Japanese Management Practices after the Big Bubble

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Abstract

Many changes are underway in Japan's distinctive human resources management practices amid the country's prolonged recession. However, such changes may not necessarily indicate the eventual collapse of the Japanese employment system, as sometimes suggested in the related literature.

Despite the adjustments companies make to cope with the economic downturn, distinctive human resources management practices in Japan's large-scale enterprises are unlikely to disappear altogether. This paper argues that distinctive management practices will continue to define the relationship between large-scale enterprises and an even smaller core segment of the workforce thus pointing to *an ad* hoc reshuffle rather than substantial restructure of internal labor markets.

Introduction

There is broad agreement in the huge literature on Japanese management on three points. First, Japanese management is understood as a set of distinctive human resources management practices, for instance the implicit guarantee of permanent employment or promotion based mainly on length of service. Second, such distinctive human resources management practices are typically found among permanent employees in Japan's large-scale enterprises. Third, changes are taking place in distinctive human resources management practices featuring in Japanese management. The third point is the focus of this paper.

The term "Japanese management" is used both in a descriptive and in a contextual sense in this paper. In the descriptive sense, the term refers to distinctive human resources management practices in Japan's large-scale enterprises. In the contextual sense, the term refers to the web of various relationships and affiliations within Japan's industrial groupings (In Japanese business literature — term *keiretsu* usually denotes *vertical* relationship between parent company and its subsidiaries and sub-contractors. For example *Toyota keiretsu* or

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Hitachi keiretsu. On the other hand, Western authors often use this term to describe *horizontal* relationships among members of big industrial groups such as Sumitomo, Mitsui or Mitsubishi. In order to avoid further confusion we shall use term *horizontal keiretsu* when referring to big industrial groups and *vertical keiretsu* when referring to company's vertical relationships with its affiliates and subsidiaries).

This dual consideration of Japanese management is necessary because the keiretsu system of industrial organization is instrumental in enabling large-scale enterprises to develop distinctive human resources management practices.

Some changes in Japanese management were already taking place in the 1980's partly because of shifts in demographics and changing employee expectations and values. However, as over recent years the Japanese economy slowed down and the country is experiencing the worst recession since the post-World War II recovery, there is much discussion of widespread and deep changes both in the descriptive and the contextual aspect of Japanese management. For instance, the implicit guarantee of a job-for-life and seniority-based rewards and promotion are becoming a fading memory for some employees while keiretsu affiliations have often come under intense pressure.

Changes in Japanese management are often considered part of an inevitable and long overdue overhaul, as Japanese companies can no longer keep insulated from market forces. Thus, for some people changes signal the welcome modernization and even Westernization of Japanese management. In this view, "irrational" practices such as life-time employment, or the seniority system have been made possible largely thanks to the substantial insulation from market forces that large-scale Japanese enterprises used to take for granted in the past. However, as the powerful forces of the global economy sweep through Japan, these practices are finally being, and indeed ought to be, replaced by what are seen as universally accepted and "rational" management practices. Therefore, the universal forces of the global economy must inevitably lead to the disappearance of distinctive, yet sorely outdated, Japanese management practices.

However, two serious weaknesses are present in the argument building on the logic of convergence. First, evidence, at times anecdotal, of changes, either in the defining features or in the context of Japanese management, is often presented in a sensational way so as to suggest a more pervasive trend (Hulme, 1996; Chiba *et. al.*, 1997; Bremner, 1998). Thus, changes in human resources management practices or in inter-firm affiliations are conveniently confused with expectations of a substantial overhaul and even collapse of Japanese management which, however, may or may not eventually take place (Bremner *et. al.*, 1999).

The second weakness in the "end of Japanese management" argument found in literature, is the scant attention to the context of Japanese management, specifically to the dynamics and conditions that have enabled Japan's large-scale enterprises to develop and sustain distinctive human resources management practices. This is despite the fact that distinctive human resources management practices are inextricably linked to the keiretsu system of industrial organization whereby large-scale enterprises make extensive use of the intricate web of sub-contracting networks and inter-firm affiliations (Dedoussis, 1995). Therefore, discussion of the context of Japanese management is a prerequisite for evaluating changes in human resources management practices.

In discussing and evaluating recent changes in Japanese human resources management practices, this paper addresses the concerns raised above. Thus, the paper discusses the extent of changes in the keiretsu system and the dynamics of Japanese management. This is because the existence of this unique type of industrial organization goes hand in hand with the development of distinctive human resources management practices found among a small minority of employees in large-scale enterprises. Discussion of the dynamics of Japanese management can provide insights on the direction of current changes in human resources management practices.

The objectives of this paper are set as follows:

First, to discuss the crucial aspect of the context of Japanese management, that is changes in the keiretsu system of industrial organization in Japan. This can help us assess the impact such changes may have upon Japanese human resources management practices.

Second, to explain the recent changes in human resources management practices associated with Japanese management. Thus, we will be able to assess the extent to which Japanese management is changing.

Third, to discuss the dynamics of Japanese management focusing on the relationship between large-scale enterprises and permanent employees. This is because it is mostly permanent employees in Japan's large-scale enterprises that distinctive human resources management practices apply to.

Although subtle and slow changes in the management practices of Japanese companies were already evident in the 1980's, it is under the impact of the current recession that revolutionary changes, as opposed to the evolutionary changes of the past decade, appear to be in store for Japanese management. As this paper focuses on recent changes in Japanese management amid the continuing recession, only the literature of the 1990's has been reviewed. This is because it was in early 1990 that Japan's "bubble economy" finally collapsed and corporate profits entered a long, drawn-out slump (Hiromatsu and Kobayashi, 1997) that continues to this day.

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The Contextual Aspect of Japanese Management —Changes in Japanese Keiretsu—

The development of various affiliations among firms belonging to a wider network of diversified business groups, which typically comprise a "main bank", a few centrally-placed corporations, and a substantial number of subcontractors, affiliates and subsidiaries, has long been considered perhaps the most striking feature of Japan's industrial structure. These affiliations among companies belonging to industrial groups are known as keiretsu. Almost invariably characterized by cross-shareholding among major companies and subcontracting of labor-intensive activities to smaller firms, the keiretsu relationship has helped members to share risks while allowing Japan's largest enterprises to achieve considerable insulation from market forces.

