed in the United States in the 1950s by William Edwards Deming and was later introduced to Japan. QC circles were introduced at Toyota from an early stage as the company adopted lean production methods that delegate responsibilities for factory-floor management to work teams. They continue to be used today, both in Japan and in Toyota's factories overseas.

I have personally visited Toyota's factories in the United States and the United Kingdom several times to interview personnel managers, team leaders, and other employees. One of these production sites is the plant operated by Toyota Motor Manufacturing UK (Toyota UK) at Burnaston in Derbyshire, an important center of manufacturing for the EU market that has achieved positive sales results. Both in its factories in Japan and overseas, Toyota has practiced QC circles for kaizen activities for many years utilizing the work team system. At Toyota UK, kaizen activities take place in the following way.

Between 3000 and 4000 blue-collar employees work in the plant. They are known as shop members and are divided into 160 groups. Each group is further divided into four teams. Each team is made up of six people in total: five team members and one team leader. The job of the team leader is to look out for defects, to provide cover for sudden absences or injuries, and to cover for a worker when two or more employees are off work at the same time. The practice of having the team leader filling in for an absent member allows the company to operate with a leaner workforce than having to allocate standby employees, which is often the case in American auto factories. The team leader does not normally work on the line at other times. Another of the team leader's responsibilities involves providing on- and off-the-job training to other team members. Each group also has a group leader. The group leader does not work on the production line, but is responsible for personnel management within the group. Above the group leaders are the senior group leaders (somewhere between 60 and 70 individuals per factory).

Each morning before the production line starts up there is a two- to three-minute team meeting and a five to ten minute group meeting to discuss quality, safety, and daily tasks. For any issues involving significant changes, a kaizen project is proposed via the QC circle known as a kaizen action meeting (KAM). Management sets subjects to be

addressed in six-month periods starting in January and July each year based on that year's company "hōshin" (policy). Team leaders act as project managers, encouraging their teams, choosing what issues to address within each given subject, and pushing these forward as kaizen projects. For example, if the subject chosen by management is "improving quality for customers," teams will first carry out a brainstorming session on all aspects of their work that can affect quality, before choosing one or two issues, using quality management control tools to analyze the problem, and then start working on the project. Each group holds a presentation meeting to present their findings every six months, followed by a company-wide presentation meeting.

The purpose of the kaizen activity is to harness members' problem-solving abilities and leaders' abilities to improve work performance. The activities help both to develop individual team members' skills and to further the long-term prosperity of the company at the same time. The twice-yearly presentation meetings are effective ways of increasing ordinary workers' understanding of the issues at stake. Toyota started small-scale daily kaizen projects when it opened its UK plant in 1991; the KAM system was introduced in 1994 to give members resources and time to spend on improvements. In 1997, the company made the kaizen project approach official and the activities of the QC circles have followed this format since then. The quality control department is responsible for managing a project. The kaizen committee chaired by the director in charge of quality control (a local hire) and the personnel department organize and carry forward the activities of the whole company, and under them the group leaders facilitate kaizen activities.

The company target is that each team should complete two kaizen projects in a year. All teams start kaizen projects, but because these projects often involve considerable burdens of time in addition to the overtime workload which is already substantial, only a few projects are actually completed. This is a fundamental difficulty with running something like the QC circles on an ongoing basis. The most important factor for making kaizen projects sustainable and enabling them to be completed, employees say, is that group and team leaders be proactive in encouraging and supporting the projects. Personnel managers point out that if employees cooperate to make kaizen projects successful, this is because they stand to receive a bonus if productivity increases as a result of kaizen improvements. The company continually makes that clear to the employees.

Comparative Advantages

Quite a few studies have been conducted on lean management, some of them praising the system and others highly critical of it. According to researchers and specialists who take a positive view, lean production as it is practiced in the Japanese auto industry helps to ensure employment security and job enrichment, and empowers employees by delegating substantial power and autonomy. Employees cooperate willingly in the running of the system and work hard to achieve the company's objectives. The key to success with lean production, many commentators say, is bidirectional commitment based on a relationship of trust between the company and its employees. James Lincoln and Arne Kalleberg are among those who have argued in these terms.[11] Another way of putting it would be to say that lean production is an ingenious technique for effectively getting more labor out of workers, including intellectual labor. One reason why the Toyota approach is superior to Fordism, according to these writers, is that it has solved "the classic problem of the resistance of the workers to placing their knowledge of production in the service of rationalization."[12]

A study group at the Massachusetts Institute of Technology, while placing a high value on the Toyota approach to human resource management, drew attention to its merits from an industrial engineering perspective. MIT professor James Womack launched a study known as the MIT International Motor Vehicle Program in the 1980s. The study looked at the production methods used in Japanese auto manufacturing plants, paying particular attention to Toyota's *kanban* (just-in-time) system, and analyzed and re-systematized the methods as a universally applicable approach that they called the "lean production system."[13] The "lean production system" in the MIT study was characterized by worker empowerment, innovative production techniques, and close relationships with suppliers. The researchers argued that neither Japanese human resource management nor Japanese production technology could function effectively alone. Both had to function together to make the efficiency of Japan's automotive industry a reality.

More critical writers have taken an almost diametrically opposed view of lean production. The success or failure of the Toyota method depends on the attitudes of its assembly workers to a much greater extent than is the case with Fordism. This means that workers have a proportionately greater power and authority as well as autonomy. But, conversely, the labor demanded from each worker also increases. Proponents of

the Toyota approach and scholars who evaluate it positively see this as "empowerment." On the contrary, critics and those who evaluate it negatively regard it as "more exploitation."

Other critical studies include the work by Joseph Fuccini and Suzy Fuccini and by Steve Babson, who have written in detail about confrontations that took place at a joint venture between Mazda and Ford in Michigan, where there were tensions between workers (members of the United Auto Workers Union) and management regarding the role of team leaders and other issues.[14] James Rinehart, et al. have reported cases of go-slow resistance and strikes at CAMI (Canadian Automotive Manufacturing, Inc., now CAMI Automotive Inc.), a joint venture run by GM and Suzuki in Ontario, among workers working on a team basis.[15] Philip Garrahan and Paul Stewart have criticized the lean production methods used at Nissan's assembly plant in Sunderland, England for encouraging workers to take personal responsibility for work-related and organizational problems, as if the company itself is not able to do anything to address these problems.[16] Other reports have pointed to dissatisfactions among factory workers at Japanese companies and poor evaluations of Japanese managers. However, quite a few of these reports rely on one-sided opinions obtained from former employees who quit their jobs at Japanese companies for a variety of reasons. Positive reports based on more balanced sources far exceed these negative reports.[17]

It is certainly true that lean production, by attempting to respond to management demands to lower production costs while improving quality at the same time, requires extra labor from workers compared to traditional production methods. A likely consequence is a commensurate increase in the pressure put on workers to deliver. Despite these reservations, the lean production model as operated by Toyota is one of the very few systems that can ensure the sustainability of employees, employment security, and the sustainability of the company itself, and it would be difficult to find a system that surpasses it at the present time.

From a quality of work-life perspective, the craft team method devised at Volvo is often claimed to be preferable to lean production. But the high costs involved in this system eventually proved to be unsustainable. In the 1970s, Volvo abandoned the conveyor belt assembly line in an attempt to improve working conditions, and introduced the craft team system based around work teams made up of several employees responsible for each work process. In *An Alternative to Lean Production*, a study published in 1992, Christian Berggren, a researcher working on Swedish

methods of management, published survey results suggesting that the craft team system was superior to the lean production method in terms of working conditions and worker autonomy, since it was formed of independent work groups that respected the humanity of the workers.[18]

I myself was impressed by the levels of workplace satisfaction when I interviewed a foreman, team leaders, and team members at a Volvo factory in Sweden in 1997 shortly before the restructuring of the auto industry. When I visited the factory floor the foreman proudly told me that the company carried out strict job rotation on a weekly basis, moving workers every week for all jobs except that of spray-painting. Although the craft team system was welcomed by workers and attracted attention from industrial engineers, the spiraling costs of the system continued to cost Volvo heavily in terms of international competitiveness. As a wave of restructuring swamped the global auto industry, Volvo's car division was sold to Ford in 1999 and then acquired by the Chinese firm Geely Automobile in 2011.[19] Craft team manufacturing has many merits in terms of the quality of work-life, but the costs involved in producing cars with this system make it unsustainable. It is difficult to see how Volvo's craft team method could compete with the Fordist manufacturing system or the lean production approach.

Lean production was born as the result of an attempt to achieve an optimal compromise between the competing demands of the sustainability of employees and employment security, and between maintaining quality and reducing costs. Lean production is widely used not only in Japan but also in Japanese subsidiary plants overseas. As a number of surveys including my own have shown, the method and the concepts behind it are generally well accepted by employees. In particular, as I will describe below, employees have a high opinion of the job security that lean production makes possible. Even more significant, as the examples of Toyota and Honda show, the method has been actually in use for many years and continues to be used fairly successfully into the present.

The Human Side of Lean Production: Reconciling Human Needs and Efficiency

As we have seen, lean production offers a solution to the difficulty of reconciling the competing aims of employee sustainability and employment security and the conflicting demands of maintaining quality and reducing costs. But what is the mechanism that allows various elements that make

up the lean production system to function together so well? And how do team members, team leaders, and other employees respond to difficulties in their daily jobs and cope with competing demands to ensure that the system as a whole functions on a sustainable basis? This section will look at these issues in some detail, focusing on the human aspects of the system.

Employment Security and a Lean Workforce

Employment Security

Since restructuring began in the 1980s, even Japanese companies where lifetime employment was taken for granted for many years now carry out job cuts more often than used to be the case. But Japanese companies still tend to value employment security more than companies in Europe and North America and work harder to avoid layoffs. Many Japanese companies place great importance on employment security in their overseas operations as well. This policy is welcomed by blue-collar employees and puts Japanese companies in a positive advantage when it comes to hiring a high-quality workforce. In Japanese auto companies, long-term relationships between a company and its employees are an indispensable part of managing the lean production system effectively.

At Toyota UK, where I carried out interviews in the course of my research, the company implements the following policies to ensure employment security. The company says that "long-term employment stability is a priority for the company, and we avoid redundancy layoffs as much as possible except as a last resort." Layoffs are generally not unusual at ordinary British companies or American companies operating in the United Kingdom. When Ford and GM closed their UK factories and withdrew from production in the United Kingdom, many people suspected that Toyota UK would simply close its factory and withdraw from the market if its results deteriorated. But despite this widespread concern, Toyota UK has not carried out a single redundancy layoff since it opened its factory in 1992. Around 2000, it was operating with a labor workforce surplus of around 10%, but even then it did not dismiss any employees. Although the company has not made an absolute promise never to lay off its employees, it has maintained a basic position avoiding layoffs except as a final resort.

There can be little doubt that this track record has a positive influence on employee morale. Workers often complain that work is tough

or grumble about the need to work overtime to finish a job by deadline. But management repeatedly explains that this is the only way to avoid layoffs. Managers frequently invoke the situation at other companies as a way of bringing home to employees how well they are treated at Toyota. Positive reinforcement and confirmation come when new members join the team and discuss conditions at their previous company.

At Toyota UK, the thinking on employment stability goes as follows: "International competitiveness comes from employment stability, not from technology." At Toyota UK, labor productivity has already been stretched to its limits, and it is unlikely that productivity can be increased further by more mechanization since the auto industry is reasonably labor intensive, as one manager told me.[20] More important than productivity, says the company, is to maintain morale and motivation by appealing to employees' hearts and minds. Employees do not like the word "productivity," which they associate with "redundancies." A personnel manager at Toyota UK told me that employees will never cooperate in improving productivity if they think there is a danger that their own jobs will disappear as a result. Company policy is therefore not to place productivity above everything else—there are factors more important than productivity, including employment stability and product quality.

This policy has great appeal to employees since employment security is considered as the most important benefits of working for a Japanese company. Employment security is the reason they give for having wanted to work at Toyota in the first place or the reason why they intend to stay with Toyota even if they are offered a better-paying position elsewhere. As explained in Chapter 2, in Japan lifetime employment is an ongoing unspoken agreement between company and employees, and not something set down explicitly in writing. There is no written guarantee of employment in Toyota's contracts either. But most employees believe that they will have lifetime employment security if they work diligently and do what is necessary to achieve company goals.

