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Circumstances, not management models, should determine corporate strategy

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Japanese company executives appear to be faced with an unprecedentedly difficult problem at present. The heart of the matter is what must be done to deal with the loss of competitiveness of Japanese businesses as a whole compared with their rivals in the United States and Western Europe.

Business stagnancy has dragged on for so long that some analysts call the 1990s a “lost decade," and it has brought a host of structural problems to the fore. It appears to have baffled many company executives and undermined their self-confidence. Ten years ago, Japan had the largest number of firms of any country-43-listed among the world's 100 largest businesses in terms of market capitalization. Now, the United States has the largest number of firms listed-61-followed by Europe with 36, while Japan has only two.

In terms of profitability, Japanese companies have been lagging far behind their U.S. and Western European counterparts. In some sectors, such as financial services, telecommunications and automobiles, an increasing number of major Japanese companies are falling under the control of U.S. and Western European business groups.

These problems with the Japanese economy are all too often discussed as matters arising from competition or the question of the superiority of either the U.S.

style of corporate management or that of Japan. Some business leaders stress the need for Japanese firms to switch to the business management style seen in the United States, while others defend the merits of the Japanese system.

There is, however, no clear-cut definition of the U.S. style and Japanese style of business management.

Common perception has it that the main characteristics of the so-called U.S. business management style are more flexible employment and wage systems, and greater transparency and accountability of business management, symbolized by the following:

- Outside directors, who are members of the board not employed by the company.
- Corporate executive officers (in charge of directing specific business operations).
- Independent auditors.
- Compliance officers, who check whether the activities of company executives and employees are legal and comply with in-house rules.

Another characteristic of the U.S. management style is that businesses give top priority to maximizing shareholder value.

The Japanese business management style is characterized by a lack of tension between company executives and shareholders. This stems from practices such as companies' holding shares in other firms for a long period on condition that the shares are not sold, and placing priority on the interests of company executives and employees rather than on those of shareholders.

As a result, companies tend to become “family" concerns led by company presidents and attach greater importance to favorable relations with customers than to boosting benefits of shareholders.

Such descriptions give the impression that the U.S. and Japanese business management styles are fundamentally different, leaving company executives with the extremely difficult task of choosing between them.

However, as Prof. Marina Whitman of University of Michigan concludes from her estimable research, it is wrong to assume that differences in the corporate management models of Japan and the United States have a long history.

Up until the 1960s, when the separation of business management from ownership came to be taken for granted, corporate executives' discretionary powers were firmly established. Within that framework, it was considered desirable to maintain stable and long-standing relations between employer and employees. It

was only natural for loyal workers to be rewarded with promotion and higher wages. The organizational hierarchy of a company headed by a president was clearly defined, which gave employees the feeling of belonging to a family.

Furthermore, major companies were regarded not only as profit-seeking organizations but also as entities with social roles in the fields of education, welfare, and public health. Such companies in the United States bore a great resemblance to their Japanese counterparts.

The 1970s, however, brought major changes to the world economy. The differences in ways in which U.S. and Japanese companies dealt with the changes created the huge difference in their management styles.

The major changes that took place were the globalization of the economy, the emergence of a growing trend toward deregulation, and revolutionary progress in technology, in particular advances in information technology.

The international flow of goods, services and funds became freer and more globalized for various reasons, including:

- The collapse of the Bretton Woods system in the early 1970s, which led most countries to adopt a floating exchange rate mechanism.
- The two oil crises, which increased international trade imbalances worldwide and stepped up the international flow of funds.
- The development of the Eurobond market.
- Tariff reductions achieved through the Tokyo Round of multilateral trade talks under the General Agreement on Tariffs and Trade.

Businesses were forced to alter their way of operating in line with the changes.

Technological progress intensified competition at the production level. The impressive technological innovations made by Japanese companies in the production of automobiles and electronic goods sent a shock wave through the U.S. business community.

Advances in information technology brought about even greater changes, rendering the financial sector heavily dependent on computers and improving productivity in all industries. Such progress also enabled all economic agents to share information of the same quality simultaneously, with the result that the monopoly on information was broken. Transparency and accountability became key words for business operations. In other words, corporate executives lost the authority they had been given tacitly by shareholders, customers and employees.

Corporations in the United States, where the free-market mechanism functioned better than anywhere else, were the first to be forced to confront the

situation. For them, challenges emerged in two forms: tension between shareholders and corporate executives, and fierce competition over the development of information technology.