Amidst the longest recession since the post-WWII recovery, the keiretsu system is under enormous pressure. Relationships between keiretsu members have become strained as smaller subcontractors resist their use as shock absorbers protecting bigger size firms from the recession and exploitative purchasing practices of major client companies. Japan's severe economic downturn has forced major keiretsu firms to break long-established relationships with smaller companies (Mori, 1994). Indeed, the strains of the recession are so severe that events unheard of and unthinkable in the past are now making headlines regularly. For instance, keiretsu banks, laden with the heavy burden of the infamous "bad" loans of the 1980's (Bremner and Barrett, 1995; Bremner *et. al.*, 1997; Zielenziger, 1999) are no longer willing or even able to come to the rescue of troubled firms (Gerlach and Lincoln, 1998; Thornton and Kerwin, 1998) while keiretsu companies can hardly afford to support ailing banks (Thornton, 1998a; Abrahams *et. al.*, 1999; Bremner *et. al.*, 1999). This is in sharp contrast with past experience when major keiretsu firms used to take for granted insulation from cyclical downturns.

Another argument for the 'imminent' '*westernization*' of Japanese management practices comes from the objective process known as *internationalization*, *deregulation*, and *secutarization* — which like an incanation are often used outside their context in referring to the changing nature of the Japanese industrial and financial structure. The term 'internationalization' has been popularized since Japan's current account instigated the first trade frictions and the Ministry of Finance (jap. *okurasho*) announced the new internationalization (jap. *kokusaika*) of the yen in the late sixties. Essentially, internationalization reflects the unification of financial markets and an increase in the international flow of funds, having gained momentum on a global scale in mid-1990s. Among the changing conditions rendered by financial liberalization is the role of financial institutions. As financial liberalization implies greater freedom for financial institutions, in particular banks, to adopt creative business ideas it encourages greater efficiency and sophistication of financial services. The globalization of markets and increasingly close financial relations within industrial groups (*horizontal keiretsu*) are promoting mutual competition among various groups and it is becoming increasingly recognized that a financial market which fails to meet the diversified needs of customers will inevitably decline as the internationalization of markets progresses. These changes have only insignificantly affected the inter-group management practices. In fact, the Japanese financial sector still comprises several well organised interest groups that have very successfully employed their political (and financial) resources to influence financial policy in Japan, thus rules governing private policy in Japan are changing in response to the demands of business and only in lesser degree to the demands of Japan's major trade partners.

Although all Japanese banks are adopting strategies to meet the changing climate of financial liberalization and internationalization — this is often accomplished through mergers, allowing them to exercise economies of scale and supplement mutual weaknesses, thus strengthening their financial position. Such was a strategy for survival adopted in the 1990 merger of Mitsui Bank with Taiyo Kobe Bank (the 7th and 8th largest of Japan's city banks (jap. *toshii ginko*). Similarly to most non-financial corporations, the banking business is fundamentally determined (as in the past) by size and banks are ranked in terms of assets or amount of deposits.

The latest evidence (late 1990s) suggests a growing preference been given to yield: high risk, high return as opposed to just safety and liquidity. There has been a marked development in accumulation of financial assets exceeding real assets, a phenomenon that is sustained by the tendency among those in the upper age bracket to save their earnings until retirement. This has contributed to larger household savings and stockpiling of corporate pension funds.

On account of the fact that individuals, as fund suppliers tended to prefer liquidity and safety in selecting financial assets, the securities market essentially played a secondary role because enterprises opted for loans from financial institutions as a preferable method of procuring funds under the official policy of artificially low interest rates. However, the issuance of large quantities of national bonds in late 1990s (part and parcel of the former PM Obuchi's public spending program) provided impetus for change. This led to the unprecedented development of national and corporate bonds, thus promoting the opening of short term financial market and further accelerating the liberalization of interest rates. In 1998–2000 large corporations which had enjoyed long standing customer relationship with major banks have reduced their borrowings from them and increased recourse to equity finance. The shift in corporate financing was accelerated by the relatively cheap cost of financing in turbulent stock market and the banks' interest in increasing lending at higher rates in the middle and retail markets. This was the most significant and fundamental financial factor contributing to the changes in the affiliation system of the *horizontal keiretsu.*

An important consequence of financial liberalization is greater competition among financial and non-financial corporations, the benefits of which include a wider portfolio choice (both in financing and investing), extended investment opportunities (diversification and specialization) and the elimination of cross subsidisation among depositors. Increased competition has resulted in lower profit margins on banks' lending, thus reducing the cost of borrowing and increasing returns on savings. The financial market in Japan (including securities and insurance) has expanded at a growth rate exceeding GNP growth in the whole period of 1990s and the importance of economies of scale in addition to economies of scope is becoming increasingly obvious to Japanese corporations. Impeding foreign entrants into the market has enabled Japanese banks to reap huge profits. Financial liberalization will lead to a more efficient allocation of scarce capital resources (reducing costs of intermediating funds) which will ultimately advantage the clientele, who inevitably pay the cost of regulation.

The growing sophistication of corporations in asset liability management has reduced their heavy dependence on banks which was typical of the Japanese *horizontal keiretsu* in the past. Almost all Japanese firms, small ones inclusive have close long term relationships with a main bank founded on implicit contracts. This traditional role is made all the more stable through mutual shareholdings, the consignment system (bank administration of bond issues) and the nomination of company executives. However, as open market develop further and corporate increase the amount of financing obtained from them, the role of banks as *de facto* leaders in *horizontal keiretsu* may diminish and furthermore, if corporations continue increasing their issuance of commercial paper, the role of banks in providing short term finance may also decrease, though it would be premature to assert that the main industrial group system will disintegrate completely.

