Japan's shareholder revolution

Over the past decade or so, there has been a fundamental change in what the managers of Japanese companies believe are their key objectives. **Ronald Dore** traces the country's conversion to Anglo-Saxon capitalism – and growing concerns about the emergence of a new 'divided society'.

'Economic reform' has been the banner slogan of Japanese governments for the last ten years, and the new government promises more of it. For prime minister Shinzo Abe, it is not quite the strident claim to fearless determination that it was for his predecessor. In his initial policy speech, he used the word 'reform' – *kaikaku* – only 17 times; Junichiro Koizumi's first speech used it 37 times. Nor was he as fond of the ponderous elaboration 'structural reform', which Koizumi used 17 times and Abe only once.

But there is no doubt about the general direction of economic institutional change: Abe's chief cabinet secretary is a dedicated neo-liberal, and the appointment of renowned market fundamentalists as academic members of his economic council is a clear sign of which way some of the longstanding controversial issues are likely to be resolved. Expect tax reforms to make it easier for foreign firms to take over Japanese firms, for example.

What have they all amounted to, these ten years of deregulation, privatisation, intensification of competition, rethinking welfare and flexibility in labour markets? 'Trying hard but could do better' – the standard patronising judgement of the *Wall Street Journal* and *The Economist* – greatly understates the degree to which the Japanese economy has in fact changed since 1990.

Not that deliberate 'reform' has been the major cause of change. Deregulation has brought greater competition and lower consumer prices in a few marginal areas like airlines and petrol distribution (thus, incidentally, contributing to the deflation that has stifled the Japanese economy over the last decade). But that has nothing to do with the big change, the 'shareholder revolution', the fundamental shift in what managers consider their job to be.

Back in the 1980s, when US business schools held up Japanese management as a model of long-termism and worker commitment, what managers saw as the best measure of their success, what puffed them with pride or made them despondent, was their market share – the measure of how they were doing vis-à-vis their competitors at home and abroad.

They sought profits of course, but chiefly as free cash for investment. How far they would allow increases in pay to eat into potential profits was primarily a 'jam today or jam tomorrow' question. Shareholders were in fact treated as creditors, and dividends were a kind of fixed charge, a standard percentage of the face value of their shares. The enterprise was a quasi-community and top managers were its elders. Their pay increases kept pace with those of people on the shop floor.

Today's Japanese managers have been 'Anglo-Saxonised'. It is not market share, but the price of their shares in the stock market that has become their central measure of how well they are doing. Few top managers any longer bother attending meetings of the management-union consultation committee, which used to be a central enterprise institution. They are too busy preparing for their next visit to Wall Street or the City of London, or the next meeting with analysts. (The Security Analysts Association of Japan, which had a mere 1,000 members when it instituted its professional examination in 1981, now boasts 21,000 qualified members.)

Different objectives lead to different results, especially in terms of 'who gets what'. This is evident in data on company performance from the Japanese ministry of finance, which has a very detailed statistical series for non-financial corporations based on a 100% sample of corporations with paid-up capital of more than one billion yen. These numbered around 3,000 in the mid-1980s, 5,600 now.

Table 1:

Comparing Japan's two most recent recoveries from recession

	Percentage change between 1986 and 1990	Percentage change between 2001 and 2005
Sales per firm	5.5%	4.9%
Value added per firm	6.8%	7.9%
Wages/fringe benefits per employee	19.1%	-5.8%
Salaries and bonuses of directors, per director	22.2%	97.3%
Profits per firm	28.4%	90.0%
Dividends per firm	1.6%	174.8%
Cumulated additions to reserves/cumulated dividends over five years	1.78	0.31

Source: Japanese ministry of finance

True believers in shareholder value have become the dominant voice in Japanese boardrooms and ministries

As Table 1 shows, the contrast between Japan's last two periods of recovery from recession – the late 1980s and the first years of this century – is stark. The Plaza agreement and a 60% yen revaluation plunged the Japanese economy into recession in 1986. In the five years of recovery that followed (what turned out to be the fatal five years of the asset price bubble), these large corporations – employing about a tenth of the private sector work force – gave most of the proceeds from growth to their employees. Wages (plus fringe benefits) went up by 19% while dividends increased by just 2%.

During the recent, much slower, recovery, between 2001 and 2005, wages did not go up but down, by 6%, and dividends went up by 175%. (Mild inflation in the first period and mild deflation in the second period affect the

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real wage implications of those figures, but not their ratios.)

As for 'orientation to the long term', in the first period, companies put into reserves for investment 80% more than they paid out in dividends; in the second period 70% less.

Perhaps even more striking is the erosion of the key assumption of the quasi-community – that managers and employees 'eat their rice out of the same pot'. In the first period, while wages rose by 19%, directors' salaries plus bonuses rose by 22%. In the last five years, while wages have gone down by 6%, directors' salaries and bonuses have gone up by 97% – and that does not count the stock options, which became legal a decade ago and have progressively increased since.

One is reminded of the 1980s in the United States, the decade of the demise of the Japanese-style community firms like Kodak and IBM. There too, shareholder activism and the spiralling of executive pay went hand in hand.

There are both rational and ideological elements in the explanation of these changes. In the 1980s, the expectation of everlasting capital gains kept shareholders so happy that stock prices bubbled, even with minimal dividends. Now they want income, and forcefully vocal foreign institutional investors now hold 26% of Japanese stock, compared with 5% in 1990. The network of mutual cross-shareholdings, the preponderance of 'stable shareholders' that used to provide a firm guarantee against hostile takeovers has been largely dismantled, partly because of bank distress, partly engineered by government regulation. Firms are no longer protected against hostile takeover.

But the ideological element is probably greater. The total loss of national self-confidence after the world's number one economic miracle entered its 'lost decade' coincided with two important changes.

First, seniority promotion has brought to positions of influence a cohort of people whom I rudely call 'the brain-washed generation'. These are the high-flyers sent by ministries and companies to the United States for MBAs and PhDs in the 1970s and 1980s. These true believers in agency theory and shareholder value have become the dominant voice in ministries and boardrooms, backed up by the media and by the economists and corporation law experts who sit on government committees.

The second big change is the evaporation of the Socialist Party and the emasculation of the enterprise unions once affiliated to it. The organised left is now reduced to a tiny and dwindling Communist Party, dull, doctrinaire and excluded from mainstream politics.

Realisation of the extent of the shareholder revolution is slowly sinking in, and a few alarm bells are ringing. It is becoming a truism that recovery is painfully slow because the export boom and a modest recovery in investment are not being matched by increased consumer spending or consumer confidence. And that is because wages are not rising.

More striking is the new voice of what one might call a new communitarian left concerned with growing poverty. Books on income distribution, social mobility and the withering of aspiration pour off the press at the rate of one a week, all deploring the new 'divided society'. That 28% of children in Osaka and 24% in Tokyo qualify for free school meals and textbooks has become one of the most quoted statistics. Table 1 reports wage figures for the 'labour aristocracy', people working in the big firms. By contrast, in smaller firms, which employ half the labour force, wages fell by 10%, not 6%.

But as yet there is no effective political force to organise the backlash and mobilise sentiment among the electorate at large. Until that happens, investors can relax. The Abe cabinet will continue to promote the conversion of Japan to Anglo-Saxon capitalism.

The different objectives of today's Japanese managers lead to very different results – especially in terms of 'who gets what'

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