Against the backdrop of individual investors' growing financial assets and the liberalization of the financial industry, pension funds and investment trust funds grew sharply, as did the stockholdings of such funds.

In other words, institutional investors emerged as the leading shareholders and rapidly increased their influence over corporate management. Institutional investors' shares as a percentage of the total shares issued by the top 1,000 U.S. companies jumped from 16 percent in 1965 to 57 percent in 1994.

Institutional investors are relentless in demanding that corporate executives boost profits to maximize shareholder value. The historical trend of separation of corporate ownership and management therefore came to be reversed and a new style of corporate management was sought after.

In response to the problems that threatened the survival of U.S. businesses during and after the 1980s, executives resorted to various measures, including restructuring and downsizing, mergers, spin-offs, hostile takeover bids and leveraged buyouts.

The race to introduce new information technology can be viewed in the same context. One idea that spread among U.S. company executives was that introducing new information technology to all aspects of corporate management before other firms did so was the most effective way of pushing up productivity and profitability, and eventually ensuring the survival of the company. The idea created new investment and promoted technological development.

Japanese corporate executives, however, lagged far behind their U.S. counterparts in the speed and scale of the action they took in response to the problems. Deregulation of the Japanese market in terms of both international and domestic trade and services was carried out at a snail's pace, hampered by strong resistance from the public and private sectors alike.

In addition, in the 1980s, when the bubble economy brought about quantitative market expansion, the need to quickly change the quality of Japanese corporate management seems to have diminished. The upshot was that the characteristics of the Japanese corporate management system were able to continue undiminished, including the practice of cross-holding shares on condition of not selling them, the rigid employment and wage systems, the absence of independent and diversified pension systems, and quantitative expansion in preference to higher profitability.

In the 1990s, the bubble economy collapsed. The greatest damage it inflicted was to destroy the traditional market structure, which had protected Japanese businesses. Japanese company executives came to realize the necessity of confronting the challenges their U.S. counterparts had faced earlier.

The need for reform did not come about because the Japanese economy lost steam, but because the environment surrounding Japanese corporate management changed.

In view of this, discussion as to the respective merits of the U.S. and Japanese corporate management styles is futile. Company executives must strengthen their firms' competitiveness, adapting them to suit the characteristics of the market at the time and place in which they are operating. The so-called U.S. and Japanese corporate management styles are nothing but a combination of traits common to many individual businesses in the two countries, which came to acquire them by seeking the corporate strategy they saw as best for them.

A majority of Japanese firms considered the Japanese management style best given Japan's cultural and economic circumstances, while U.S. firms considered the U.S. management style the best for similar reasons.

What is of critical significance concerning current corporate management is that, as a result of the changes that emerged in the world market during and after the 1970s, markets worldwide are taking on the same characteristics at a rapid pace.

What matters now, therefore, is how to respond to this. Whether to choose between the Japanese or U.S. management styles is no longer the point.

There is, for example, talk about which style is more favorable for company employees. But it is difficult to determine whether employees are treated more favorably under the life employment and seniority systems, or whether they benefit more from a system whereby young, competent and aggressive employees are given important positions. Company executives must decide on the basis of which strategy is best for the survival of their company.

The characteristics of the market in which any given company is operating will continue to change. The magnitude of the changes that so-called e-commerce will bring to all aspects of corporate management is enormous and unimaginable.

Calls for environmental protection, safer products and corporate cooperation with the local community will continue to grow, and may even shake the concept of capitalism - or the pursuit of maximum profit - to its very core.

There is also talk about attaching importance to shareholders. But who are

these shareholders? High-handed pension funds or speculative day traders? Will the pursuit of profit be given top priority perpetually? Is it not possible that the idea of according supremacy to the market principle will someday come to an end after a long series of ups and downs? Over the next few decades, these possibilities will probably become realities.

The best company executives are those who can foresee future changes and respond to them with courage. The current prosperity of the U.S. economy can be attributed to the fact that the United States has many competent executives and that U.S. society is capable of producing such talented business leaders.

Even U.S. company executives, however, must sooner or later confront new changes, and whether or not they can cope effectively remains to be seen.

Many Japanese company executives failed to respond swiftly to the changes that emerged in the 1970s. They must catch up with their U.S. counterparts as quickly as possible to put themselves in a position to handle future changes.

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