Weakening ties and re-evaluation of mutual support between affiliated firms (*vertical keiretsu*) are reflected in industry-wide surveys suggesting that both major manufacturers and their suppliers are now apt to select business partners on the basis of business criteria rather than historical ties (JETRO, 1996). However, as companies seek transactions with non-affiliated firms, decline in cross-shareholdings within keiretsu groups, the very heart of keiretsu alliances, becomes unavoidable (Mori, 1994). Thus, while approximately two-thirds of the stock market's tradable shares were locked up in keiretsu networks at the start of this decade, this had fallen to less than 50% in late 1998 (Bremmer, 1998). Nevertheless, cross-shareholdings still account for around 65% of the market capitalization of big companies (Abrahams *et. al.*, 1999). Looking at the decreasing importance of long-established affiliations and practices, and, at times, almost crumbling keiretsu ties, observers have suggested that the safety net supporting the long-term growth strategy of Japanese companies and their capacity to insulate employees from downside market risks have been badly tattered (Lincoln *et. al.*, 1996).

Do changes taking place in keiretsu relationships signal a longer-term, systematic and substantial restructuring, and perhaps, as often claimed, eventual collapse of the keiretsu system? Or, do these changes represent nothing more but short-term, *ad hoc* and opportunistic responses, as Japanese companies try to cope with the recession? These are crucial questions to consider because, as noted previously, the development of distinctive human resources management practices in Japan's large-scale enterprises is made possible largely due to the keiretsu system of industrial organization. Therefore, if changes in keiretsu relationships are substantial and long-term, they are likely to have a pronounced impact upon the descriptive aspect of Japanese management. Conversely, the impact on distinctive Japanese human resources management practices is bound to be far less significant should changes in the keiretsu system be of a temporary and superficial nature only.

If sensational articles about radical changes in inter-firm affiliations and even the imminent collapse of Japan's industrial groupings (Bremner, 1998; Bremner *et. al.*, 1999) are scrutinized, it appears that changes are rather slow and desultory and made on a case by case basis in a reactive rather than proactive fashion with scant evidence of a thorough overhaul of the keiretsu system (Abrahams, 1998a; Abrahams, 1998b). While the wisdom of maintaining inter-group affiliations under the strains of the current recession is often questioned, companies are not always prepared to discard affiliations that have proved beneficial in the past (Benson, 1998). The suggestion that "old habits die hard" (Thornton, 1998a), simplistic as it may sound, may nevertheless serve as the starting point for evaluating the slow pace of change of the keiretsu system in the light of significant mutual benefits that such "habits" of inter-firm linkages are known to have provided in the past.

Keiretsu are often portrayed in literature as change-adverse, outdated industrial groupings (Bremner, 1998), indeed as "dinosaurs" (Hulme, 1996), that must urgently reform, or, more precisely, remodel after Western organizations in order to survive in the global marketplace. This view shows lack of understanding of the essence and dynamism of inter-firm relationships and alliances as it implies that keiretsu affiliations and transactions are not "modern", that is not in line with the requirements of the emerging global economy. Thus, while there is little hesitation in emphasizing and hailing changes that make keiretsu less "Japanese", and presumably more modern, developments that make keiretsu even more "Japanese" and also more modern tend to receive less attention.

For example, re-evaluating and severing ties with existing suppliers, and decline in cross-shareholdings within industrial groupings are often hailed as signs that keiretsu finally make the decisive leap to "modern" practices abandoning "outdated" Japanese habits. By contrast, the increase in ties with new domestic partners and suppliers (JETRO, 1996) as well as the establishment of keiretsu partnerships and new cross-shareholdings at the global level that has followed the internationalization of Japanese enterprises (Edgington, 1990; Oliver and Wilkinson, 1992; Echikson and Thornton, 1999), are conveniently ignored in the literature viewing keiretsu as inflexible remnants of Japan's outdated industrial structure. Thus, it is not surprising that changes that bring Japanese enterprises even further away from international norms (Brull, 1996) receive little attention as they are seen as steps in the wrong direction.

Portraying keiretsu as outdated industrial groupings doomed to the fate of dinosaurs in the era of the global economy, unless they "un-Japanize" their ways by adopting "modern" practices, can perhaps be useful as an ideological position only. However, there is little to this position in terms of a persuasive argument in the light of evidence suggesting the replication of Japanese practices at the global level as local suppliers and smaller firms are brought into the network of globally operating Japanese keiretsu (Mac Duffie and Helper, 1997). Further, the argument of "outdated" Japanese keiretsu practices versus "modern" Western forms of industrial organization is hardly persuasive given the fascination with (Dyer, 1998), and often emulation of, the essentials of keiretsu affiliations by Western companies, albeit under different names such as supplier alliances and partnerships (Kelly and Port, 1992; Chappel, 1993; Dyer, 1996; Faulhaber, 1998).

To return to the essence of the questions posed earlier, that is which way do current changes in keiretsu point to? There is plenty of evidence that practices no longer useful are, even slowly, discarded by keiretsu companies (Bremner *et. al.*, 1999; Kunii and Takahashi, 1999). At times, changes appear to bring keiretsu networks closer to Western organizations, for instance when emphasis is placed on business criteria at the expense of long-established relationships. On the other hand, however, there are examples of change producing even more inter-firm dependence (Lincoln *et. al.*, 1998), an essentially "Japanese" feature. Clearly, there is neither a universal blueprint for changes nor is the extent and direction of changes the same for all companies.

Although change may depend on circumstances specific to one company or group of companies, an overall faster pace and wider scope of changes might have been expected given the severity of the current recession. One reason that revolutionary changes in keiretsu have, so far, not materialized may be that Japanese managers are unwilling and even unable to introduce deep and broad changes given the cohesive nature of many business practices. Reluctance for radical change is not entirely unjustified considering that the long-term tenacity and effectiveness of Japanese firms have often confounded doubters (Lincoln and Nakata, 1997). Another possibility is that Japanese managers have failed to realize that the current slowdown is structural rather than cyclical (Abrahams, 1998b) thus calling for substantial restructuring rather than *ad hoc* reforms. So far, all the rhetoric to the contrary notwithstanding, a wait-and-see attitude in conjunction with marked reluctance to implement radical restructuring and the expectation that a turnaround in the economy is not far away appear to guide changes in keiretsu.