This way of thinking and management policy regarding employment security are shared by almost all Toyota's overseas factories.

As already noted, the faith that employees have in virtually guaranteed employment comes from the company's past record and the fact that the company has never laid off employees since the plant opened. The company takes every opportunity to remind employees of this fact. At the same time, employees also believe that Toyota is a well-managed firm with good prospects for the future, and since there have never been

layoffs in the past, they believe that the company will not cast aside its employees even in a market downturn or in a situation where the individual employee becomes less useful to the company.

What is interesting in this context is that local employees working at Toyota factories in the United States or the United Kingdom do not interpret guaranteed employment as something the company gives them out of paternalistic benevolence. Rather, employees believe that future employment security is something they earn by their own hard work and contributions, and not a gift from a benevolent company, and consequently feel no need to rely on the company's kindness to make it certain. In other words, they believe that the future success of Toyota depends on the efforts of individual employees toward the company goals and that job security comes about as a result of their commitment. This way of thinking is congruent with their individualistic values, which regard individual effort as the primary factor determining personal destiny, and with their belief that the best way to achieve success is to work hard for it.

In Toyota's factories in the United States and the United Kingdom, Anglo-Saxon values of this kind combine with and support the Japanese practice of guaranteed employment. At the same time, this way of thinking seems to allow American and British employees to reconcile the contradictions between paternalistic Japanese ideology and Western individualistic values. Interestingly, the belief behind this way of thinking, which goes that "If I work hard now I will be able to gain greater happiness in the future," or "deferred gratification for future reward," is part of the Protestant ethic depicted by Max Weber, which constituted an important force behind the early development of modern capitalism in Northern Europe and Northeastern regions of the United States. This philosophy encourages employees to believe that it is worth working hard and making sacrifices now in return for the reward of guaranteed employment in the future. This belief in a tacit agreement on guaranteed employment is supported by the rationale for keeping the workforce as lean as possible. This will be discussed further in the next section.

The Lean Workforce System

The lean workforce system, based on the principles of rational distribution of employees and a minimum workforce, is made possible by employees' faith in their employment security. At the same time, this confidence in employment security is backed up by the logic behind the lean workforce allocation, as well as by the company's past results and future prospects.

As already noted, Toyota UK describes long-term employment security as a company priority and promises to avoid layoffs wherever possible, pointing to the fact that there has not been a single instance of job cuts in the cause of rationalization since the plant opened. Nevertheless, there are regular complaints from employees about the heavy workload that results from the minimal allocation of workers and the requirements of overtime work. The company responds by explaining that using a minimal workforce is part of what makes it possible to avoid layoffs. The implication is this: the company is able to maintain employment security because it employs only as many workers as it can continue to support in good times and bad. The company hires the minimum number of employees necessary to keep the company going, with the understanding that when business is good employees will have to work a little harder than normal. This allows the company to survive downturns in the business cycle without ending up with excess employees, thus avoiding the need for layoffs.

The logic of the lean workforce, therefore, provides employees with plausible grounds for believing in their future job security—aside from whether they are actually true or not. Many employees accept the idea that job security is guaranteed by the lean labor system and that job security is worth obtaining even at the cost of an increased workload. It therefore serves to justify the heavy workload and commitment expected of employees, not only from the company's point of view but also from the employees' perspective. In other words, it is not that employees simply trust in Toyota's benevolent intentions or have an emotional commitment to the company's aims. Rather, the rationale for the lean workforce provides logical grounds for their belief in employment security. The decision to accept the present workload demanded of them is, therefore, the result of a rational choice based on cost-benefit analysis of the available alternatives as they see them.

The lean workforce system also serves to make each employee aware of the importance of his or her own role. Working in a system in which a single person's mistake can adversely affect the entire system encourages individual workers to feel that they have an important part to play. At least for some employees, the pride that this inspires help to support them through their daily work.

Management believes that emphasizing its position on avoiding layoffs helps to improve employees' opinion of the company, builds relationships of trust with employees, and makes it easier to gain their

understanding of the need for a lean workforce system. This, in the company's view, also helps to cut down on management costs.

Trusting Management and Careful Recruitment

Lean manufacturing is built on a relationship of trust between management and employees that is supported by relatively stable team membership, long-term reciprocity norms, work-team-based task allocation, a degree of discretion and responsibility given to the team, and management policies based on a belief that people are basically good and can be trusted. These policies, in turn, are made possible by the painstaking hiring and training. Let's look at some examples from Toyota UK and Toyota Kentucky.

In implementing the lean production system, Toyota demonstrates to employees its basic position: there are no incompetent employees in its workforce. If there is a problem with an individual employee, a supervisor will point out the problem and the employee will receive training to resolve the issue. This is the other side of the same policy mentioned above that emphasizes employment security and avoid layoffs as much as possible. This policy is based on a considerable degree of faith in the quality of its workforce. In order to make it practicable, Toyota takes special care with hiring, through a long recruitment process incorporating interviews. In this way, Toyota hopes to hire high-quality workers who are compatible with the company's systems. Thanks to the fact that the local employment situation makes it difficult for workers to find comparable jobs on the local labor market, Toyota is able to choose its pick of good workers in the region by offering stable employment, good wages, and fringe benefits.

The company offers a week's orientation program to introduce new hires to the company philosophy, work team concept, and production system. Toyota stresses team results and its training is based on the idea that team cooperation is more important than individual effort when it comes to achieving goals. Most employees come to accept this approach after their introductory training, according to the company, and become supporters of the teamwork approach.

Policies based on the concept of human nature as fundamentally good, such as those adopted in Toyota, have prevailed in traditional Japanese management. The premise that people were basically good and could be trusted (*seizensetsu*), on which traditional Japanese management

systems were founded, was an important part of the Confucian worldview that significantly influenced the industrialists and entrepreneurs who led the development of modern industry in Japan in the late nineteenth into the early twentieth century. Confucianists in positions of authority, whether they were bureaucrats in the Tokugawa shogunate or industrialists in the Meiji era, were less disposed than their Western counterparts to see their subordinates as donkeys responsive to sticks and carrots. They tended to see them as human beings who would respond to moral appeals and believed in the "efficiency of benevolence in evoking loyalty, and of trust in evoking responsibility."[21]

This idea that people are fundamentally good is one of the foundations of Japanese management and forms the basis of the management policy at Toyota. This view of human nature has close affinities with the concept of "Theory Y" described by American psychologist Douglas McGregor. McGregor believed that behind every managerial decision and action are assumptions about human nature and behavior. McGregor categorized these assumptions into two mutually opposed "ideal types," which he called Theory X and Theory Y.[22]

Theory X is a set of assumptions which in fact have significantly influenced managerial strategies and practices in a wide sector of American industry. At the core of any theory of human resource management lie basic assumptions about human motivation. Theory X assumes that the average human being has an "inherent dislike of work" and can only be controlled by the promise of rewards and the threat of punishment. According to this approach workers avoid responsibility wherever possible, are driven to look for security, and tend to lack ambition. It follows that a strict division of responsibility, in which managers make decisions and workers follow orders, is the only way for an organization to achieve its objectives.

Theory Y takes a different view. Depending on circumstances, work can be either a source of self-fulfillment and satisfaction or a cause of suffering. Even without external controls and coercion, the average human being will exercise self-direction and self-control in the achievement of objectives, and not only accept but also, under proper conditions, seek responsibility. Avoidance of responsibility, lack of ambition, and an excessive preoccupation with security above all else are not innate human characteristics but regrettable consequences of people's experiences in society.

The fundamental idea behind Theory Y is the integration of organizational objectives and individual goals and needs. However, it is extremely rare in reality for organizational requirements and personal objectives

to match perfectly. Nevertheless, McGregor argues that we should seek the degree of integration in which the individual can best achieve his or her goals by directing efforts toward the success of the organization. By "best" McGregor means that "this alternative will be more attractive than the many others available to him: indifference, irresponsibility, minimal compliance, hostility, sabotage."[23]

McGregor's argument backs up Toyota's approach and its view of human nature as fundamentally good. But at the same time, Toyota's managers understand that it is impossible to eradicate the possibility that some members of a team will be uncooperative or fail to pull their weight. The existence of such members in a team can easily cause distrust and animosity within a team. The appearance of even one member who refuses to cooperate with the reciprocity norms or the flexible give-and-take relationships implied in the word "team" could present a major threat to the work teams. If team members' contributions are unequal, this has a negative impact on morale and could put work teams in jeopardy. The company is well aware of this risk and attempts to prepare team members for these problems.

At the orientation employees receive immediately after hiring and repeatedly during their further training, they are reminded of the importance of teamwork and warned in advance that problems can arise. The company attempts to equip team members with tools and techniques for dealing with situations in which they are confronted with an uncooperative or recalcitrant member. They are taught not to criticize or rebuke the problem member, but seek to understand where the problem lies, why it took place, and try to think of steps that can be taken to ameliorate the problem. The approach is to inform the member in question that he or she has got a problem, to ascertain the cause of the problem, and to work together to find a solution. Rather than trying to deal with such problems on their own by pointing fingers and assign blame, team members are encouraged to be open and work together to deal with the problem.

All team members are paid equal wages. This can lead to resentment and a sense of unfairness if one member is seen not to be pulling his weight. But team members at Toyota are encouraged not to give into this sense of unfairness and to think of ways to resolve the problem together instead. The company claims people often become believers in this approach after receiving help with their own problems from other team members. As communication and cooperation on problem-solving

accumulate in the course of daily work, the idea of teamwork and trusting one's colleagues gradually permeates the company culture.

Even after careful screening, thorough orientation training, and persuasive use of group norms, it may sometimes happen that a problematic member continues to be uncooperative and refuses to follow instructions. In such cases, the company may have to resort to corrective actions, which may include dismissing the employee in question.

The kaizen system explained in the previous section consists of activities designed to find ways to improve the quality of employees' own work, in terms of quality control, cost reductions, and improved safety. The system encourages members to work to improve their skills, and this system, too, is based on the idea that people are basically good and trustworthy. It also affords employees an opportunity to exert themselves intellectually in their work, which can otherwise tend to be monotonous. This is a responsibility as well as an opportunity that employees are expected to take advantage of. From the company's perspective, kaizen activities make use of members' problem-solving skills and leadership abilities to improve the way work is done and improve the company's performance. The incentive for team members, as noted, is the bonus they receive if performance improves as a result of kaizen activities.

Avoiding Antagonism Between Teams and Between Teams and Management

Cooperation among team members, based on relationships of trust, vital for a work team to function. A sense of solidarity, belonging, and loyalty are other important factors that help a team to function well. As we saw in our discussion of social capital in Chapter 4, however, group solidarity and the in-group loyalty it creates can lead to animosity toward out-groups at the same time, with negative external effects. Policies designed to encourage close human relationships within a group can lead to an exclusionary attitude toward outsiders. It has been observed that strong bonds and cohesiveness within a group are often accompanied by an atmosphere of exclusiveness and superiority.

Cooperative relationships within a work team are important, but if that sense of solidarity leads to animosity toward out-groups, or antagonism toward managers or the company, then the unity of the organization as a whole is threatened. Theoretically, there is a possibility that work teams could be detrimental to achieving organizational goals.

This could happen when policies to strengthen relationships within a team or group (the unit above team level) increase in-group solidarity to the extent that members develop an exclusionary attitude toward outsiders. This can lead to hostility and antagonism between teams, groups, and departments within the company. At Toyota UK and Toyota Kentucky, several types of tasks are not assigned to any particular group. These include facility maintenance, work area cleaning, and management of parts and tools. All work teams are expected to share responsibility for these jobs, performing them in free moments when their other commitments permit. As long as there is a healthy give-and-take relationship between groups, this does not normally create any serious problems. But in a context of rivalry between two groups, this can lead to animosity and resentment if one group is felt not to be doing its share.

There is a further risk that this resentment will develop into a situation where team members will come together in opposition to the company or management. This phenomenon is quite common in organizations where an antagonistic relationship exists between labor and management. Toyota has a number of policies in place to prevent hostility between teams and between groups, which can pose a significant threat to the organization's ability to achieve its goals.

