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**Keiretsu groups: Their Role in the Japanese Economy
and a Reference Point (or a paradigm)
for Other Countries**

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Abstract

This paper examines the role of *keiretsu groups* in the Japanese economy. In the extraordinarily successful postwar period *keiretsu* became an essential factor in enhancing economic growth and structural upgrading as well as closing up a productivity and technology gap between Japan and other developed countries. The term of *keiretsu* has been applied to a variety of Japanese intercorporate networks. In general, *keiretsu* groups are defined as clusters of independently managed firms maintaining close and stable economic ties, cemented by a governance mechanism such as presidents' clubs, partial cross-ownership, and interlocking directorates. Within the broad definition lie two distinctive variations. The horizontal *keiretsu* are conglomerates covering several industries linked by cross-shareholding, intra-group financing and high level management by a central (often shadowy) body of directors. The vertical *keiretsu* are groups around one big manufacturer and consist of a multi-layered system of suppliers focused on the core company.

Keiretsu groups are of great interest for researchers and scholars both from the point of view of the explication of the dynamics and ability to achieve and maintain in competitive conditions, and in order to seek pointers to identification of successful features of corporate groups in general. Moreover, *keiretsu* groups provide an interesting normative model, and possible sources of practices and examples for Central and Eastern European transition economies, especially Polish corporate groups.

There are two main research objectives of this paper:

- The first objective is to describe the organizational structure and mode of operation of two types of *keiretsu* groups (horizontal and vertical), and their role in Japan's economy.
- The second objective is to present a comparison of *keiretsu* groups and corporate groups in other countries, especially Poland's corporate groups. The main question arises whether in Poland there were conditions to establish corporate groups of *keiretsu* type at the beginning of the system transformation in the 1990s, or whether such conditions exist now, after accession to EU.

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1. Introduction

The most distinctive form of network organization in Japan, and most critical to understanding its economic system, are the clusters of industrial, and financial corporations known as *keiretsu* groups. In the extraordinarily successful postwar period *keiretsu* became an essential factor in enhancing economic growth and structural upgrading as well as closing up a productivity and technology gap between Japan and other developed countries.

The term *keiretsu* has been applied to a variety of Japanese intercorporate networks. In general, *keiretsu* groups are defined as clusters of independently managed firms maintaining close and stable economic ties, cemented by a governance mechanism such as presidents' clubs, partial cross-ownership, and interlocking directorates.

Within the broad definition lie two distinctive variations. The horizontal *keiretsu* are conglomerates covering several industries linked by cross-shareholding, intra-group financing and high level management by a central (often shadowy) body of directors. The vertical *keiretsu* are groups around one big manufacturer and consist of a multi-layered system of suppliers focused on the core company.

Keiretsu groups “have been a key element in Japan’s rapid industrial development and transformation since the 1950s,” writes K.E. Calander (1993, p. 142). In such sectors as petrochemicals, telematics, atomic power, real estate development, and Middle East oil exploitation, *keiretsu* groups have taken the strategic initiative for Japan. H. Okumura (2000, p. 137) suggests that in the high growth period *keiretsu* groups became “the source of Japan’s competitiveness”. Even among those who would not take it quite that far, the *keiretsu* groups substantially shape the character of economic competition. At a macroeconomic level, R.E. Caves and M. Uekusa (1976, p. 63) argue that *keiretsu* groups are “a major and conspicuous force in the Japanese economy”.

R. Kensy (2001, p. 230) states that *keiretsu* groups are the largest and most relevant institution in Japan’s economic system. *Keiretsu* groups have taken the lead in so many areas of Japanese development that they will continue to play a leading role in molding the future. By transforming their companies internally from industrial to postindustrial, they are not only restructuring the entire Japanese industrial landscape but have also assumed the power and responsibility of future social and cultural objectives.