The paradoxical attitude of Japanese managers, illustrated by slow and reluctant changes to the keiretsu system in the face of a prolonged recession, merits an explanation. Does perhaps the establishment of new inter-firm affiliations and partnerships in Japan and the internationalization of Japanese keiretsu networks suggest that Japanese capitalism is more resilient and dynamic than often assumed, and even different from Western capitalism? So far, there is little in changes in inter-firm affiliations indicating that Japanese keiretsu are about to collapse or to be remodeled after Western organizations. At this point, it may be suggested that

Japanese capitalism is indeed different from Anglo-Saxon capitalism, the dominant form of capitalism of our times, in several important respects including the very nature and social perceptions of the firm as well as inter-firm transactions and alliances (Cutts, 1992; Gerlach, 1992, Dore, 1994). This position is elaborated upon later in the paper.

The Descriptive Aspect of Japanese Management Changes in Human Resources Management Practices

It was a long tradition, among Western experts of Japanese management, to overemphasize the role of company philosophy. It was almost assumed that the Japanese tend to think that once the fundamental company philosophy is established, everything else will follow, including corporate objectives, goals and job specifications (Deming, 1978). American companies, on the other hand, emphasized clear-cut (read: modern) objectives and detailed job specifications. The difference was one of the reasons why many Western companies hesitated to adopt the Japanese style of management. Typical example of this attitude was a statement by a CEO of a major US bank quoted in Theory Z by William Ouchi: "*These Japanese don't understand objectives and it drives us nuts*". Meanwhile, the president of another (Japanese) bank affiliated in New York would say: "*These Americans just don't seem to be able to understand the objectives*" (Ouchi, 1979). The reality was that neither system was particularly 'modern' nor 'outdated' and both systems followed their own logical rules. It turned out that the Americans needed measurable targets, such as the amount dollar increase in loan volume or the percentage of decrease in operating costs they needed to achieve for measurable period. On the other hand, Japanese managers did not think it was necessary to give the managers measurable targets. They thought (quite logically) that if the managers could determine what their relationships with customers, employees, the local community, and the bank's competitors should be, then the actions they should take will automatically follow. Here, the compromise seems a rational answer to the never-ending dispute on the superiority of Japanese "*sakura*" management over the US "*cowboy*" management practices — or vice versa. The diversity of local and international markets and the demands of more sophisticated supply and demand will need both approaches for the management techniques and strategies to be efficient and profitable.

Speculation on the efficacy and survivability of distinctive human resources management practices in Japanese firms has long been a major issue in the Japanese management literature.

Such speculation has been built upon the argument that "irrational" and "outdated" human resources management practices in Japanese firms will inevitably be replaced by the more "rational" and "modern" practices of Western companies (Fingleton, 1995). Sidelined temporarily by Japan's economic boom and the "learn from Japan" fad of the 1980's, speculation on the demise of Japanese management has returned to the limelight as companies feel the strains of the country's long recession. Amid Japan's gloomy economic conditions and even gloomier forecasts (Krugman, 1999) the view that Japanese management is declining is so strongly held that even a date for its eventual collapse has been boldly predicted (Mroczkowski and Hanaoka, 1998).

The view that Japanese management is withering is not entirely unjustified in the light of evidence that not even a single of the human resources management practices, identified as "Japanese" in the literature, has escaped changes. For example, companies are slashing their annual intake of new recruits (Updike, 1995; Thornton, 1998b) while "structural" shifts are evident in recruitment, such as the growing emphasis on hiring experienced employees with specialist skills rather than inexperienced graduates from top universities (Lincoln and Nakata, 1997; Mroczkowski and Hanaoka, 1998). Further, external recruitment and headhunting are getting wider acceptance among employees (Graham, 1998) signaling the erosion of internal promotion.

In line with changes in recruitment practices, individual performance and results-oriented performance are replacing group performance and loyalty as the new criteria for establishing salary levels (Sanford, 1995; Chiba *et. al.*, 1997). A new salary system with annual compensation depending on the attainment of company targets is now in operation in several Japanese firms (Lincoln and Nakata, 1997; Mroczkowski and Hanaoka, 1998). Related to changes in the salary system is the development of the dual-promotion system that, by distinguishing between management responsibilities and titles on the one hand and status and pay on the other hand, aims at making a smooth transition from seniority and length-of-service biased promotion to performance-based promotion.

Table 1 The Evolving Management Differentials in Japan and the US

Variable	**US System ("Analytic")**	**Japanese System ("Holistic")**
Fundamental assumption	*If each employee is perfect, the aggregate of employees should be perfect as well*	*If the employee understands the whole system—the system will work well*
Policy Focus	*Microscopic on individual policies*	*Macroscopic on the whole process*
Inter-company human relations based on:	*Asymmetry*	*Synergism*
Departmental Management Objective	*Specific targets for individual departments*	*General target for the whole company*
Process of Evaluation	*Sub-optimization (the optimum for each division)*	*General optimization* Each division evaluated according to the optimum targets for the whole company
Skills and Qualifications Rewarded	*High degree of professional specialization*	*The ability to cope with different and changing professional requirements*
Ability to adapt to changing business conditions	*Asymptotic (new strategies developed by divisional top management without active participation of employees)*	*Symmetric (top management as well as employees actively cooperate in development of new business strategies)*

Other changes in Japanese management include less emphasis on group decision-making in the context of the current recession compared to better times in the past (Benson, 1998). Further, formal management and supervisory training is gradually replacing informal on-the-job training (Umeshima and Dalesio, 1993). Cutbacks in bonuses and overtime (Benson, 1998; Abrahams, 1999) is yet another departure from Japanese management practices. Notably, not even the "pillars" of Japanese management, that is lifetime employment and the seniority system, have been immune from change (Nakamoto, 1999a). Thus, restructuring plans of Japanese firms often include retrenchments or "temporary" lay offs (Thornton, 1998c; Economist, 1999), although natural attrition rather than compulsory redundancies appears to be the preferred mode for shedding excess labor capacity whenever possible (Abrahams, 1998a; Nusbaum and Price, 1999). The seniority system is under heavy pressure as not enough posts are available to accommodate all eligible employees following the economy's abysmal performance for the past several years.