Keeping Work Units Small

At Toyota UK, each team comprises six employees: five team members and a team leader. A similar system is used at Toyota Kentucky, where a single team is made up of five or six employees: four or five team members and one team leader. At many other companies in the manufacturing industry, the makeup of a factory workforce is often in a ratio of 20–30 workers under each supervisor. Toyota's teams are therefore considerably smaller than the industry norm. Having a high proportion of leaders to team members also increases each employee's chances of being promoted, providing an incentive to team members to aim for positive evaluations and earn a promotion to team leader. Regularly keeping an eye on quality and contributing kaizen ideas are two contributions that can earn positive evaluations. The relatively small number of team members under each team leader makes personalized and unobtrusive supervision possible, effectively reduces wasted labor, and increases the opportunities for rewarding team members who have made a positive contribution.

The Company as a Team

Toyota sets great store by the concept of the "company as a team," and encourages employees to place their loyalty to their work team within the larger context of the company team. Toyota recognizes that an approach based on the work team alone is not sufficient to integrate the organization and bring all parts of the company together to achieve the organization's goals. The concept of "company as a team" is useful for ensuring that the goals and norms of the work team do not diverge from the corporate philosophy and helps to assure that the solidarity developed among team members does not work against management and company goals.

Variety of Work Through Job Rotation

At Toyota's factories in the United States and the United Kingdom, the job rotation system allocates four or five jobs to each team. The working day is divided into four shifts (normally consisting of a 2-hour work shift, 10–15-minute break, 2 hours of work, 30 minutes for lunch, 2 hours of work, 10–15-minute break, and a final shift of 2 hours of work). Each team member normally works on a different task during each work shift.

Team members are able—indeed required—to acquire a variety of skills and to learn how to perform a number of different jobs. This allows team members to understand a wider range of the production process and to be more aware of their own role within the overall process. This enables each employee to understand the meaning of his/her own job in terms of the entire production process and see how it contributes to the whole process—a standpoint that would otherwise be difficult to attain. The majority of production jobs are narrowly focused and repetitive, and in many cases the work itself can be intrinsically monotonous and boring. Rotation affords some variety to the work, reducing the risk that employees will be driven to antagonistic actions that would go against the goals of the organization by the monotony and tedium of the work.

Job rotation has other merits, which will be described in the following sections. Job rotation is required in principle at both Toyota UK and Toyota Kentucky, and employees learn about the importance of job rotation in their orientation training. But in fact for a variety of reasons not all teams carry out rotation on a regular basis. At the Toyota factories, I have visited some practiced job rotation and others did not.

Incentives

Better-than-Average Packages and Promotion Prospects

The salaries (including twice-yearly bonuses known as "performance awards") and fringe benefits offered by Toyota are higher than the average for the region, and most team members say they enjoy better working conditions than in their previous jobs. Many employees in specialist or managerial positions, however, have previously held jobs that offered better conditions in terms of salary, job content, and working hours, and these people generally do not have a positive view of the commitment required by their current employer. Nevertheless, most of them seem to agree that overall their package, including job security, is relatively good.

In Toyota's factories in the United States and the United Kingdom, employees believe that the company tacitly promises them job security. But this is not something they regard as obliging them to remain at Toyota should a more attractive opportunity present itself elsewhere. They believe that although the company has a duty to fulfill its promises to employees, employees are not under any obligation to stay with the company. In Japan, where lifetime employment was the norm for many years, low labor market fluidity makes it difficult for employees to change jobs, but in the United States or the United Kingdom these conditions do not exist. The employment security characteristic of Japanese-style management is clearly attractive to American and British employees, especially since they do not have to face the other side of lifetime employment—the high barrier to changing employers. In a sense, they have the best of both worlds.

For team members, the chance to be promoted to team leader is a major incentive. The team leader's job offers more intellectual challenge as well as greater variety and prestige. Keeping team members motivated is of critical importance to the viability of the work team system. In Toyota's factories, the ratio of team leaders to team members is high, and this increases team members' chance of being promoted to team leader and possibly to group leader. These promotion opportunities that the Toyota's team system allows is an important part of the incentive for team members.

Relatively Small Pay Differentials

One of the characteristics of traditional Japanese management is the relatively small differentials in treatment between different position levels within the company hierarchy. As well explained further in Chapter 6,

this often has an adverse effect on motivating managers and other higher-level employees. However, the egalitarian approach, which traditionally minimized pay disparities and provided promotion opportunities across blue-collar-white-collar distinctions, along with on-site management whereby managers interact with workers on the shop floor, helped to satisfy workers' social needs and esteem needs, and was effective in fostering their sense of belonging and their pride in the company.

Today, managerial strategies in Japanese companies are more diverse. Some companies have actively looked to introduce American-style practices, while others have stuck with the basic approaches of traditional Japanese-style management. Toyota belongs to the latter group, and its policies on human resource management and keiretsu relationships have not undergone any substantial change for decades.

The same basic approach is used in the company's factories overseas. The human resource policy at Toyota UK, for example, was as follows when I visited. First of all, all employees are paid their salary and fringe benefits according to the same format. An annual salary system is applied to all employees and salaries are paid at the end of each month. The same is true of pensions, health insurance, and other fringe benefits, where the same system applies to all employees. Nonmanagerial employees do not receive a bonus (incentive payment). Bonuses are paid to managers only, but these are relatively low compared to bonuses at other companies, normally between 10 and 12 or 13% of salary, with a large component of the bonus determined by the length of service.

The twin principles of "fair evaluation and treatment" and "single status" are at the core of the company's concept of personnel management. As a general rule, all employees have equal access to the various company facilities on a daily basis. Offices are laid out in an open-plan style, with the president and chairman working alongside others in the "general room." When there is a need for privacy, employees reserve a meeting room. Managers are issued the same uniforms as shop members and use the same employee canteen. Even in the company parking lot, there are no designated spots and all employees are free to park wherever they can find a space.

A personnel manager told me that managers do their utmost to avoid an "us versus them" situation that could lead to antagonisms, and said that managers were expected to accept this egalitarian approach in a spirit of "noblesse oblige." Naturally, salary levels vary according to position and a person in a managerial role typically receives around four

times the starting salary of a shop member (and roughly six times in the case of an employee dispatched overseas from head office). But the company takes a variety of measures to minimize employees' consciousness of these differences and maintain morale.

The egalitarian approach based on "fair evaluation and treatment" and "single status" has led to the improvement of the actual treatment of blue-collar employees and consequently has increased the positive view they have of the company.

Learning Different Skills

In the previous section, I mentioned that one of the advantages of job rotation is that it gives team members an opportunity to understand the meaning of each job in terms of the overall production process, at the same time as bringing some variety to otherwise monotonous work contents. Another advantage of the system is that it allows team members to learn a number of different jobs and to acquire a range of diverse skills. By learning new skills, team members acquire portable capacities that provide a boost to their own employability.

Coping with Monotony

Recruitment at Toyota is a careful and lengthy process, including interviews, and considerable effort is made to select workers who are adaptable to Toyota's systems and able to perform work that requires concentration on repetitive physical motions. As described above, measures such as job rotation, team work, and job enlargement programs presumably help to mitigate the monotony and tedium of production line work. Despite these measures, however, there is no denying that much of the production work in an auto plant is monotonous, involving a little intellectual challenge.

Standardized Work and "on Automatic"

Most of the tasks that team members perform in a Toyota auto plant come under the category known as "standardized work." All the elements of the job, including motions, tools, positions, and materials are defined in detail and identified in an exactly prescribed time sequence determined on the basis of the measurements of precise time taken for each correct movement. Such standardization is one of the fundamental concepts of scientific management as devised by Taylor, and is

an approach widely used in American as well as Japanese manufacturing plants. Standardization of the work process is essential in order to produce to precise specification efficiently without sacrificing quality. Standardization also has advantages in other respects. Repeatedly performing the same job improves a worker's ability to perform the job. As a worker gains proficiency, it eventually becomes possible to perform the motions without thinking. As workers grow more skilled at performing their tasks, their work becomes more rhythmical and mistakes fewer. At this stage, workers are said to operate as if on autopilot or being controlled by an automatic device. This state is often called "on automatic."

"On automatic" or "on autopilot" were originally expressions used to describe a plane or other machine that can be operated in automatic mode. When used of humans, the term refers to a state in which a person is so used to performing a given task or motion that his or her body moves without conscious thought and performs the act instinctively and mechanically. Once we have truly mastered a task, we are able to perform it automatically without thinking about what we are doing—common examples might include driving a car, typing on a computer keyboard, chopping vegetables, or in the case of a language teacher, running through pattern drills. Released from the need to think consciously about the action or task in hand, we are free to let our minds wander as we work. This is the major advantage of the on-automatic state. Of course, being on automatic also involves risks: a person might become absentminded and unable to respond to a sudden unexpected situation, or may find that special effort is required to adapt to change because behavior has become so habitual.

It is often claimed that being on automatic is what makes it possible for workers to deal with the repetitiveness and monotony inherent in factory jobs while still producing high-quality products. This is not something that is limited to the auto industry, but is a common phenomenon on any manufacturing factory floor. Experienced workers can perform the motions automatically and complete their assigned tasks at a given pace without engaging their conscious mind. In many cases, their minds will be somewhere quite different: thinking of what to have for dinner that night or making plans for the weekend.

Monitoring the "on Automatic" State

Once a worker becomes sufficiently proficient at a given job and the on-automatic state is achieved, the worker can perform the job more

easily at a given pace and with fewer mistakes. The on-automatic state is said to reduce the incidence of defects caused by insufficient concentration and also results in fewer injuries and less damage to equipment. The monotony and boredom of the work can sometimes drive workers to go against the goals of the organization, but appropriate monitoring of the on-automatic state can help to reduce the incidence of such behavior.

While Toyota wants team members to reach the level of proficiency that accompanies the on-automatic state, they also require concentration on the work at hand. These two demands contradict each other. For this reason, while accepting the benefits of the on-automatic state, Toyota also stresses the need to make sure that it is kept within an appropriate range so that it does not cause injury, damage to facilities, or undesirable behavior that will interfere with organizational goals. In order to maintain a balance between the contradictory aims of enabling workers to do their jobs virtually without thinking and requiring them to maintain an appropriate level of concentration, proper monitoring and discipline within the work team is essential. Concrete programs and steps taken to this end include job rotation, job enlargement programs, and health and safety awareness programs. Together, these measures are thought to prevent injuries and damage, prevent the on-automatic state from going too far, and also help to prevent loss of morale due to boredom.

As mentioned previously, job rotation at Toyota means each team is assigned a set of four or five jobs and each team member is responsible for mastering a number of different tasks. The day is divided into four two-hour shifts and workers perform a different task in each work shift. Rotating jobs means that each worker is responsible for a wider range of tasks, which gives variety to the work and helps to prevent workers from falling into an excessively automatic state. Under this system, more time is required for a worker to master several different tasks, but this is more than made up by the resulting gains in concentration and morale.

Rotation also helps to prevent injuries and damage. Rotation makes it possible to share jobs involving a risk of repetitive motion injury among several team members, reducing the possibility of injury. Variety also helps to reduce the risk of injury or damage caused by inattentiveness. The fact that all members of a team share responsibility for the same set of tasks encourage feelings of closeness, camaraderie, and thus helps to make team norms more effective.

Varied safety awareness programs also help. Safety awareness programs can be effective in encouraging workers to remain alert even when they are performing repetitive tasks. Various measures are taken on the factory

floor to encourage workers to be aware of safety and to prevent the lapses in concentration that can accompany the repetitive performance of the same task. Members are expected to attend short daily safety meetings, and there are contests to come up with safety slogans and posters. Safety issues are frequently raised at regular meetings, and various approaches are used to remind employees of the dangers present in the workplace and to highlight the importance of safety.

Many employees relieve monotony by talking with their colleagues. Naturally, this does not represent a special method for dealing with tedium recommended by the company. But a working atmosphere that allows team members to stop for a short chat with a colleague when they have to go and fetch a part is a major advantage in preventing low morale caused by boredom. Team members have other ways of dealing with boredom. Their minds may drift as their bodies automatically go through the repetitive motions of their assigned tasks. They may console themselves with the thought that as long as they are earning a decent wage, they can't complain. Some no doubt see the monotony as part of a process that has to be gone through in order to earn promotion to more challenging work as team leader.