According to T. Ozawa (2001, p. 480) until the end of the high growth period “*Keiretsu* was part and parcel of Japan’s industrial dirigisme, serving as the critical vehicle through which state-created capital was channeled into investment projects considered essential under industrial policies”. *Keiretsu* groups served as an effective mechanism to reduce “coordination failures” in large-scale investment projects, in which business firms individually are not willing or able to take risks. M. Porter *et al.* (2000, p. 152) adds that *keiretsu* groups are still the engines of innovation and new business formation.

Keiretsu groups played key roles in the restructuring of declining industries (M.L. Gerlach and J.R. Lincoln (2004, p. 31). One of the real strengths of the Japanese economy in the post-war period has been in its capacity for fast adaptation to macroeconomic shock (e.g., the 1974 oil crisis, the 1986 “*Endaka*” revaluation of the yen) and smooth transitions from stagnant or declining industries (e.g., shipbuilding, steel) to sectors in which Japanese competitive potential remained high. These structural adjustments were by and large carried out without labour unrest, government subsidy, and business failures troubling Western economies that moved down a similar path.

More recently E. Sanidas (2005, p. 2) in his study on organizational innovations in the world economy notes that *keiretsu* groups (and prewar *zaibatsu* conglomerates) “*significantly and positively impacted on Japanese economic growth*”.

All above the cited authors focus on the apparent advantages of *keiretsu* groups. With the economic stagnation of the 1990s, studies have been more critical of the horizontal *keiretsu* mode of financing. For example, T. Hoshi and A. Kashyap (2001, s. 186) argue that *keiretsu* finance performed well for long time and then failed to adopt to changing circumstances connected with the liberalization and deregulation of the Japanese financial system. During the high growth period the costs of *keiretsu* finance were outweighed by the benefits. However, by the 1990s the costs were obvious and the benefits obscure. The cost of *keiretsu* finance regards banks: regulation induced banks to compete on size rather than profitability, the convoy system discouraged innovation; banks and firms: can result in inefficient rescue operations; firms: may rise founding costs for firms that are not prone to serious adverse selection and moral hazard problems, can lead to too much debt financing, might discourage risk-taking.

Since the early 1980’s, Japanese transnational corporations have become main entities in the world economy, and now have a high rate of physical investment in new, greenfield sites. It has had detrimental consequences in the Japanese economy, particularly for small and medium sized firms (SMEs) which operate in vertical *keiretsu* networks. It has led to concerns about “*hollowing out*” Japan’s domestic industry, raising the possibility of long-term industrial decline. The increase in outward foreign direct investment (FDI) flows has not only diverted new investment from Japan industrial regions, but also enhances the ability of large Japanese transnational corporations to outsource their production globally. This has caused a reduction in the demand for intermediate goods supplied by Japan SMEs, in particular, the vertical *keiretsu* firms who have become “isolated” due to the increasing trend towards overseas production. According to K. Cowling and P.R. Tomlinson (2000, p. 360) this relatively unrestrained shift of production by Japan’s transnational corporations is contributing to a massive “strategic failure” of the Japanese economy.

Since the late the 1980s stable cross-shareholding system within *keiretsu* structures has come under sharp critique. The system was first questioned by the US government, which, during the US-Japan Structural Impediments Initiative Talks that began in 1989, suggested

cross-shareholdings were anti-competitive. Also the system was widely condemned in the US following the well-publicized attempt by greenmailer T. Boone Pickens to purchase a stake in Kyoto, a Toyota group parts manufacturer, on the grounds that it showed a total disregard for the “rights” of shareholders in Japan (Learmount 2002).

Y. Yafeh (2003, p. 259) provides empirical support for the claim that during the 1990s, cross-shareholding arrangements within horizontal *keiretsu* groups and ties between ailing financial institutions and their client companies have been acknowledged as potential impediments to structural change, especially with respect to the introduction of market-based means of corporate finance and governance.