Evaluating changes such as those mentioned above, the literature is often preoccupied with evidence that Japanese management is becoming "Westernized". Such preoccupation, in conjunction with the renewed inclination to view management practices in Japan as "outdated" and "irrational" following the "learn from Japan" boom of the 1980's, is reflected in the uncritical use of anecdotal, insignificant and even inappropriate evidence to suggest that Japanese management is at last shedding its irrationality to become like Western management. However, as previously suggested, Japanese capitalism differs from Anglo-Saxon capitalism with respect to the nature of the firm and inter-firm transactions and alliances. Significantly, distinctive Japanese human resources management practices can be sustained largely because of the very nature of inter-firm transactions and alliances (Dedoussis, 1995). Therefore, while changes pointing to the "*Westernization*" of Japanese management cannot be ignored, it is critical to look at changes from the viewpoint of what differs from the West. This is because, as discussed in the next section, the "typical" Japanese firm differs form its Western counterpart (Aoki, 1990).

What is, then, in the current changes in Japanese management that makes it different from Western management? One cannot explain the past and present differences by overlooking the cultural and societal differentials in both societies. The very history of Japanese society has been just the opposite of that in the United States. People of homogenous race, religion, and history have existed in Japan for over sixteen centuries. They have had little interaction with other ethnic groups. This history has naturally resulted in a unified Japanese value system, one in which there are large areas of common values. Most social values in Japan are well established and widely accepted, to the extent that it has often been said that unique or individualistic people have a hard time living in Japan. Although this view is mostly a stereotype it helped to explain the rarity of unique, epoch-making inventions or discoveries by the Japanese. For example, more than 70% of Japanese workers believe that a worker should help co-workers whereas only some 16% of American workers think that way (*Rodosha Ishiki No Kokusai Hikaku in Gendai no Nihonteki Keiei,* M. Tsuda, 1997). The automatic Japanese response in favour of assisting co-workers is the natural consequence of following a unified value system and a company philosophy that emphasizes contributions to the wellbeing of the company and society rather than to specific rules.

The difference between the Anglo-Saxon and the Japanese systems in terms of management techniques often reduces to a matter of whether one begins the process with desirability or with acceptability. The Japanese tend to fill in the center first, establishing what is desirable. The Anglo-Saxons, because of their wide variety of value systems, tend to first specify the parameter for what is acceptable. It is interesting though that usually it is rather easy to define a center for a wide area than the gravity center, but much more difficult to define the area's exact parameter. Once rigid boundaries are fixed, workers 'naturally' tend to gravitate toward meeting the lower requirements of acceptability rather than striving to achieve the more exacting ones of desirability.

Looking at distinctive responses that big Japanese companies make in attempting to minimize the impact of adverse market forces will provide another answer to this question. One example is the transfer of employees to subsidiaries and affiliated companies in keiretsu networks (Kamada, 1994). After legal restrictions on employee transfers were removed in 1985, employee "loaning" has become quite widespread during the current recession as evidenced by the very high percentage of companies reporting either temporary or permanent transfers of employees to affiliated firms (Mroczkowski and Hanaoka, 1998).

Another distinctive response is "voluntary" early retirement, which may come as early as 45 or even 40 years of age. Early retirement schemes, often involving the transfer of retirees to subsidiaries, appear to have increased steadily over the last few years (Economist, 1994; Thornton, 1998; Economist, 1999). Early retirement is often used in conjunction with another distinctive response, that is the re-hiring of retired employees. Early retirees, re-hired upon retirement either by current employers or by affiliates, have no security of employment and receive lower salaries although their duties and workload often remain the same as before retirement. Early retirement and immediate re-hiring appears to be widely practiced as cases of firms whose entire workforce consists primarily of such retired and subsequently re-hired employees are mentioned in literature (Lincoln and Nakata, 1997). Two factors, namely the early, by international standards, mandatory retirement age in Japan, and the abolishment of legal restrictions on wages earned by pensioners have certainly contributed to the spread of this practice.

Japanese firms are attempting to alleviate the impact of the economic downturn by several other means such as, cutbacks in bonus, salaries, and non-statutory welfare benefits, increased use and, at times, abuse, of subcontractors (for example by delaying payments), reduction in working hours, increased holidays and unpaid vacations. Looking at certain practices, for instance reduced working hours, unpaid vacations or cutbacks in bonus payments, one might be inclined to suggest that there is little, if anything at all, distinctive about changes in Japanese management since such practices are commonplace in Western companies as well. However, in order to understand what sets apart current changes in Japanese management from the way Western firms respond to market adversities and economic downturns the following may be considered.

Distinct practices used extensively within keiretsu networks, such as employee "loaning" (Kamada, 1994), "voluntary" early retirement and subsequent re-hiring, and effective down-grading of transferred or re-hired employees' status and conditions, do not exist in Western countries to any appreciable extent. Even if occasionally present, the wider application of such practices is severely restricted due to the absence of a supportive legal, institutional and, primarily organizational, context. For example, besides being illegal, the practice of employee transfer is impossible as inter-firm linkages, that would have facilitated it, are much weaker and often non-existent.

In Japan, on the other hand, the relaxation and even complete removal of legal barriers in conjunction with a permissive institutional environment, as unions have focused more on receiving employment guarantees than on challenging management prerogatives regarding task assignment, and, above all, the highly supportive organizational environment of keiretsu groups, provides conditions for the potentially wider and far more systematic application of the practices mentioned above compared to what can, at most, be the limited and *ad hoc* use of the same practices by Western companies. Therefore, while on the one hand the response of Japanese and Western firms to adversities may appear similar in some respects, on the other hand keiretsu affiliations in conjunction with a more permissive environment allow the former substantial flexibility in the management of human resources.

Given the obvious rigidities of permanent employment, flexibility in the management of human resources may appear a paradox. However, flexibility is made possible through the implicit guarantee of continued employment but not necessarily of specific employment conditions, which are adjusted in response to the economic and business environment. Therefore, changes in management practices in Japan, often seen as evidence that Japanese management is collapsing, have enabled companies to safeguard one essential "pillar" of Japanese management, that is permanent employment, as evidenced by the exceptional use of outright layoffs by even the most troubled companies. This is because such changes have affected mostly the manifestations rather than the essence of permanent employment.