In places like an auto plant, where standardized products are mass produced through a strictly regulated process, it is not uncommon for workers to become antagonistic to the organizational objectives as a result of the monotony of the work. Many studies have reported clever and creative schemes thought up by bored workers to deliberately restrict productivity. "Deviant behavior" is reported to have been quite widespread at GM's auto production plants, where some workers would drink alcoholic beverages or smoke marijuana before starting their shift or during breaks, or one worker would leave the workplace while a coworker covered both workers' responsibilities and both workers continued to be clocked on and paid.[24] Terry Besser, who carried out an extensive study at Toyota Kentucky, found no evidence of conduct that could be interpreted as contrary to organizational goal achievement or hostile to the company among the workers she interviewed.[25] Besser says that although some interviewees referred to team members with a "bad attitude," who did not take part in clean-up operations, group discussions, company and team socializing activities, and QC Circles, she did not find any evidence of destructive antagonism beyond that level.

As mentioned previously, in a production facility it is possible to maintain productivity and quality of work by encouraging on-automatic state and ensuring that it does not get out of control. If a company can

monitor the on-automatic state successfully, it should be possible to produce high-quality products even if the workers are not particularly enthusiastic about or highly committed to their jobs, excepting extreme cases in which employees become openly antagonistic to the company and start to actively work against organizational goals.

Community Spirit, Family-like Consideration, and Relationships of Trust

Attempts to Introduce Paternalistic Management in the West

The management approach that treats a company as a large family is not an idea that is exclusively the property of Japanese companies. At the start of the twentieth century, when Taylor's scientific management was introduced into auto plants in Detroit, its cold and bureaucratic way of treating workers was not quite acceptable to Americans and there was considerable resistance to its introduction. It is said that one reason why mass production by the Taylorite model succeeded in the auto industry is that in Detroit at the time, employers were able to recruit workers from among recent immigrants from Italy, Austria-Hungary, Russia, and other Eastern European countries, rather than having to rely on local workers who may have been more resistant to the new model. Success was largely due to specific conditions of the labor market in Detroit in the early twentieth century.

At Ford and other new mass producers, management tended to treat employees not as part of a large corporate family but as strangers to be controlled and disciplined through a set of bureaucratic rules. But Henry Ford also implemented many paternalistic practices that did not fit with this new industrial approach. These included the 5 dollar daily wage (which essentially doubled wages for many workers), the establishment of a "sociological department" that was responsible for workers' welfare, the practice of encouraging workers to move into new housing to prevent slums and the founding of a school to teach new immigrants English. It was not a genuine form of Taylorism that was implemented in Ford's factories at the time; rather, theoretical Taylorism coexisted alongside a considerable number of paternalistic practices in the actual system.

This changed with the Great Depression. Mass layoffs led to violent clashes between management and labor, and relations between the company and its workforce deteriorated. After World War II, a new pattern

of labor relations became established—namely, adversarial and rule-dependent relationships reliant on labor agreements and other legalistic means of handling worker complaints. Job control unionism spread in American companies, with labor unions formally representing workers in negotiations with management to hammer out deals on wages and working conditions for jobs that were strictly defined by formalized job descriptions.[26]

In Great Britain, too, a minority of managers ran their companies on paternalistic lines that contradicted capitalistic market principles even as those principles became dominant in the labor market from the nineteenth century onward. There were times of a serious shortage of trained workers, and managers struggled with fluctuating labor supply and unreliability of workers. Some progressive industrialists tried to deal with these problems by introducing ideas somewhat similar to the family-like paternalistic systems based on a Confucian ideology that had been passed down in Japan.[27] Based on traditional ideas of paternalism (the idea that an employer should take care of his workers the way a father looks after his children) and humanitarian ideas of charity and philanthropy, factory owners looked after workers and their families when times were tough, building schools for their children, and hospitals and churches for the communities where workers lived. Examples of this approach include the Saltaire model village built in the mid-nineteenth century by Sir Titus Salt for the workers at his wool mill, and the Port Sunlight model village that William Lever and his brother James built in 1888 for the workers at their soap-making company (today's Unilever).

Some of the companies founded by these pioneers of family-like paternalistic management, such as Unilever, are still in existence today. But most of them collapsed or disappeared over the years. In Britain, paternalistic management was only ever practiced by a small minority of industrialists and their efforts never reached a scale where they could influence the character of the employment patterns in the country as a whole. Many of these pioneering schemes were aborted or were diluted beyond recognition because their original meaning and intentions were lost, and ultimately they were not capable of changing the highly market-oriented character of the British employment system as a whole. In Japan, by contrast, the paternalistic approach became the norm in a sufficient number of companies in sufficiently dominant positions to form a characteristic pattern, and the national employment system developed a strong focus on the organization as a community.

Location of Japanese Subsidiaries and Historical and Economic Background of the Region

Looking back on history in this way reminds us that paternalistic, family-like management concepts once existed even in the United States and the United Kingdom, normally thought of as the home of market individualism. We should remember that American society has always been marked by an appetite for organizing groups and a fondness for community solidarity that exists alongside the often fragmenting and atomizing tendencies of individualism. The extent to which community spirit is present in a particular environment is determined by a variety of factors, one of the most important of which is the historical and economic background of the region in question.

Japanese companies often choose to locate their American and British factories in rural areas. Honda's plant in Marysville, Ohio and Toyota's in Georgetown, Kentucky are examples. Labor unions and unionist ideology tend to be less pervasive in these regions than in some other parts of the country. These parts of the country also tend to be home to relatively stable and homogeneous communities where traditional values and Protestant culture are still important molders of local society and where something of the atmosphere of early twentieth-century small-town America still survives. This culture, in which individualism is balanced by community-mindedness, is thought to be one factor that has made people in these regions relatively open to the Japanese-style management approach, which treats the company as a large corporate family and values job security and team spirit above other concerns.

In the American auto industry, the Taylorite approach to factory management and the job control unionism that is concomitant with it has gradually weakened over the past forty years and has been replaced by a more team-oriented style of organization imported from Japan. Approaches that incorporate Japanese-style lean production system or modified versions of it have become common in the American auto industry. Although it is considered that lean manufacturing increases pressure on workers, in fact, many employees basically accept the approach and the ideas behind it. And many workers working within a lean production system do not support extreme unionism—many of them have fiercely resisted unionization by the United Auto Workers Union (UAW).

Since it started operations in 1992, Toyota UK has been based at its plant in Burnaston, Derbyshire in a rural part of the English Midlands,

using more or less the same lean production method as in the company's American factories. The company seems to have succeeded in fostering a degree of belonging and pride in the company even among British employees normally considered to be quite individualistic. It is apparently common for employees to go to the local pubs after work in their company uniforms marked with their company name—behavior that would certainly be unlikely if they did not feel at least some sense of identity or pride in their company.

Policies for Primary Work Groups

The work team system does seem to encourage the formation of primary work groups, and provides a platform for groups whose members often develop close and caring relationships inside and outside the workplace. Toyota encourages this sort of community spirit, and provides funds for teams and groups to use on socializing activities. The small size of the teams and the fact that they tend to be quite long-lived help a sense of camaraderie to develop. Job rotation, in which all team members share responsibility for the same group of tasks, also helps to develop team solidarity, as we have seen.

At both Toyota UK and Toyota Kentucky, opinions on socializing outside work hours are divided. Some employees look forward to socializing with their team or group outside work, while others resent the pressure to spend time with colleagues in their free time, although they may enjoy socializing with team members at work. But there is little doubt that the work team system allows members to build social relationships with colleagues and that many members regard these social relationships as a benefit. Another important aspect of company policy is the flexibility with which it applies rules, as described in the following section.

One of the policies Toyota uses to gain its employees' trust is to apply a high degree of flexibility to the way it operates the company bureaucracy and regulations, bending the rules where necessary to accommodate individual employees. Flexibility itself is nothing particularly unusual. For instance, transferring a worker who has been injured to another job rather than terminating employment is a practice at many other companies besides Toyota.

But Toyota's response is more nuanced than most and goes farther than most companies would. Besser covers several examples in her study.[28] In one case, when a vacancy arose for a team leader, two

members who wanted to apply had completed the necessary training course but had not yet passed the final exam. The group leader and personnel manager decided to postpone a decision on selection until the two members had completed their test rather than appointing a team leader from among the other employees who already held the necessary qualification. In another case, a team leader who was going to be sent to Japan for training asked for two weeks' leave immediately after the training to travel around Japan with his wife. The company decided to accommodate his wishes, even though the date of the return flights was already set and changing the schedule for one employee involved some accommodation by the company. In another example, a group leader and personnel manager helped a team member who had developed a drinking problem and had repeatedly violated company rules on attendance and performance by having him admitted to Alcoholics Anonymous and instructing him to seek help from a counselor.

There are many such examples. The company's track record of flexibility in cases like this increases employees' trust in the company management, and makes them feel confident that the company is "doing the right thing." If the company is guilty of an oversight or injustice, employees feel confident that it would have worked to correct the problems if it had known about them. In other words, Toyota's attitude toward employees is supported by a tacit expectation on the company's part regarding reciprocal relationships. If the company is flexible, reasonable, and humane in its treatment of employees, it can expect employees to take in return a benign view of any mistakes the company might make, trusting that the problem is due to an innocent oversight and that the company will take appropriate steps to correct any problems it knows about.

But this bureaucratic flexibility is not without its drawbacks. It often happens that what is perceived as flexibility by one person is seen as favoritism or capriciousness by another. Also, managers who have the prerogative to apply the rules flexibly can use the system in a reasonable way to adapt it to the circumstances of individuals, but there is also the risk that they might use it for personal benefit. Ensuring that managers do not misuse their powers is, therefore, vital for maintaining relationships of trust.

According to Besser, at Toyota Kentucky a person from the personnel department is involved in most decisions of this kind to make sure that managers do not hand out personal favors or make arbitrary decisions.[29]

This policy helps to create the impression among employees that the company only breaks or bends its rules in cases where it is in the interests of the company as a whole to do so. Many companies take steps to run their systems flexibly and accommodate the individual circumstances of individual employees, but Toyota expends more effort than most companies and takes particular care to ensure that these flexible decisions are not exercised arbitrarily or as personal favors. Such efforts contribute to the formation of a community atmosphere in the company.

The Global Potential of the Lean Production System

The lean production system has been widely employed in Toyota's overseas production facilities with considerable success. This success has prompted various studies of the system in the United States. In particular, the MIT International Motor Vehicle Program led by Womack and others looked at Toyota's approach in some depth. The project worked on the assumption that lean methodologies could be benchmarked as universal production methods that could then be transferred for use in any country in the world.

The participants in the study maintained that the relative ease with which lean production had been exported despite the cultural differences between collectivism-oriented Japan and individualism-oriented America demonstrated that the system was not limited to any specific culture.[30]

Not everyone agreed. The American sociologist Robert Cole argued that the ability of Japanese managers to penetrate primary work groups and harness organizational ability is inseparable from Japanese culture and that such a culture-bound feature of organization management cannot be applied in other countries. Japanese employers might be quite effective in penetrating and mobilizing primary work groups to achieve organizational goals, but this success rests heavily on culturally unique patterns of behavior that would not be easily absorbed in other countries.[31] Cole argues that the ability of Japanese organizations to mobilize primary groups to achieve the organizational goals stems from the unusual extent to which Japanese workers are dependent, structurally and psychologically, on the organization that employs them.

Francis Fukuyama has also argued against the MIT group, objecting to its assumption that Japanese and American cultures represent two opposite poles, with Japan as a classic example of a group-oriented culture and the United States a classic example of an individualistic culture. This

assumption is shared by many researchers but, Fukuyama asserts, in fact, it is not true that the United States is a particularly individualistic culture.[32] "The Taylorite model of industrial organization, invented in the United States and thence exported to the rest of the world, was actually not a typical or inevitable product of American culture," he says, and "its replacement by the more communally oriented lean production model" has brought American workers back to the earlier communal traditions of the workplace that they lost in the course of industrial development.[33]

As we have seen in this chapter, in Japanese auto plants in the United States, work teams made up of American workers are used as the primary groups for achieving organizational goals—an attempt that has been largely successful. But this does not change the truth of Cole's observation that the company's ability to mobilize primary work groups comes from the workers' heavy dependence on the employer. Even if American workers are not as dependent on the employer as their Japanese counterparts, dependence is certainly one of the reasons for the success of lean production in the United States. American workers, especially in areas with high unemployment, also depend to a considerable degree on a "good employer"—in terms of wages, fringe benefits, and job security.