2. Conglomerates *zaibatsu* as *keiretsu* Phenotypes

2.1. Family business in the Tokugawa period

In the *Tokugawa* period (1603-1868) Japan's socio-economic and political system was a feudal system. The political system was defined as *bakuhau* and was based on the parallel existence of two political institutions: *shogun (bakufu)*, being the state authority, and regional administration, that is feudal landlords (*daimyo*). The mechanisms that tied this system were of a feudal character at the very top, particularly at the level of relations between a *shogun* and *daimyo*, whereas in administrative units (*han*), within the direct jurisdiction of a *shogun* or *daimyo*, bureaucratic methods of governing prevailed. In the sphere of foreign relations the *Tokugawa* period was characterized by Japan's voluntary isolation for over two and a half centuries (Allen 1972, p. 14).

Economic relations in the reign of the *Tokugawa* regime were based on Confucius doctrine adapted to the requirements of the *bushido* ethical code. At the end of the 16th century feudal landlords started to establish settlements around their ancestral estates. In these settlements trade and services developed. Peasants delivered their agricultural products and craftwork and then sold them to merchants, thus being able to supply themselves with all necessary products. Merchants exchanged rice, received by samurais as remuneration, for money and delivered ordered products. Merchant business transformed in time into large trading houses operating in Osaka, Edo, Kyoto and other larger cities.

Confucian learning in the *Tokugawa* period helped to create a concept of reign and the vision of a harmonious society. Social order took the form of a natural hierarchy where each individual held a particular place and endeavored to fulfill their life tasks. In a social structure there was a rigorous hierarchy of four castes below the imperial family and noble courtiers, that is samurais holding power, peasants and craftsmen providing production and services, and merchants dealing with the goods distribution. Outside the caste system there was a Buddhist and Shinto clergy.

The position of merchants in the socio-economic system of *Tokugawa* resulted from the relations imposed on them by the Confucian doct, including basic goods distribution, was subject to the authority's interference. Feudal aristocracy traditionally believed financial matters were discreditable to samurai dignity. Similar to Middle Age Europe business profit was held in contempt. Merchant's activity, with profit making and capital accumulation being its essence, was wrapped in suspicion. As a result, the merchants under the *Tokugawa* regime were much more exposed to the authority's arbitrary action, for instance debt cancellation, compulsory loans or property confiscation, than merchants in Europe.

Even though feudal aristocracy despised merchants' lifestyle, they were in fact dependant on them as merchants assured them a contact between the cities and villages. From

the beginning of the *Tokugawa* period *shoguns* and feudal landlords admitted merchants holding special status to their service. Many of them were former samurais who at the time of civil wars specialized in goods deliveries, for instance military supplies. As merchants were not free people, their only attribute was the fact that they were suppliers for the ruling class. Thus, in these circumstances cooperation between the castes was started. It is proved by the appearance of guilds and license organizations. *Bakufu* approved of some merchant associations from the beginning, for instance those holding monopolistic positions in the silk and gold trade. Later monopolistic associations dealing with silver, copper, lime and plant oil production and trade were established. Towards the end of the 17th century the *bakufu* ban on establishing private associations for the protection of own business was mitigated, which allowed whole traders guilds to be established. At the beginning of the 1720's *bakufu* allowed the establishment of merchant unions, treating them as the center providing price stability and the appropriate distribution of goods. Mutual dependence between the samurai caste and merchants families was adopting a special character with reference to business and financial operations between the *shogun* domain and feudal landlords' estates.

At the beginning of the 18th century, after *Tokugawa* rulers' reign was formed, *shogun* introduced the obligation of temporary stay of feudal landlords in Edo as hostages, to be able to control them directly and win their loyalty. The need of constant transfer of rice and ores, as well as other goods, between feudal landlords and their families staying in the country arose at that time. This, in consequence, led to the establishment of national mercantile centers in three main cities of the then Japan, that is Osaka, Edo and Kyoto. Towards the end of the 17th century approximately 100 of such centers, belonging to individual feudal landlords and used as storage places of rice coming from individual provinces as tax due to the *shogun*, were established in Osaka (Allen 1972, pp. 13-29).