Inevitably, the familiar dilemma whether we should look at the "tree" or the "forest" is present in any attempt to draw conclusions from current changes in Japanese management. There is no doubt that a few "trees" reminiscent of Western management can be found among the broad and striking changes taking place in Japanese management. On the other hand, though, the "forest" looks decidedly "Japanese" not only because of the resilience of particular practices, such as permanent employment, but primarily because of its capacity to rejuvenate itself by producing even more distinctively "Japanese" practices, such as employee "loaning", "voluntary" early retirement, and re-hiring of labor.

Therefore, sensational headlines and predictions about the imminent collapse of Japanese management notwithstanding, we would like to suggest that the basic configuration of Japanese human resources management remains essentially intact. This position is supported by Whitley's (1992) contention that "the interconnections and the mutually reinforcing nature of some business characteristics suggest that, once established in particular institutional contexts, effective business systems may develop considerable cohesion and become resistant to major changes". There is no denying that Japanese management is currently in a state of flux as several changes are taking place. However, having reviewed the evidence it may be suggested that there is more noise rather than reality as far as revolutionary, or even substantial, change in Japanese management is concerned.

Dynamics of Japanese Management

Although not always unambiguously stated, there is the view in literature that Japanese management, both in the contextual and the descriptive sense, is bound to lose its distinctiveness as Japan becomes integrated into the World economy. This view notwithstanding, the prevalence of subcontracting relationships and various inter-firm affiliations suggests that Japanese management, in the contextual sense, has maintained its distinctiveness. Indeed, the trend to develop and strengthen inter-firm affiliations in general and the subcontracting system in particular remains unabated as large-scale Japanese enterprises, nowadays concerned more with streamlined management than with economies of scale, hive-off various activities in the form of subsidiaries (Aoki, 1987). Surely, this susceptibility to 'internationalization' (read: *americanization*) of Japanese management practices will vary across the whole decision making spectrum (see table)

Table 2 Susceptibility of Japanese management practices to 'internationalization'

MANAGEMENT AREA	**Decision-making**	**Degree of susceptibility**
Financial management	*Investing decision* *Financing decision* *Dividend decision*	*High* *Medium* *Medium*
Marketing management	*Advertising strategy* *New distribution channels*	*High* *Medium*
Human resource management	*Replacement practices* *Decision-making process* *Personal Review Process* *Quality Control*	*Low* *Low* *Low* *Low*

Generally, Japanese corporations are seen as most innovative in the area of financial management where the need to adjust to the new demands of the world financial markets was epitomized by the longest postwar recession of the 1990s and the following restructuring of the Japanese banking system. In marketing decision making big multinational Japanese companies were traditionally seen as market leaders and the medium-sized companies are quickly closing the gap. In the area of human resource management where the confrontation with foreign markets is less visible — the traditional decision making processes were modified to fit with the new demands of more competitive markets but not changed in any revolutionary nor reformist way.

Besides allowing greater flexibility in adjusting employment levels in response to business conditions, the use of subcontracting networks and subsidiaries effectively translates into the decentralization of human resources management thus abating some of the difficulties associated with managing a workforce comprising heterogeneous groups of employees in large integrated firms. In this way, a relatively undifferentiated employment structure protecting the interests of permanent employees can be maintained in large-scale enterprises (Dedoussis, 1995). Thus, the decentralization of human resources management within keiretsu networks provides conditions for Japanese management, in the descriptive sense, to maintain distinctive features.

However, if conditions allowing the maintenance of distinctive features exist, the nature of the Japanese firm and its affiliations with other firms must be examined. This is because distinctive features are observed at the firm level (the descriptive aspect of Japanese management) and also at the inter-firm level (the contextual aspect of Japanese management). The firm in the neo-classical view, that has dominated thinking, is identified with the profit-maximizing entrepreneur or, in a modern context, with the shareholder seeking maximization of its stock value under the competitive wage system. In the shareholder-oriented firm, managers are presumed to serve the interests of owners passively.

In contrast to the view of the firm focusing exclusively on the interests of shareholders, Aoki (1987; 1990) has proposed that employees in Japanese firms are as important a constituency as shareholders. Thus, corporate management decisions of Japanese firms are subject to the dual control of financial interests, that is ownership, and employees' interests. Along similar lines others (Komiya, 1989) have argued that Japanese firms choose the amount of capital and labor inputs as well as the amount of output in order to take care of the interests of both shareholders and employees, by providing the former with a share of profits and the latter with employment security and income.

Three characteristics of the firm subject to the dual control of shareholders and employees stand out. First, the dually controlled firm, taking into account employees' extra benefits from the growth of the firm in the form of enhanced future promotion possibilities, tends to pursue a higher growth rate in investment decision making than the shareholder controlled firm facing the same level of employees' current earnings. Second, by regulating employment levels, the dually controlled firm offers a higher level of employment security than the firm identified with the interests of shareholders alone. Third, in order to protect the interests of employees, the dually controlled firm spins-off labor-intensive activities to subcontractors and subsidiaries where wages are relatively lower (Aoki, 1990).

What evidence is there that the three features of the dually controlled firm are indeed present in Japanese companies? The following paragraphs will attempt to answer this question by focussing on large-scale firms, as it is mainly this sector of the Japanese economy that the concept of the dually controlled firm is associated with.

Market Share vs Profitability

The well-known tendency of Japanese firms to focus on market share and longer-term growth rather than profitability, recognized as a major difference between Japanese and Western firms, is due to the fact that keiretsu banks, aiming at the maximization of their own profits from loans, pressure client firms to engage in the maximization of sales rather than profit. Thus, to the extent that banks can influence decision making in affiliated firms, they attempt to make firms expand output levels in order to take on more debt. As almost 70% of all stocks are owned by institutions and corporations (Jones and Tsuru, 1997) and banks hold a substantial part of it (Gerlach, 1992), they have an influential voice in the decision making of individual firms. Thus, keiretsu affiliated firms, under pressure from banks to use more capital, even when losses are steadily mounting (Zielenziger, 1999), tend to over-emphasize production relative to profits (Weinstein and Yafeh, 1995). Excess capacity in several industries attests to the focus on growth and market share.

The Benefits of Japanese Replacement System

In contrast to the US where replacement is a fundamental managerial idea, in relatively established Japanese corporations, blue-collar workers are rarely fired. If more advanced skills are required for newly introduced machines or technology, previous workers are given on-the-job training. If an employee does not fit well in a particular job, that employee is assigned to another position. Therefore, it is probably accurate to say that replacement is not practiced in Japanese management.