Fukuyama has argued that Japan and the United States share a degree of community-oriented culture. Human relations theorists like Elton Mayo and Fritz Roethlisberger tested this kind of community orientation in the American workplace. As we saw in Chapter 4, the well-known Hawthorne experiments led by Mayo and others showed that workers' sense of belonging to their peer group and the norms within the group have a greater effect on workers' satisfaction and productivity than the physical working environment.[34] This suggests that group orientation and community orientation play an important role in the behavior of American workers too. If this is the case, then it should be possible to apply the lean production method and its primary work group concept among American workers. And, as we have seen in this chapter, the lean production method has indeed been used successfully by Japanese automakers in their American and British factories.

The answer to the question "Can the lean production system be used successfully in other cultures?" therefore seems to be: Yes. But it does not necessarily follow that the "lean production method can be transferred to any country in the world," as the MIT group argued. As we have seen, lean manufacturing supported by work teams, QC circles, and other systems, is built on the premise of relationships of trust among

employees and between employees and management. And, as explained in Chapter 4, these relationships of trust are supported by the accumulated social capital that exists within the wider society. Without the accumulated social capital that allows relationships of trust to function, it is unlikely that lean methods could be successfully introduced.

Also, as we have seen, the success of the lean production system is inseparable from employers' ability to mobilize primary work groups, and this is made possible by the extent of workers' dependence on their employer for stable employment. In countries like the United States and the United Kingdom, where the accumulation of social capital has reached a certain level, and in regions where difficult employment conditions make employees highly dependent on employing organizations, the probability is high that the system can be introduced effectively. In regions like this, it is likely that the lean production can be introduced successfully using the methods proposed by the MIT study group.

Notes

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CHAPTER 6

A Hybrid Model of Human Resource Management

As we saw in Chapter 3, the various capitalist economies of advanced industrial countries can be divided into two broad categories according to the extent to which they allow the principles of free-market competition to function. These are referred to as the Anglo-Saxon model and the coordinative model. The Japanese economic system is generally placed along with the social democratic systems of many European countries as an example of a coordinative market economy. However, Japanese capitalism deviates from market principles even more markedly than the European coordinative model, with coordination mechanisms affecting the activities of individual companies to a much greater extent. If the economies of the world were arrayed according to the extent to which they allow the principle of the laissez-faire market to operate, the Anglo-Saxon model and the Japanese model would sit at opposite ends of the spectrum.

As I have argued throughout this book, the Japanese approach to business management offers benefits that other systems do not possess, but it suffers from a number of problematic aspects as well. Incorporating some of the effective aspects of the Anglo-Saxon model into the Japanese model would be an effective way of avoiding these drawbacks and overcoming some of the weaknesses of the Japanese approach as it has traditionally been practiced. Needless to say, the Anglo-Saxon model, too, has strengths and weaknesses of its own, and it seems likely that importing some of the positive aspects of the Japanese approach to management might help to counteract some of those weaknesses.

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By analyzing the relative strengths and weaknesses of these two systems, often thought of as representing diametrically opposed approaches, it should be possible to devise a hybrid system that incorporates the best aspects of both and that can be used successfully around the world. In this chapter, I present a multilayered hybrid model that combines the mutually complementary aspects of the Japanese and Anglo-Saxon systems, focusing on human resource management. Incorporating the strengths of both systems, the model is aimed at improving workplace motivation, promoting the creation of new value, and enhancing performance. The model is thought to be applicable in many countries of the world.

No single human resource policy will represent the best strategy for all employees. And even with the same employees, the same policy will not always work indefinitely. The appropriate human resource strategy will naturally vary for each individual depending on personal characteristics, the nature of the work, and the respective life stage of the person in question. The ideal human resource strategy, therefore, would require managers to consider their policies carefully for each individual employee.

In order to meet actual management demands, however, it is necessary to introduce some grouping of employees even if it means ignoring some of the complexities of human thoughts and behavior that may be relatively unimportant for the purpose of creating workable organizational policies. According to past surveys, the factor having the greatest impact on patterns of motivation is the position held within the organization.[1] Over the past decade or so, I have conducted questionnaire surveys and interviews with company employees in the United States, the United Kingdom, Germany, and Japan. The results have shown that people's attitudes to their jobs and companies differ significantly depending on the level of their position within the organization. When managers consider possible human resource policies to boost their employees' motivation, therefore, they need to analyze motivation patterns and work-related values of each position group in the organization, and work out policies effective for the respective groups.

The Multilayered Hybrid Model: Combining the Best of the Anglo-Saxon and Japanese Model

One effective way of formulating different motivation policies for each position level is to divide all members of corporations into four broadly defined groups. Each of these four groups has its own views and attitudes

to work as well as its own needs and aspirations, and these four groups operate on different levels of motivation. The four groups are (1) Executives; (2) gold-collar employees (managers, professionals, entrepreneurs, consultants, etc.); (3) blue-collar, clerical (lower-level white-collar) and service employees [permanent employees]; and (4) blue-collar, clerical (lower-level white-collar) and service employees [nonpermanent employees, that is, fixed-term contract and part-time employees]. The rest of this chapter will discuss the motivation strategies appropriate to each of these four groups.

Executives

Motivation and Incentives

As we saw in Chapter 1, the management environment has changed dramatically over the past several decades. In addition to the increasingly intense global competition, companies are also subject to manifold demands from shareholders, clients, employees, and other stakeholders. Company executives must work harder than ever to increase profits while meeting stakeholder demands and considering corporate social responsibility.

Despite these changes in the management environment, many high-level managers continue to enjoy positions of power that place them at the summit of corporate society, and receive high salaries that reflect such status. Despite the challenges they face, they are generally seen—by themselves and by others—as "winners." The incentives for executive team members are great—remuneration, power, social prestige, and challenge. Together, these incentives fulfill most of Maslow's five-stage hierarchy of needs. The incentives are roughly as outlined below.

1. *Remuneration.* Senior executives generally receive the highest levels of financial reward of any employees within the organization, and in addition to basic salary, their total package usually includes bonuses, stock options and other long-term incentives, as well as fringe benefits and managerial privileges.
2. *Power.* Managers derive various rewards from their work besides financial remuneration. One of the most important is power. Senior executives exercise leadership in order to make reality of visions they hold, and are in a position to issue orders and move

human and financial resources at will. The exercise of power is a source of pleasure to many people, and this makes power an important incentive. According to D. C. McClelland, an American psychologist, those who have a strong need for power are more effective as managers than those who do not.[2]

3. *Challenge*. Senior executives' work allows them to fulfill their need for achievement, their desire to take on greater responsibility and achieve success with their work. They enjoy the challenge of executing plans and taking risks in the midst of uncertainty. The rewards for success are substantial, but the potential losses if they fail are also great. The "gambling" is an important aspect of the job. This thrill of the gamble, as well as the sense of achievement to be had once success has been won, go a long way to fulfilling self-actualization needs and, therefore, represent a major incentive.
4. *Social recognition*. Social recognition is often another major incentive for senior executives. The desire for social status and reputation—to be recognized and rewarded with status, prestige, and the respect of others—belongs to Maslow's category of esteem needs. Satisfying this desire for social recognition by providing opportunities to appear in the media also can be an extremely effective incentive.

As we have seen, the jobs of executives provide major incentives. But their ideologies, ways of thinking, and behavior can vary considerably according to the historical and cultural background. These differences are particularly significant between Japan and the West as they differ widely in terms of history and culture. In any attempt to discuss the human resource strategies for executives, it is necessary to understand these differences.

The Case of US and European Executives

Many executives in European and American firms receive salaries that could give them an almost aristocratic lifestyle. They are given luxurious offices set apart from the areas where regular employees work, and are generally treated as privileged individuals who enjoy a position of high prestige and authority. In the United States, a CEO can take home a pay packet worth more than 300 times that of the average employee (see Chapter 4). In Japanese companies, by contrast, which is known for the relatively small disparity in salaries by status, the figure is between 5 and 30 times. One of the characteristics of executive pay in European

and American companies compared to Japan is the higher proportion that performance-based bonuses make up of total pay. Also, in European and American companies, long-term incentives account for a much higher percentage of total remuneration than in Japan.

In Western companies, bonuses generally make up a larger proportion of executives' pay than is the case with regular employees. Bonuses worth between 50 and 80% of basic annual pay are normally given to senior managers, with this sometimes rising as high as 90%. In many companies, executives also receive long-term incentives, including stock options. Long-term incentives of this kind make up a high percentage of total pay for executives in American firms in particular, in some cases rising as high as 90% of total pay.

The purpose of stock options and other forms of long-term incentives is to motivate managers to contribute to the long-term growth and prosperity of the company, to increase morale, and to reward managers who have made a significant contribution in these terms. Theoretically, under the stock option, managers should receive these rewards only in times when the company's profits have increased as a result of the managerial effort and decision, leading to an increase in the company's stock price. If this were the case, the practice might well be effective as an incentive.

In reality, however, senior executives often receive large payments from stock options regardless of the company's performance or profitability. Stock options are paid out to senior executives under extremely favorable conditions, and it is left up to the holders of the stock to decide when to exercise their options, so that directors and senior executives can often use inside information on future stock prices to choose the best timing for exercising their stock options.

There is little consensus on the question of whether executives' pay realistically reflects the company's performance and the responsibility of executives. Some commentators argue that executives' compensation bears little relationship to their responsibilities. According to this view, executive pay is largely determined by the industrial sector in which the company operates and the power structure within the organization.

The company's power structure determines its mechanisms of control, or more specifically, determines the practices for setting managerial pay. In American companies management normally consists of directors and officers—the senior managers who are in charge of the day-to-day business of the company. Directors excluding those with directly relevant vested interests make up the compensation committee that decides

the pay for senior managers and other directors. The board of directors normally includes a substantial number of outside directors, and these outside directors also serve as executives or board members at other companies. They, therefore, generally tend to be sympathetic to the practice of paying high compensation to executives. Corporate management structures of this kind, characterized by interlocking directorships, make it possible for high executive compensation to become institutionalized and normalized. As a result, it is often argued, compensation no longer functions as an effective incentive to motivate executives to work hard for the company's performance.

Opinion varies when it comes to the levels of executive remuneration and the question whether the work executives do is really worth such generous pay. Many shareholders, and the public, in general, have been quite critical of what they regard as overpaid executives. With lower-level managers, salary is normally set at a level 10–25% higher than that of the highest-paid employee they supervise. There can be little argument about these levels of salaries. But the large salaries paid to senior executives, as well as the bonuses and long-term incentives, privileges, and perquisites they receive regardless of the company's results, are turning senior executives into a privileged elite class in today's society. Public opinion, in general, is critical of the tendency for senior executives to award themselves compensation packages that are often hundreds of times larger than those of ordinary employees in the same company.

Efforts to correct the "excessive" remuneration of senior executives have already borne fruit in the form of several pieces of concrete legislation. In the United States, the information disclosure requirements of the U.S. Securities and Exchange Commission now oblige companies to publish details of remuneration paid to the CEO and any other managers earning in excess of $100,000 (annual salary and bonuses). Furthermore, the U.S. Securities and Exchange Commission has adopted rules requiring companies to disclose CEO-worker pay ratios. Companies are required to disclose their pay ratios for the first fiscal year beginning on or after January 1, 2017.[3]

Provisions included in the Federal Deposit Insurance Act to prevent excessive remuneration also help to keep a check on bankers' pay. Shareholders' groups have demanded stronger limits on the amount companies can pay their directors and executives. As a result of this legislation, boards of directors must now act with greater responsibility than before when setting directors' pay.

British scholar of management Charles Handy has argued that the Anglo-Saxon model of corporate governance often leads to problems when managers seek to pursue self-interest. He suggests profit-sharing as a way of avoiding these problems. In continental Europe, some small companies already distribute a fixed proportion of after-tax profits to employees and express in tangible form the rights of employees as members of the organization. Under this system, employee representatives participate in a discussion not only on their compensation but also on company plans in broad outline, thus encouraging them to share in the responsibility for future earnings. Such a framework introduces a sort of democracy to decisions on compensation. It is hoped that such changes will help companies to gain greater understanding, commitment, and contributions from their employees, and ultimately that this will lead to an improvement in company results and performance.[4]

Implementation of such laws and practices as discussed above makes it possible to supervise executive compensation and ensures that it does not exceed levels out of all proportion to their performance and responsibilities within the company. Such practices also make it possible to provide incentives for executives to work not only for themselves but for the benefit of the organization as a whole as well.