In the 18th century most of the oldest Japanese merchant families established their position. Large merchant houses of the *Mitsui*, *Sumitomo*, *Kinokuniya*, *Yodaya* or *Konoike* families could strengthen their influence despite the authorities' restrictions thanks to the fact that samurais themselves coming from landlord families, and sometimes even *Tokugawa shoguns* themselves, were supported by the merchant capital.

Hachirobei Takatoshi Mitsui, who started his activity as a silk merchant in the middle of the 17th century, was a founder of the *Mitsui* dynasty. Then he extended his activity to cover other commodities, with the extensive use of barter. He also founded a local credit enterprise and a rice and money exchange shop. His son founded Echigoya warehouse in 1673 in Edo. In the 1680's the enterprise already had subsidiaries in Kyoto and Osaka and started operating on a large scale. In the 1690's *Mitsui* became privileged purveyor of fiscal services of the shogun and imperial court despite serving a similar function towards several *daimyo*. By this time *Mitsui* had created an extended chain of wholesale centers with their warehouses assuring those sales. The *Mitsui* family organized a chain of couriers between Osaka and Edo, and started to purchase land for agricultural management as well (Yonekura 1985, pp.63-104).

The *Sumitomo* family first dealt with medicaments and the iron-ware trade in Kyoto. In the first years of the *Tokugawa* period *Sumitomo* became engaged in copper mining and sale through Osaka, and copper refinery exploitation in Kyoto and Osaka. After *Sumitomo* learnt the modern copper smelting method from European merchants, Japan became the world's largest copper producer. In 1783 together with establishing a monopoly for copper production and trade by *bakufu*, *Sumitomo* became the *shogun's* representatives in the Kansai area; later, in 1791, they started exploiting rich deposits in Besshi. The high income acquired from copper production and trade allowed *Sumitomo* to extend their activity to cover production of textiles, clothing, sugar and medicines. One of the *Sumitomo* clans founded a money exchange firm.

2.2. Industrialization following the *Meiji* Restoration and “political merchants”

The second half of the 19th century witnessed an intensive modernization of Japan's socio-economic and political system. In 1868 the *Meiji* Restoration took place, the *shogun* was overthrown and the emperor regained all power. The *Meiji* period reforms were directed from above and were connected with the transition of the feudal system into enlightened monarchy and a relatively open capitalistic economy. The *Meiji* Government democratized social and political relations, modernized the army, and adjusted the legal system, institutions and mechanisms market economy conditions. They also undertook action to improve the fiscal system and home capital development.

At the time of the *Meiji* reforms almost all of Asia was under British, Russian, French and Dutch control. One of the forms of defense against the threat of losing state independence was economic growth stimulation and army extension. The increase of central authority importance and entering a path of social and economic modernization allowed the ruling class to retain their power. In consequence, fast economic development was accompanied by limited changes in social structure, culture and the “nation's spirit”. A *Fukoku Kyohei* slogan, nationalistic at the beginning of the *Meiji* reforms that meant the country's prosperity and army extension, was substituted with a *Dai Nippon* slogan in the 1930's. Semifeudal Japan in socio-political and economic structure, using modern industrial production based on Western methods, entered a path of fast economic growth and foreign expansion.

English and French liberalism as well as Prussian absolutism provided the *Meiji* government with solutions for political organization; the army organization was modeled on the Prussian experience, the Navy – on the British one; the system of education and universities was reformed according to French and German models; the banking system was initially based on the American model, later Belgian (Patrick 1967, pp. 239-89, Ishii 1991, pp. 214-30).