The same refers to *vertical keiretsu* system. Like the employees within the corporation, suppliers with a long histories of established business records with a mother-company do not expect to be replaced under the usual circumstances. The recession of the 1990s has proved that having multiple suppliers does not necessarily increase everyday costs (due to the lack of economies of scale and the increase of variability involved in having two sources). This did not create any significant downstream losses resulting from unfit parts or difficulty in assembly, which in turn increase the chances of required rework.

The development by large-scale enterprises in Japan of internal labor markets, offering the implicit guarantee of long-term employment to a select segment of the workforce, has been noted in the literature (Ariga and Brunello, 1993). Long job tenure becomes possible as internal labor markets are characterized by considerable insulation from market forces (Doeringer and Pior, 1971). During the current recession, large-scale firms in Japan have chosen to substantially reduce or even freeze hiring and implement accelerated early voluntary retirement plans rather than resort to outright layoffs (Neff *et. al.*, 1993; Spindle *et. al.*, 1994; Harney, 1999a; Harney, 1999b; Tett and Nakamae, 1999).

Some evidence corroborating the inclination of Japanese firms to treat redundancies as a last resort is the country's unemployment rate. Although the current rate (June, 2000) of

4,8% is the highest for the last fifty years, unemployment in Japan is probably well below what it ought to have been had earlier alarming predictions (Neff *et. al.*, 1993; Bremner and Takahashi, 1996) about imminent massive layoffs actually materialized. Indeed, redundancies have affected mostly non-permanent female employees rather than their permanent male counterparts. Thus, regulation of employment levels, by means of reduced or no hiring in conjunction with redundancies of non-essential personnel such as women (Saso, 1990), help to protect employment for a select part of the workforce. Internal labor markets in large-scale Japanese firms do not only safeguard employment security for permanent employees but they also provide this group with higher average earnings (Abrahams, 1998a) after non-essential and lower-paid personnel have been retrenched.

Subcontracting and Vertical Keiretsu

Protecting employment and the interests of permanent employees is also contingent upon the ability of large-scale companies to subcontract labor-intensive activities to low-wages, smaller-size firms and subsidiaries. Thus, hiving-off activities in the form of subsidiaries reflects attempts by Japanese companies to adopt "leaner and meaner" organizational structures (Whitehill, 1991: 274; Harney, 1999c; Kunii *et. al.*, 1999; Nakamae, 1999; Nakamoto, 1999b) in response to the prolonged recession. Although often slow, restructuring involving not only shedding of peripheral businesses but also establishment of new subsidiaries, is under way among Japanese firms Thornton and Bremner, 1998; Editorial FT, 1999; Harney, 1999d; News Digest FT, 1999). Legislation, currently under consideration, that makes it easier for companies to spin off businesses (Nakamoto, 1999c) is likely to strengthen even further the preference for subcontracting various activities during periods of economic adversities (Benson, 1998).

In spite of the continuing recession, Japanese firms have resisted retrenchments of permanent employees thus protecting the interests of this segment of the workforce. The prohibitive, and often astronomical, costs involved in retrenching permanent employees (Editorial FT, 1999) may partly explain this attitude of firms. On the other hand, however, permanent employees, through their costly company-specific expertise and skills, are essential for the long-term survival and growth of the company and the realization of high, long-term profits. Therefore, it may be expected that protecting the interests of permanent employees will continue to be a feature of dually controlled firms despite changes in employment conditions as may be necessitated by environmental factors (Sullivan and Peterson, 1991). Such changes in employment conditions, for instance re-allocation of employees to affiliated firms, should be seen as signs of restructuring rather than as evidence pointing to the collapse of internal labor markets in dually controlled firms.

Competition and Cooperation

The other misunderstood dynamic feature of Japanese management is its emphasis on consensus decision making.

While in the US company each division or department operates and functions according to well-defined operational procedures — in Japan decisions are mostly made by consensus. Sometimes there are no clear-cut connection between responsibility and authority, whereas that connection is an integral part of the typical US business organization. This is precisely why the lack of a definite connection between responsibility and authority is one main reason for the Japanese executives to make far-reaching and bold decisions. This logical and functional link between consensus-based decision making and the innovative and original strategy developments have been proved many times over the past 30 years — from the most effective responses to the two oil crises in 1973 and 1979 to the comprehensive business restructuring undertaken there in the late 1990s. The basic assumption underlying this type of decision-making scheme is that each division or department functions well if the corporation, as a whole function functions well. Therefore individual departments and divisions within Japanese corporation have never significantly engaged in internal competition or non-cooperation that commonly occur between, say engineering design departments and production departments in a typical US company. Where there is a spirit of cooperation – nobody blames the other for a failure and nobody takes responsibility for the defects.

To achieve that kind of orientation to problem-solving, top management must train managers to take the viewpoint that naturally leads to quickly focusing on most important question. Once fundamentals are understood in terms of corporate objectives, the solution to any issue follows automatically.

As Japanese firms abandon certain activities, get into new fields, and expand operations overseas, existing inter-firm affiliations will be in time replaced by alliances with new suppliers and subcontractors. If during the process of evolution, Japanese firms remain under the dual control of ownership and employees, while searching for leaner organizational structures and focusing on flexibility, both in terms of labor costs and in terms of the intra-firm deployment of human resources, two opposing forces will be present. That is, on the one hand the need to contain costs, streamline operations, and keep companies as lean and flexible as possible, thus serving the interests of ownership, and on the other hand the need to protect the interests of permanent employees, thus fulfilling an obligation to the other important constituency. The most likely outcome of the interaction of the opposing forces will be a smaller body of permanent employees and a "leaner" form of Japanese management.