The Case of Japanese Executives

The advantages of Japanese-style business management—including "a long-term perspective in business strategy," the "human relations approach," "egalitarianism," and "on-site management"—are strengths that should continue to be used in the future. They also promise to be effective in helping Japanese companies in their operations overseas. In particular, an approach based on these characteristics seems likely to function well in the case of manufacturing companies operating in the emerging economies in Asia.

1. Japanese Management Philosophy: Theory Y, Social Mission and Reputation

The philosophy of Japanese managers, which values the human relations approach, egalitarianism, and on-site management, is not something that was acquired in the recent past. As we saw in Chapter 5, these three qualities were in the minds of the entrepreneurs and managers who drove the development of modern Japanese industry after the Meiji Restoration of 1868. Heavily influenced by the Confucian ethics handed down from the Tokugawa period, they were firm believers in the idea that human

nature is basically good (*seizensetsu*). Unlike business leaders in the West, who were disposed to see their subordinates as donkeys who could be motivated only by a judicious combination of carrot and stick, Japanese industrialists tended to view their subordinates as human beings who would respond to a well-pitched moral appeal to their conscience. This view of the essential nature of human beings formed the foundation of Japanese management philosophy and clearly predisposed Japanese managers to choose the management practices that suited the abovementioned three qualities rather than others.

As we saw in Chapter 5, the dominant approaches used in Western and Japanese companies correspond to the diametrically opposed concepts proposed by Douglas McGregor as Theory X and Theory Y. The Confucian belief in the inherent goodness of human nature on which traditional Japanese management was founded closely resembles McGregor's Theory Y.

In the years following the Meiji Restoration, when modernization slogans like "Rich Country Strong Military" and "Increase Production and Encourage Industry" dominated the political discourse, the ideal image of the entrepreneur was the considerate paternalists at the head of an organization who contributed to the government's modernization campaign as leaders of a large workforce. In general, they did not aspire to be capitalists who exploited others for selfish purposes. Both the industrialists of the private sector and the managers of state-owned government corporations wanted to be seen as morally upright "good citizens" in the eyes of society. This was particularly the case at a time when entrepreneurs and businessmen were struggling to raise their social status relative to that of civil or military servants of the state. Given the ideology of Japanese society at the time, eye-catching wealth alone was not sufficient to win social prestige, no matter how highly people might respect the determination and intelligence that had made this success possible.[5]

This does not mean that they had no interest in making a profit and growing their companies. But the high importance of honor and respect in the political and social climate of Japan at the time disposed Japanese business leaders to value their social reputation more than their counterparts in other countries. They likely found most desirable a management policy that would not only enhance their public image, but also contribute to the profit, growth, and efficiency of their company.

As a result of this historical background, Japanese managers are more likely to employ an approach based on on-site management and human

relations even today, and their approach to compensation is often much more egalitarian than that of managers in European and American firms. This approach builds respect for management and a sense of belonging among employees, improves motivation, and effectively integrates the organization. These are some of the positive aspects that should be maintained into the future. Traditional Japanese management also has a number of problematic aspects, however, to which I will turn below.

2. The Need for More Performance-Based Evaluations

Unlike in Western companies, many managers of Japanese companies start their careers as ordinary employees in the same company, gradually rising to the top. In recent years, growing number of prominent entrepreneurs have successfully started their own businesses while still young, without taking this traditional route to corporate success. The number of such entrepreneurs is increasing particularly in growth areas such as IT, the Internet, as well as in temporary staffing agencies and other human-resource-related businesses. Despite this new tendency, however, in most large companies the majority of senior managers have followed the traditional route, starting at the bottom and working their way up via a series of gradual promotions.

Under this practice, a position as director is often seen as a reward, for past achievements in a specific field or department rather than being awarded to the person best suited to the company's future strategy after an analysis of candidates' abilities and talents. Likewise, the company president often designates and appoints his successor largely on the basis of his own evaluation of candidates' ability and contributions, and a smooth succession is often valued over wider strategic considerations. Under the lifetime employment system in which most employees remain with the same company throughout their careers, it is extremely uncommon for high-level employees to switch companies. Promotion to directorship positions are often used as rewards within the lifetime employment and years-of-service-based seniority systems, and this results in the tendency to produce more directors than are necessary. As the board of directors becomes bloated, directors become prone to prioritize their own interests over those of shareholders, and retaining their present positions becomes an end in itself. The board thus tends to lose much of its "self-cleansing" function.

This practice has bred complacency among managers. During the favorable conditions of the high-growth period, when the market continued to grow year by year, it was possible to run a company successfully

simply by maintaining the status quo and following the same strategy. There was not much need for creativity or strong leadership from managers. Indeed, there was a widely shared belief that continuing to maintain the status quo within the established framework was an essential part of self-preservation. The downsides of this practice were exacerbated by the lifetime employment system. The guarantee of a job for life encouraged older employees to start counting down the number of years until they would retire. In a system of lifetime employment and years-of-service-based seniority, most senior managers are most likely the oldest employees in the organization, increasing the proclivity of managers to focus excessively on the short term. In many cases, senior managers have little thought beyond reaching retirement age safely and moving on to an advisory role at a subsidiary company. Some directors have no concern for what may happen after their own appointment comes to an end. They, therefore, have little incentive to support thoroughgoing reforms based on a long-term perspective. Their priorities are keeping things peaceful and quiet—not "rocking the boat," so as to assure that they get through to retirement without major upsets or disasters.

However, over the past several decades the business environment has changed dramatically as a result of intensifying global competition, rapid technological advances, market deregulation, and political instability in the countries where companies have overseas subsidiaries. If Japanese companies are to succeed in developing the new products, businesses, and industries they need to respond to these changes. They will need to realign their management resources on a large scale and effect radical reform of the practices they follow. Japanese companies today definitely need strong leadership with initiative required to carry such reforms forward, and motivated management teams that can break out of the status quo and create new value.

To incentivize senior executives in Japanese companies to demonstrate this kind of leadership, there is an urgent need to reform the reward system. Companies will be called on to change the current system of evaluation and reward to the system in which performance and results are reflected more prominently in executive compensation. The current Japanese practice, in which pay differentials based on performance and position are relatively small, is effective at motivating lower-level employees, as will be explained in more detail later. But it gets in the way of motivating talented managers and higher-level employees. To make the best use of human resources with the creative abilities and leadership required to

carry companies forward, or to use talent from outside the company, it is essential to link executive compensation more closely to performance. In carrying out such reform of the reward system successfully, it is necessary to incorporate the best aspects of the Western-style performance-based approach into the remuneration policies of Japanese companies.

Nevertheless, it will be vital to ensure that the results-based approach is kept at a level that will be socially acceptable, both within the company and in the wider society. There is a need for remuneration practices that accurately and fairly reward performance while keeping pay within reasonable levels. Also, as we saw in the section on corporate governance in Chapter 3, there is a need to take a fresh look at the number of directors in Japanese companies and make their boards function more efficiently.

There is little likelihood that executives themselves will take steps to promote any reform of executive incentive practices either in Japanese or Western companies. It will, therefore, be necessary to use external pressure to correct the problematic aspects of executive incentive practices. Particularly in Western companies, pressure from outside the company is indispensable in correcting the excessive levels of executive remuneration. This will include giving shareholders greater powers to oversee boards of directors, stronger legislation requiring companies to disclose compensation details, and application of pressure through critical public opinion. Also, as mentioned previously, such measures as bringing employee representatives into meetings to discuss company strategies and plans, including those for compensation programs, may help remedy the deficiencies of current incentive practices.

Gold-Collar Employees

Gold-collar employees include those engaged in senior white-collar jobs, such as professional and managerial posts, entrepreneurs, and jobs created in newly growing sectors such as the information and knowledge industry (experts and engineers, including consultants and computer programmers).

Work-Related Values of Gold-Collar Employees

Gold-collar employees are expected to play an important role in activating the company and creating new value. How to utilize these individuals is a chief challenge for companies. The gold-collar group includes a considerable number of people for whom the primary meaning of work

lies in self-actualization. These people expect to find meaning in the work itself, and want to develop their talents and make the most of their own potential through their work. Many of them want to be engaged in an activity that provides opportunities for problem-solving, self-expression, and ego-assertion.

Gold-collar employees' views and attitudes toward their work are clearly identified in the research I have carried out in the United States, Europe, and Japan. For example, in a questionnaire survey conducted in the United States, United Kingdom, and Germany from 2005 to 2010, I asked the respondents what they felt to be important in their work. Managers, professionals, and those with a high level of education (master's or doctorate and above) responded by indicating that the most important factors are "having challenging work to do," "being able to realize their potential," and "getting a sense of accomplishment."[6]

This characteristic of the gold-collar group is also seen in Japan. The question "What are your reasons for working?" is included in "The survey on People's Lives," regularly conducted by the Cabinet Office of Japan. Looking at the trends in the results of this survey from 1977 to 2015 shows an increasing proportion of managers and professionals answering that "I work to utilize my talents and skills and to find a purpose in life." In 1977, this answer represented only 16% of the total, but by 1999 it had risen to 49.6%, almost half of the total. The trends have continued since then. Throughout four decades the percentage of those who place most importance on self-actualization is consistently higher among professional and managerial personnel than among blue-collar and clerical employees.[7]

In addition, many gold-collar personnel are highly motivated throughout their lives, have a liberal attitude, and want their spouse to have a job and seek self-actualization through work. This tendency in the gold-collar group is a common phenomenon seen in most advanced countries. In comparing Japan with Europe and the United States, the effects of historical and cultural differences still remain, and gold-collar employees in Japan have a somewhat stronger group mentality than those in Europe and the United States. However, this gap between countries or regions is narrowing.

Motivation Policy for Gold-Collar Employees

This group is expected to make the greatest contribution to income generation and growth of the company. How best to effectively respond to

their need for self-actualization, to inspire leadership, and to bring out their creative capabilities is a matter of utmost importance for companies. Creativity for developing new products or markets is most effectively fostered by stimulating the desire for self-actualization, so management must provide the opportunity for development that can respond to this need in each member, especially one who has potential as a leader.

Gold-collar employees respond best to challenges—to opportunities to display their abilities and hone their talents. Thus, motivation can be enhanced by letting them participate in strategic processes, in designing their own work, and in making and executing their own decisions. The surveys that I conducted in the United States and the United Kingdom also show that professional and managerial personnel want to take part in the decision-making process. Participation in decision-making can be regarded as an essential and indispensable part of self-actualization for gold-collar employees.

Gold-collar employees find value in receiving proper recognition for their achievements. Performance-based treatment is essential for encouraging gold-collar employees to exercise their abilities. Since gold-collar employees seek opportunities for challenge, it is often appropriate to set high-performance standards for them. If they get good results, they should be rewarded accordingly. In order to do this, it is necessary to develop a remuneration system linked to performance and activity, and a fair and transparent evaluation system. In other words, it is necessary to treat these employees according to the fundamental principle of performance-based management in which an employee's salary and benefits reflect a fair assessment of his or her performance.

It is important to provide not only a salary but also future development opportunities as an incentive to performance. For gold-collar employees, a promotion with an overseas transfer is often a strong incentive.

European and American companies generally adopt a performance-based system. In Japan, by contrast, as explained in Chapter 2, many companies that once tried using performance-based systems have since revised their decision after finding that they did not produce the hoped-for results. In general, performance-based management has not yet been used effectively in Japan. However, in order to make effective use of gold-collar employees, Japanese companies, too, need to introduce a Western-style performance-based approach and put together an incentive system that reflects ability and performance more prominently in the way

gold-collar employees are rewarded, as in the case of senior executives discussed above. The lifetime employment system and the seniority system that characterize the traditional Japanese-style management are not suitable for motivating and utilizing capable gold-collar employees.

In providing incentives to gold-collar employees, it is vital to ensure that performance is properly reflected not only in financial remuneration but also in promotions. The slow pace of promotion under the traditional Japanese system often keeps companies from making adequate use of the talents of gifted young employees. Basing promotions and advancement on ability and performance would make it easier for companies to start training leaders from an early age and allow them to single out promising young candidates for fast-track advancement. It would allow companies to promote talented employees at appropriate timing and train them to become competent leaders in the future.