In order to improve the pecuniary system the *Meiji* government introduced common

currency. Under the Decree on New Currency of 1887 the system of the gold standard started to abide. Later, however, due to the difficulties in the trade with Asian countries and perturbations on the world market of ores, this system was abandoned and a silver standard system was adopted. At the same time the government started the issue of banknotes that were not backed by ore reserves. The issues of the new money were used for financing public debt and partly for credits for people and feudal clans that still remained after the previous system. Due to low trust in the new government society did not trust the banknotes to be currency and they gradually lost their value in favor of exchangeable money despite various attempts undertaken by the administration to stop this tendency. Under the Decree on National Banks of 1873 a modern banking system based on the US National Banking System model started to develop in Japan (Brown 2002).

As the government gradually stopped exchanging unconvertible banknotes into fully exchangeable standard money, the issue of the first ones rapidly increased, which, in consequence, increased currency value instability and foreign trade deficit even more. An anti-government riot in Satsuma, which appeared to be very costly to suppress, crowned these unfavorable circumstances. In order to finance growing expenditures the government increased the issues of unconvertible banknotes and government bonds. In consequence, these actions led to hyperinflation.

With the situation that arose a new minister of finance Prince Matsukata introduced a program aiming at public expenses limitation, unconvertible banknote withdrawal from circulation and currency stabilization. As a result of the undertaken action the number of nonstandard banknotes in circulation was significantly reduced and the disproportion between the value of both kinds of money was decreased. It led, however, to profound deflation and economic stagnation.

In 1882 the Decree on Japan's Bank, prepared by Prince Matsukata, that was valid until a new law on the central bank was passed in 1942, was introduced. A characteristic feature of the new system, based on the Belgian model, was the subordination of a newly created institution to the government (Ministry of Finance). At this time commercial banks lost the right to issue banknotes and were transformed into commercial deposit-credit banks. The principles of the establishment of so called common banks running deposit-credit activity and the way of their operation were settled by the Banking Decree of 1890 (Takeda 1966, pp. 98-100).

Stock market establishment and development at the end of the 19th century was of significant importance to the development of the Japanese financial system. Tokyo and Osaka Stock Exchanges were established under the Decree on Stock Exchanges. Brokers' firms, initially dealing with the government bonds trade, and starting from the 90s – stocks and shares trade, were established as well. Capital market development played an important role in financing not only public debts but also the business sector, thus creating an opportunity of acquiring financial means from the sources alternative to bank loans.

At the end of the 19th century the first long-term credit banks were established as well. In 1898 Hypothec Bank of Japan, which provided long-term credit mortgages secured for agriculture and food sectors, was founded. In subsequent years other long-term credit banks providing financial means for heavy industry development (*Industrial Bank of Japan*), Hokkaido island development and agricultural sector (*Colonial Bank of Japan*), as well as Korea industrialization (*Chosen Shokusan Ginko*), were established. Long-term credit banks were established on the basis of public means and they were specially protected by the state. Their main objective was to support the process of capital accumulation and financing industry development by providing long-term loans. These banks played a significant role later, in Japan's industrial politics after the Second World War.

The government's fiscal problems of the 1860's and the beginning of the made the *Meiji* Government adopt a program of mass privatization of all state-owned enterprises. The Decree Concerning Factories Sale, issued in 1880, stated that companies put into full operation would be transferred into private investors to support home industry and capital development. Actually, wide scale sales that enabled large *zaibatsu* conglomerates' development were started. The extent of the privatization processes may be proved by the fact that in 1874-1896 the government implemented 26 projects in cooperation with *zaibatsu*, covering coal, copper, silver and gold mines, cotton and silk spinning mills, shipyards, cement factories, iron works, a sugar refinery and a glass factory. The majority of companies were sold to *zaibatsu* very favorable terms, that is at prices much lower than the outlays borne by the government to start their activity (Kobayashi 1985, pp. 64-5).