Conclusions

It has been a foregone conclusion that Japanese business success began when Western ideas were grafted onto the traditional 'holistic' orientation of the Japanese companies. Reflecting the perception that capitalism in Japan is different from Anglo-Saxon capitalism, new terms have appeared in literature over recent years. Thus, the basic character and structure of the Japanese market has been termed "alliance capitalism" (Gerlach, 1992) while distinctive human resources management practices of Japanese firms and inter-firm transactions are seen to take place within the context of the "community of people" (Dore, 1994), "spirit of cooperation" (Kaku, 1997), or "network organization" (Fruin, 1998). Considering the way Japanese firms are responding to the worst recession in half a century, one may conclude that Japanese capitalism, as manifested at the level of the firm and inter-firm transactions, is indeed different from Anglo-Saxon capitalism. However, to suggest the same regarding the character and structure of the Japanese market is a more controversial proposition, as it requires readiness to acknowledge the possibility that different forms of capitalism can exist.

Such readiness is not always present in literature. Indeed, the "outdated" and "irrational" form of Japanese capitalism, referring to the character and structure of the market, is often expected to lose out to the "modern" and "rational" Anglo-Saxon capitalism, eliminating in the process distinctive manifestations of capitalism at the firm level. Whether the outcome of the "Darwinian contest" (Dore, 1994) will be decided by market forces alone, or by a combination of political forces and market forces, remains to be seen. So far, the more immediate threat to Japanese capitalism appears in the form of political forces, exemplified by persistent US pressure to break up the keiretsu system for creating "structural impediments" to the entrance of foreign goods and firms into Japan's protected markets. Yet, the use of political force in advancing a country's interests is far from indicative that that particular country's form of capitalism is more rational, superior or even desirable. Indeed, if that were not the case, the need to resort to political pressure would have been much less common after all. Even if applied by the World's economic superpower, political pressure may not be expected to have a lasting impact on the shape of Japanese capitalism.

Will market forces, then, help to eradicate the distinctive nature of Japanese capitalism? As national frontiers become less important in restricting economic activity, it may be argued that distinctiveness in the character and structure of the Japanese market will come under increasing pressure from universal market forces. However, to answer the above question in the affirmative, one would need to assume that the World becomes one single marketplace dominated by universal forces. Yet, rather than becoming one single marketplace, the World is splitting into regional zones of production and trade blocks dominated by broadly similar but far from universal forces. Rather than coming out of thin air, the forces that prevail within these production zones and trade blocks tend to be associated with institutions and systems of organization that, at a certain point in time, are seen as efficient, desirable or superior.

Therefore, to suggest that distinctive, but, as seen by many, residual features of Japanese capitalism will succumb to the Anglo-Saxon type of capitalism is premature and indicates short memory. One only needs to remember that just until a few years ago the World was marveling at Japanese institutions and systems of organization. Further, the continuing enthusiasm for Japanese practices such as loose functional, and even hierarchical, demarcations and creation of keiretsu-like inter-firm alliances in other countries attests to the need for scrutinizing the argument for one particular type of capitalism dominating the world. Finally, there is the tempting "what if" question. That is, what if Japanese companies backtrack on reform, as some have already done (Thornton, 1999), and start strengthening rather than breaking keiretsu ties? Assuming that the Japanese economy recovers in the near future, having by most recent indicators hit rock bottom, companies may find it easier to resort to their old ways and practices than to enforce radical and painful restructuring. It may come as no surprise then that, in many quarters, Japanese success and resilience will be attributed to the same management practices and systems of organization that are currently under such strong criticism!

The distinctive nature of Japanese capitalism has been noted in many earlier studies (Clark, 1979; Dore, 1986). More recent works suggest that, rather than being historical aberrations, Japan's "alliance capitalism" (Gerlach, 1992) and "network organization" (Fruin, 1998) represent a form of capitalism different from Anglo-Saxon capitalism. Not only is Japanese capitalism different but, as far as Japanese managers are concerned, it appears a preferred alternative to Anglo-Saxon capitalism notwithstanding the government's attempts to deregulate and liberalize the economy through the "big bang" reforms. Indeed, with the exception of the introduction of a few Western personnel practices to Japanese companies, such as emphasis on skills during recruitment and performance in remuneration, Japanese managers do not appear to consider Anglo-Saxon capitalism an alternative to Japan's homegrown capitalism. This is evidenced by the slow pace of restructuring and resistance to any radical departure from established organizational practices. In this environment, what are likely developments in Japanese management?

Regarding the contextual aspect of Japanese management, that is the keiretsu system of industrial organization, alliances, perhaps somewhat weakened, with existing suppliers and subcontractors may be expected to continue as some companies resist change. At the same time, new alliances will be put in place as restructuring takes place in other companies and Japanese firms internationalize operations. Such alliances may be also formed as foreign firms adopt and adapt the keiretsu system as an alternative or complement to their organizational practices. The ground for "alliance capitalism" and "network organization" may be especially fertile in Asian economies in the Pacific region (Fruin, 1998). Thus, in the contextual sense, referring to affiliations and relationships between companies that cooperate for mutual advantage, Japanese management may be seen in a new light. That is, as a distinctive form of industrial structure that, although associated with the name of the country where it was originally noticed, is nowadays considered a viable alternative to the "arms length" capitalism of the Anglo-Saxon model.

Turning to the descriptive aspect of Japanese management, that is the distinctive human resources management practices, observed in large-scale organizations. It is only reasonable to expect that, as long as recession continues and Japanese firms look for ways to reduce fixed labor costs, employees will have to make do with leaner bonus payments, fewer opportunities for promotion and, generally, with a more flexible permanent employment system. While on the one hand, distinctiveness in management practices may appear to fade, on the other hand, the capacity of Japanese firms to develop new distinctive organizational traits such as employee transfers should not be underestimated. An important development related to the descriptive aspect of Japanese management is the enthusiastic adoption and adaptation of Japanese human resources management practices by foreign firms in the quest for a flexible and multi-skilled workforce. Thus, Japanese management, in the descriptive sense, has become almost synonymous with efficient modern practices.

Japanese management, both in the descriptive and the contextual sense, has shown much resilience during the current prolonged recession confounding frequent predictions about its demise. At the same time, the internationalization of human resources management practices and organizational practices, originally associated with Japanese firms, has established Japanese management as an alternative to the Anglo-Saxon management. However, whether the "Japanization" of management practices in foreign firms can make Japanese management a paradigm with relevance beyond the shores of Japan will depend on the outcome of the "Darwinian contest" between Japanese and Anglo-Saxon capitalism.

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