In the knowledge industry that is at the core of today's economy, the ability to harness the creative talents of gold-collar employees is of vital importance. In today's knowledge industry, intellectual forces, that is, the human resources that create intellectual assets, have taken over from money capital as the most important element in capitalistic production. Securing human resources that can create intellectual assets is, therefore, a key factor in a company's activities. Unlike money capital, however, human resources have a will of their own and cannot simply be tied down to the company. How to effectively utilize intellectual human resources, and whether or not it is possible to provide the appropriate work environment and incentive to stimulate their creative activity, is essential for the company to remain competitive.

It is argued that in order to extract the latent intellectual potential of human resources, it is effective to minimize control and create an environment where they can set their minds free and achieve high-level goals and self-realization. For instance, the method referred to as "autonomous control with guidance" and the concept of empowerment can be applied effectively. "Autonomous control with guidance" is a method for loosening control to the utmost while promoting flexible role-sharing and specialization, casting aside stereotypes.[8] The basic concept is that leaders should provide the necessary information and resources and identify the goals, and then let members go their own way. If the appropriate environment has been created, it becomes possible to empower employees and extract their latent potential. This is what is known as "empowerment."

In this section, we have looked at the work-related values of gold-collar employees and effective strategies for motivating them. The following sections will discuss blue-collar, clerical (lower-level white-collar), and service employees.

Blue-Collar, Clerical (Lower-Level White-Collar), and Service Employees [Permanent Employees]

This section discusses blue-collar, clerical or lower-level white-collar, and service employees (hereinafter referred to as "BCS employees") who are hired as permanent employees. Permanent employees are full-time, regular employees who are hired for a position without a predetermined time limit. Nonpermanent employees whose work content is similar but whose employment terms differ will be discussed in the following section. There are several major differences between the most effective strategies for motivating the gold-collar employees discussed in the previous section and those for BCS employees.

The primary motive for many BCS employees is a monetary reward. Along with financial remuneration, however, ensuring employment security, satisfying social needs through a human relations approach, providing a sense of community, and applying policies rooted in egalitarianism and on-site management can also be effective for motivating this group. This is particularly true at a time of economic recession, when it becomes difficult for companies to offer regular wage increases. As we saw in Chapters 4 and 5, these are among the distinguishing features of traditional Japanese management. A human resource policy that incorporates these elements can be effective with the BCS group.

The End of Continuous Wage Increases

During the period of high economic growth, the constant wage increases made it possible to continually motivate BCS employees. Starting in the 1970s, however, an increasing number of industries began reaching maturity and their global markets became saturated, making it financially difficult for many companies to go on providing regular wage increases. As a result, employees in these industries could no longer achieve constantly rising living standards that they had come to expect.

Thus, whether or not incentives other than money can positively motivate employees becomes a crucial factor determining product quality and productivity. Of course, providing the necessary income for

employees to make a respectable living, or paying salaries that are nearly equivalent to the labor market price, is a prerequisite for maintaining employees' willingness to work. However, if consideration is given to other incentives that contribute to improving employee motivation, management can inspire employees so that they feel a commitment to their team and organization.

In Japan, a sense of belonging and loyalty to the company were fairly common among employees until the 1970s, but most commentators agree that these qualities have gradually faded and that the tendency for individualism has become much stronger today. However, as we saw in Chapter 4, Japanese companies have recently begun to move back in the direction of giving importance to social connections in the workplace and are increasingly looking to improve employee satisfaction through strategies based on typically Japanese management qualities, including stable employment, policies that help employees fulfill their social needs, a familistic company culture, and the firm-as-a-community approach. Employees tend to welcome these policies, particularly in the context of the deteriorating employment and work environment brought on by the competitive pressure of globalization. We looked at several examples of such policies in Chapter 4.

Characteristics of Japanese Management that Are Effective at Increasing Motivation Among BCS Employees

Under the present conditions in which it is difficult for companies to offer regular pay raises, management needs to consider nonfinancial motivators. Important nonfinancial factors in improving BCS employees' motivation are employment security, a human relations approach, egalitarianism and on-site management, as stated previously. All of these are characteristics of traditional Japanese-style management. A look at human resource policies that focus on these factors follows.

1. Employment Security

It is crucial for BCS employees to be stably paid the expected wages if they work conscientiously, and to continue to work at their company as long as they wish to do so. Providing stable employment is a very effective means for fostering the commitment of BCS employees. Many companies have constantly cut jobs since restructuring began in the 1980s. An increasing number of firms are cutting jobs even when the economy is good.

Even in Japan, where lifetime employment practices have been adopted for years, from the early 1990s an increasing number of companies began

to reexamine their commitment to lifetime employment and reform the traditional practices they maintain. These reforms continued until early in the 2000s, when many companies started to notice the downsides of excessive reforms and many returned at least in part to their former systems. At present, a majority of companies say that they intend to continue to use lifetime employment (see Chapter 2).

These companies believe that the merits of the lifetime employment system in terms of encouraging loyalty and commitment and making possible long-term personnel training outweigh the advantages to be gained by abandoning the system. Loyalty and trust help companies to reduce management costs and create a sense of belonging. The system also elicits the psychological energy that fuels devotion to work and willingness to contribute to the company that cannot be induced by financial rewards alone. In this sense, the loyalty and trust that accrue from stable employment are indeed valuable assets. Many Japanese firms attach importance to employment security in their overseas subsidiaries, too. As my research makes clear, this policy is highly valued by local BCS employees and gives Japanese firms a relative edge in recruiting quality workforce overseas (see Chapter 5).

It seems likely that these policies emphasizing employment security would produce similar effects and function effectively in the management of BCS employees in other countries as well.

2. Human Relations Factors

Another important nonfinancial factor contributing to the increased motivation of BCS employees is satisfying their social needs. BCS employees are involved in a wide range of jobs and tasks in the workplace. In some cases their jobs may involve elements that allow them to satisfy some of their high-level needs such as esteem needs or self-actualization needs. Managers should certainly endeavor to give them as many opportunities for achievement and growth as possible. Because of the nature of the work many of them perform, however, it is often difficult to find such opportunities in the workplace. For example, work that mainly consists of the repetition of simple standardized tasks involves little intellectual effort or stimulation.

Even in situations where it is difficult to find meaning in the work itself, however, it is possible to maintain employee motivation by paying attention to human relations factors and allowing them to fulfill their social needs—needs to belong to a group or organization, to be accepted by colleagues, and to exchange friendship and affection among

colleagues. Even in situations where they cannot derive much satisfaction from the work itself, in other words, employees remain examples of *homo socialis* and can thus be motivated by their social needs. It should be possible to increase their workplace satisfaction by helping them to pursue these needs. This has been well demonstrated by empirical studies carried out in the area of the human relations management theory, including the Hawthorne experiments (see Chapter 4).

Human relations factors include solidarity among coworkers, social friendships, and peer training.[9] Solidarity is built on the willingness of employees to defend one another in the face of assaults from management, or other groups of employees, or customers.[10] This sense of solidarity is founded on the common experiences that workers share through their work and the feelings of involvement and attachment that arise from these shared experiences. Solidarity can alleviate the feelings of alienation that arise from performing work in which employees cannot find any meaning. In workplaces that are relatively stable, long-lasting, and are normatively integrated, social friendships among colleagues can flourish.[11] Peer training is a concrete aspect of social friendship at work. In workplaces where employees possess considerable autonomy and significant knowledge not controlled by management, employees often actively pass on this knowledge to coworkers to ensure that production continues.[12]

Traditional Japanese-style management placed emphasis on the stability of the group or organization and was characterized by a holistic and family-like relationship between the employer and employees. It was generally considered that employers should pay attention not only to the workplace matters but also to various aspects of the private lives of their employees. Although Japanese management practices have changed considerably in the past thirty years, the importance of human relations factors at the workplace has not changed very much. In Japan, social aspects or human relationships in the workplace still constitutes an important factor in providing work satisfaction to employees of any position level in the organization.

The aspects of the Japanese approach that help to satisfy employees' social needs are widely used in the overseas subsidiaries of Japanese companies, and have generally met with a positive response by local employees.

3. Egalitarianism and On-site Management

In order to meet employees' social needs, it is effective to regard the organization as a community and to express the willingness to treat its members as basically equal. Without giving an image of "control", many

corporations in advanced countries in general now stress the concept that the company is a "cooperation system" operated by members fulfilling their own functions. As for human resource management, efforts have been made to ensure equal opportunity and reduce formal disparities among positions.

For instance, an increasing number of companies are reducing the status-based difference in the form of the wage payment and fringe-benefit system. At typical US and UK companies, the distinction between blue- and white-collar employees in terms of the pay system is clearly stated. In many cases, blue-collar and white-collar clerical employees (who are classified as non-exempt employees by Fair Labor Standard Act) were paid weekly or biweekly wages calculated on the basis of an hourly rate. On the other hand, upper-level white-collar employees (administrative, executive, and professional employees who are classified as exempt employees) are paid monthly salaries determined under an annual salary system. In recent years, however, some US and UK companies have eliminated the distinction between employees paid on an hourly and annual basis, applying the annual salary system to blue-collar employees as well. In other words, all full-time employees receive a monthly salary in these companies.[13]

Moreover, the disparity in fringe benefits, including pensions and holidays, between blue-collar and white-collar employees has been eliminated in these companies, and these benefits tend to be paid at a uniform rate. Many companies are providing improved health management, safety management and training as part of the policy to improve treatment of blue-collar employees.

One of the characteristics of the traditional Japanese-style management is the small disparity among positions within the company. As mentioned previously, this egalitarianism has a negative effect on motivating executives or gold-collar employees. By contrast, however, the Japanese egalitarian approach that attempts to keep wage disparities small and to provide promotion opportunities across blue-collar-white-collar distinctions, as well as their "human touch management" (*ningen shugi*) or on-site management (*genba shugi*) that encourage managers to make contact with shop-floor-level employees, is highly effective for managing BCS employees. This Japanese approach contributes to satisfying the social needs and the esteem needs of BCS employees. It has also helped heighten their sense of belonging and pride in the company.

As explained in Chapters 4 and 5, this approach is still used effectively for managing BCS employees by Japanese companies and their overseas subsidiaries, and can be used in the future, too. It seems likely that this approach could be applied effectively to the management of BCS employees in companies in many other countries too, not in Japanese companies alone.

For BCS employees, the degree to which pay is linked to performance should be kept to a minimum. As explained in Chapter 2, it is generally appropriate to make the performance-dependent part of compensation larger for higher-level employees, and smaller for lower-level employees. In many cases it will not be appropriate to introduce a performance-based pay system for BCS employees. A pay system in which the employee's compensation is determined on the basis of individual performance is particularly unsuited to BCS employees. However, paying relatively small uniform bonuses to all members of a team as an "extra" payment will generally be welcomed as a way of rewarding the performance of a team or the company as a whole.

Work-Sharing System

As mentioned in Chapter 1, the demand for blue-collar labor has declined in the past several decades due to the introduction of new technologies and the change in the industrial and occupational structures brought about by post-industrialization. To minimize job losses due to labor adjustments, it is important to consider adopting shorter working hours or a work-sharing program for blue-collar employees.

Now that many governments are unwilling to intervene in economic activities by means of tax increases and expanding public investment, a reduction in working hours is seen as the only feasible solution to maintaining employment without sacrificing productivity. Trade union leaders are also accepting shorter work hours as a means of ensuring long-term employment.

Various surveys show that the number of employees wanting shorter working hours is larger than the number of employees who do not want a reduction in hours. Trade unions in the EU continue to demand reduced working hours in collective bargaining.[14] If longer working hours cause fatigue, employees call for reduced working hours even if their income declines. According to a survey of permanent employees who are fathers, the longer the working hours are, the deeper their dissatisfaction. They hope for shorter working hours even if they lose some

income.[15] Supporters of shorter working hours argue that reduced working hours can improve company productivity and international competitiveness by reducing fatigue and increasing efficiency. Especially, new time reduction plans accompanied by the flex-time system is considered to improve productivity by enabling the optimum use of capital and facilities.

The greatest concern with shorter hours is the extent to which employees will tolerate a reduction in their take-home pay. In Japanese companies, when it is necessary to make cuts to personnel costs, various measures are used to avoid laying off permanent employees, as explained in Chapter 2. If even this is not sufficient to resolve the situation, a work-sharing program for reduction in working hours is considered. Even in times when company performance has seriously deteriorated, Japanese companies are able to avoid job cuts by carrying out work-sharing programs that involve considerable wage reduction. This is possible because the companies place high value on long-term employment and because a relationship of trust exists between employees and management.