From the beginning of the period of Japanese economy and society modernization the lack of a strong middle class owning financial means and experienced in industry finance and business development was a significant problem. Leading merchant families experienced in banking and business activity in the *Tokugawa* period supported the economic changes of the *Meiji* period, earning the name of so called "*political merchants*" (*Seisho*) (Morikawa 1992, p. 4). The political merchants that developed into major *zaibatsu* can be divided into three groups according to the kinds of services they provided for the *Meiji* Government: first *Mitsui* and *Yasuda*, financiers licensed to handle national tax revenues; second, Okura and Fujita, merchant enterprises that supplied goods and services required by the regime; and third, *Mitsubishi*, which received special subsidies from the government for shipping operations (see Table 1).

Zaibatsu Sumitomo obtained the confirmation of a license from the *Meiji* government for the exploitation of rich copper deposits in Besshi. *Mitsui* was appointed a privileged purveyor of fiscal services to the government for financial support given for the *Meiji* government in the first several critical years for the government, plus numerous privileges, which opened possibilities for further expansion. It was expressed by *Mitsui Bussan (Mitsui & Co.)* establishment in 1876, the firm which obtained the monopoly for the sale of high quality coal from the Miike state mines. It allowed *Mitsui Bussan* to acquire experience in foreign trade

Table 1. Group-specific Origins in 19th Century Japan

	Origins	Growth and Relations with the Government
<i>Mitsui</i> *	Dates back to 1673; “ <i>political merchants</i> ” who provided financial services to the <i>Tokugawa</i> regime since the late 17 th century.	Historically close ties to various governments. Growth and diversification through acquisitions, in part through establishment of new business, in part through government privatization and contracts.
<i>Mitsubishi</i> *	Founded by a former Samurai after the <i>Meiji</i> Restoration.	Initially investment in shipping enjoyed government protection, subsidies, loans etc. Subsequent growth and diversification patterns broadly similar to Mitsui’s.
<i>Sumitomo</i> *	Dates back to the late 16 th century with ties to the <i>Tokugawa</i> regime.	Diversified from mining into trading, finance, and industry. Again, diversification and growth through both acquisitions and through the establishment a new business, with government support.
<i>Yasuda</i> *	“ <i>Political merchants</i> ” from the <i>Meiji</i> Restoration period. Mainly provided financial services (including the establishment of the third national bank in 1876).	Less diversified than the other large groups more focused on banking and finance. Again, both acquisitions and new business as mechanism of growth.
<i>Asano</i>	Around 1870, no previous political ties.	Initial fortune out of various investments. Growth through cooperation with separate financial institutions.
<i>Fujita</i>	Origins: supplier of good and engineering works to the new government (with contacts to major figures in the <i>Meiji</i> government).	An internal family feud led to the dissolution of this group and its reorganization as the <i>Kuhara zaibatsu</i> .
<i>Okura</i>	Merchant (groceries) before the <i>Meiji</i> restoration; converted into gun production in 1860s and then into overseas trading starting 1873.	Growth mainly through acquisitions. Despite substantial operations overseas, government contracts remained major sources of income.

* denotes the “*big four*” *zaibatsu* groups

Source: T. Khanna, Y. Yafeh (2005, p. 83)

and expand their activity for army supplies at the time of suppressing the uprising in Kyushu in 1877.

Despite the fact that *Mitsui* and *Sumitomo* were not the only *zaibatsu* deriving from large merchant families of *Tokugawa* period, only these conglomerates managed to win enormous economic as well as political influence. Other merchant families of the *Tokugawa* period, for instance *Kamoike*, did not develop so dynamically, staying in the background of the mainstream of economic changes of the *Meiji* period.

2.3. Organizational structure and governance of *zaibatsu*

One essential feature of the *zaibatsu*, guaranteeing control over the entire network of companies by a family clan, was a pyramidal structure. In this structure a holding company (*Honsha*) was situated at the very top, wielding control over the network of suppliers and subsidiaries as well as dependent firms. Large merchant families issued stock which allowed the financing of industrialization and creation of large pyramidal *zaibatsu* groups (Okazaki 2001, pp. 243-268).