Work sharing also serves a social purpose as it provides more people with work and thus a purpose in their life. The introduction of the work-sharing system will be considered at more workplaces for the benefit of both labor and management.

Blue-Collar, Clerical (Lower-Level White-Collar), and Service Employees [Nonpermanent Employees]

Expansion of Nonpermanent Employment

As mentioned in Chapter 2, the number of nonpermanent employees (fixed-term contract and part-time employees) in advanced countries has continued to increase over the past three decades. Many companies have reduced the ratio of permanent employees, and instead have raised the ratio of nonpermanent employees. Reasons for the increase in the proportion of nonpermanent employees are related to the changing needs of companies and the shifting conditions of the labor market, as described below.

First, the hiring of nonpermanent employees has made it possible to cut labor costs and facilitate labor adjustment. Companies can recruit short-term employees who involve lower legal risks and less financial burden, and can dismiss them easily if necessary. With post-industrialization,

employment has decreased in the large-scale manufacturing industries, while it has increased in such tertiary industries as information, healthcare, restaurant, large-scale retailing and worker dispatch business. Since these latter industries are always under pressure to keep up with changing labor demands and technological advancement in tandem with intensifying competition, they need to constantly adjust their labor force. Nonpermanent employment was quickly adopted in these sectors, and there are many workplaces where most of the necessary work is performed by nonpermanent employees.

Second, nonpermanent employment has become inevitable due to the changing labor market structure. The growing number of working women and senior citizens requires a system that can provide gender/age-friendly employment patterns.

Third, individuals with different work values and lifestyles cannot realize the optimum work–life balance without being able to choose from various working pattern options. The rapidly growing number of nonpermanent employees includes many who are paid on an hourly basis at a rate that is lower than that of permanent employees. However, fixed-term contracts that pay higher wages for sophisticated expertise are also increasing. As the changes in the business environment and technological innovation accelerate, more companies prefer to hire professionals or specialists with portable skills and knowledge only for specific periods. Companies often employ such persons under fixed-term contracts that pay much higher wages than that of permanent employees. This type of employment is increasing particularly in the information and knowledge industries. With the increasing number of temporary staffing agencies that dispatch fixed-term or part-time workers, it has become relatively easy for companies to hire such people.

Motivation Policy for Nonpermanent Employees

Nonpermanent employees are diverse in their working patterns, as well as in their economic and family situations. It is necessary to consider the balance of various working patterns and employment conditions and to draw up a policy for improving the motivation of nonpermanent employees. Some nonpermanent employees are satisfied with their working patterns and prefer not to have the time pressure of full-time employment. Their main life interest or purpose lies in areas other than work. Some individuals may be seeking a desirable job and temporarily choose nonpermanent employment to make a living in the meantime.

Their behavioral standard at the workplace is to do daily routine tasks with the effort that they feel is equivalent to the salary they receive.

Since employment security is the greatest concern for many nonpermanent employees, however, management's attitudes to maintaining job security can have a major impact on the levels of their commitment.[16] Also, one effective way to improve their motivation further is to reduce the pay disparity between permanent and nonpermanent employees, and offer them opportunities to be promoted to permanent status.

Policies that focus on the social needs of nonpermanent employees are another effective way of increasing their work satisfaction. Just as with BCS employees who are permanent employees, satisfaction with the social aspects and human relations aspects contributes greatly to maintaining motivation and improving work satisfaction of this group. "Human-touch management", where managers are in direct contact with employees on the factory floor or other place of work, as well as social friendship and connectedness among coworkers, are among the factors that can increase work satisfaction of all BCS employees, regardless of their status as permanent or nonpermanent employees. In cases where the work mainly consists of humdrum, routine tasks and in and of itself does not contain any factors that can positively motivate employees, the human relations approach of this kind can mitigate the sense of alienation that arises from performing such work.

Nonpermanent employment includes several different categories, one of which is the fixed-term contract for professionals or specialists with relevant work expertise and experience. Such contract employment often ensures high salaries that far outweigh the instability of employment. High pay rates constitute a strong incentive in such cases. Moreover, this employment pattern can provide such incentives as self-actualization, acquisition or improvement of skills and knowledge through work, and utilization of potential ability. In this regard, they function at the same motivation level as the gold-collar group.

Let me summarize the policies I have outlined above regarding BCS employees.

With regard to BCS employees, whether they are permanent or nonpermanent employees, taking advantage of the benefits of traditional Japanese-style management, including employment security, a human relations approach that satisfies social needs, egalitarianism, on-site management, and the firm-as-a-community approach, allow companies to raise employees' feelings of pride and satisfaction in their workplace,

to maintain and improve their motivation, and may ultimately lead to improved results for the company as a whole. Particularly at a time like the present, when increasing global competition has caused a deterioration in the employment and work situation, a return to earlier tradition of social connectedness that have increasingly been lost from the workplace, rebuilding a sense of community, and restoring norms of reciprocity and mutual assistance meet the needs of the employees. This will encourage more cooperation among workers on a daily basis, allowing teamwork to function more effectively, and thus helping the company both directly and indirectly to achieve its aims.

Conclusion

This chapter has examined work-related values and motivation patterns in four major position groups within organizations, i.e., (1) executives; (2) gold-collar employees; (3) permanent blue-collar, clerical, and service employees; and (4) nonpermanent blue-collar, clerical, and service employees. An effective human resource policy for each group has been presented on the basis of this examination.

In working out an effective motivation policy for each position level, a multilayered hybrid model can be created by taking the Japanese and Anglo-Saxon human resource management models, which are heterogeneous systems with antithetical features, and making the best mix of each model's advantages. This model for human resource policy is a product of the mutually complementary integration of both models. As the parts of each system that are useful differ by position level, four different hybrid sub-models can be formed, by combining different sets of the parts of both systems. This model is thought to be applicable in many countries of the world. The effective human resource policy for each position level can be summarized as follows.

1. In designing incentive systems for executives, companies should utilize the advantages of both the Anglo-Saxon and Japanese governance models. This makes it possible to remedy the problematic aspects of both systems. This approach will be especially beneficial to Japanese companies that want to reform their incentives for executives. In order to improve the motivation of executives, or to hire persons of talent from outside for executive positions, Japanese companies need to break away from the traditional

reward system, which favors small economic and social disparities, and shift to the Western model in which remuneration varies significantly according to merit and performance.

2. Gold-collar employees are expected to play an important role in revitalizing organizations, creating new value, achieving good results, and making organizations grow. They value self-actualization through work and seek the opportunity to display and hone their talents. Thus, motivation can be enhanced through their involvement in strategic processes, and through autonomy in designing their work and implementing their own decisions. The traditional Japanese system, which favors small disparity in remuneration among members of the organization, is not effective in motivating gold-collar employees. It is necessary to adopt the result-based approach of the Western model and develop a remuneration system more closely linked to work performance.
3. It is of prime importance for BCS employees (permanent employees) to be stably paid the expected wages if they take responsibility and are conscientious, and to be permitted to continue to work at their company as long as they wish to. Offering stable employment, therefore, is an extremely effective way of gaining commitment. For this group, satisfaction with the social and human-relations aspects of the workplace is an important part of their overall work satisfaction. Therefore, using a management approach based on the traditional Japanese model, which is rooted in employment security, a human relations focus on employees' social needs, egalitarianism, on-site management, and team spirit, can help to maintain and increase the motivation of BCS employees.
4. Nonpermanent BCS employees are more difficult to discuss, since their working patterns and their economic and family circumstances are so diverse. In many cases, however, providing employment security and minimizing the differences between them and permanent employees can be useful incentives. Policies that pay attention to social needs are effective in increasing work satisfaction among nonpermanent BCS employees just as they are among permanent BCS employees.

Human-relations led management, in which managers enter the workplace and communicate face-to-face with employees, as well as connectedness and social friendship among coworkers, are among the factors

generally considered to be characteristic of Japanese-style management. An approach based on these aspects can be effective at maintaining and improving the motivation of BCS employees, regardless of whether they are permanent or nonpermanent employees.

What then are the implications of these findings for Western managers, academics, and human-resource professionals seeking to learn from Japanese management, and Japanese counterparts looking to the West to help improve their company management?

1. Western companies can learn the following from Japanese-style management.

(a) In an increasingly competitive global market, many companies in North America and Europe are focused on shareholder value and short-term economic returns, and have been forced to make even greater demands of their employees and adopt even more flexible employment policies. As shown in Chapter 1, this has had a negative effect on employee motivation and work engagement. Companies in the West might be able to learn from Japanese policies of valuing employment stability and avoiding layoffs as much as possible.

Employment stability is extremely important for lower-level employees but is also important for gold-collar employees including professionals and middle managers. By placing more importance on long-term employment stability and working harder to avoid layoffs, and by subjecting personnel cuts to careful consideration and thorough deliberation, Western companies can create a workplace environment in which employees can concentrate on their work without worrying about their job security. Such a policy is effective in gaining the commitment of the employees, increasing their intrinsic motivation towards high performance, and improving retention rates.

(b) Companies in the West can learn from the Japanese corporate practice of human-relations led management. As discussed above, the policies that pay attention to the social needs of employees are particularly effective for lower-level employees such as blue-collar, clerical, and service employees, regardless of whether they are permanent or nonpermanent employees. Although lower-level employees are paid the least, they are integral to the success of an organization since they are the ones who assemble auto parts,

arrange merchandise, serve food, and provide customer service. Nevertheless, it may be difficult to derive much satisfaction from the work itself in these lower-level jobs, and the tasks themselves can often be stressful.

The Japanese approach based on a human-relations focus on employee social needs can be effective at alleviating the stress arising from these situations and increasing work satisfaction. In this approach, the company encourages a sense of community to be shared by managers and employees and attempts to cater to employees' social needs—the need to belong to a group, to be accepted by peers and colleagues, and to exchange social friendship. This approach includes "human touch management" or on-site management whereby managers enter the factory floor or other place where work is going on and converse with employees directly to see for themselves how work is proceeding. By making employees feel that they are cared about and appreciated, such practices can help increase their work satisfaction and motivation, and improve organizational and individual performance.

(c) Another important aspect of Japanese management of potential value to Western companies is the egalitarian approach to distribution of company profit. One of the characteristics of Japanese-style management is relatively small differences in pay between employees of different ranks within a company. As mentioned in Chapter 4, the ratio between top executive compensation and average worker pay is more than 300 hundred times in American companies while in Japanese companies the ratio is generally between five and thirty times. Differences in rewards are necessary according to the weight of responsibility and to achievement, but have to be kept to levels that are acceptable both within the organization and to society at large. From this point of view, many companies in the United States and Europe might want to consider reducing the pay gap between top executives and the average employee.

2. Japanese companies can learn the following from management in Western corporations.

(a) In order to enhance the motivation of higher-level personnel, i.e., senior executives, middle managers and gold-collar employees, Japanese companies need to change their current incentive system

to approximate the Western model in which performance and results are reflected more prominently in compensation. It is particularly important to prioritize performance in decisions on pay and promotion for senior executives. For these higher-level positions, the Japanese-style seniority-based promotion system should be abolished. Such reforms would enable Japanese companies to improve the motivation of these higher-level employees, or to more easily hire persons of talent from outside for these positions. They would also help increase the inter-firm mobility of employees in those strata. Nevertheless, it will be important, as stated above, to keep pay for higher-level personnel, especially for top executives, within levels that are acceptable both within the company and in the wider society.

(b) As discussed in Chapter 3, Japanese companies have come to depend increasingly on financial markets for funding, and individual shareholders and investors, particularly such institutional investors as pension funds, have come to have a significant influence on company management. This has resulted in increasing pressure on Japanese companies to improve governance and restructure their boards of directors. They can learn from their American counterparts in ways of organizing and operating their boards, as they strive to cope with these changes. One measure adopted at an increasing number of Japanese companies is separation of the board of directors and the executive board as is done in the United States and establishing positions on the board of directors for outside directors.

Also Japanese companies will have to allocate more resources for building effective relations with shareholders and focus more attention on shareholder interests in response to the increased institutional pressures. Japanese companies can learn much from the experience of American companies in working out strategies for this process.

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