The process of constructing pyramidal *zaibatsu* group structure may be presented in models. Let us consider that a family has a fortune of 1 billion yen and invests it in a family business, Choten Corp. The family sees a multitude of profitable business opportunities, and feels it could profitably invest many billion yen. To see how the family can undertake these investments by constructing a pyramidal group, yet retain control of Choten and all these new ventures see Figure 1.

First, the family expands Choten Corp. (top pyramid structure) by issuing new public shares worth almost 1 billion yen. Public shareholders end up owning almost fifty percent of Choten, which is now worth almost 2 billion yen. This gives the family almost 1 billion yen cash, yet preserves its complete control of the family business. This is because its fifty per cent plus stake lets it appoint the board of directors. Choten is now set to become the apex firm of the pyramidal group.

Next, the family organizes two new firms, Hitotsu-Ichi Corp. and Hitotsu-Ni Corp. Each is financed with a 500 million yen equity investment from Choten and a public offering to raise almost 500 million yen by selling outside shareholders almost fifty percent. Hitotsu-Ichi and Hitotsu-Ni now each have 1 billion yen. The family now fully controls three firms, with unconsolidated balance sheets totaling 4 billion yen, and 3 billion in consolidated assets. The family's control is complete because it fully controls Choten, and the Choten board votes a fifty percent plus stake in both Hitotsu-Ichi Corp. and Hitotsu-Ni Corp., and thus controls their boards.

To expand further, the family has Hitotsu-Ni set up four new firms. Hitotsu-Ichi organize Futatsu-Ichi and Futatsu-Ni, financing each with a 500 million equity investment and a public offering to raise almost 500 million yen by selling outside shareholders almost fifty per cent. Hitotsu-Ni Corp. organizes Futatsu-San and Futatsu-Yon similarly. The family now fully controls seven firms, with unconsolidated values totaling 8 billion yen, and 5 billion in consolidated assets.

In the next step, each Futatsu level firms organizes two new companies. The family now fully controls fifteen firms, with unconsolidated balance sheets totaling 16 billion yen, and 9 billion in consolidated assets. Each Mitsuo level firms can then similarly organize two Yottsu level firms, resulting in a pyramid of thirty one firms worth 32 billion yen on paper and holding 17 billion yen in consolidated assets. This process can be repeated until the family

Both public investors and querulous could be tapped for capital and excluded from corporate governance (Morck, Nakamura 2004).

Big *zaibatsu* *Mitsui*, *Sumitomo*, *Mitsubishi* and *Yasuda* (“the big four” or “old”) were established and developed in the *Meiji* Restoration as well as the *Taisho* period. *Zaibatsu* worked out an autonomic mechanism of reconstructing their pyramidal structures involving a shift of companies losing competitive advantage inside a pyramidal network and substituting them with other companies, as well as founding a new holding company.

To the end of the *Edo* period clans dealing with clothing production and money exchange were on top of the *Mitsui* pyramidal structure. The gradual decline of textile industry production in the 1870’s brought about the necessity of entire restructuring involving a shift of this production line inside the structure to lower levels. In 1876 *Mitsui Bank* found itself on top of the *Mitsui* structure as a holding company. In 1909 the *Mitsui* Board decided to carry out another restructure by joining new firms on top of the structure, that is *Mitsui Mining* and *Mitsui Bussan* (Yonekura 1985, p. 69).

Sumitomo’s structure was similar to *Mitsui*. Financial institutions were located near the top, whereas industrial enterprises were deeper inside the structures. Direct subsidiaries, similar to *Mitsubishi* and *Mitsui* included: a bank, a trading company (*Sogo Shosha*), insurance company, coal mine and department store. Relatively few *Sumitomo* firms issued shares that were on the Stock Exchange, for instance *Sumitomo Bank* in 1917, *Sumitomo Trust* in 1925, *Sumitomo Chemical* in 1934, *Sumitomo Metal Industries* in 1935, and *Sumitomo Electric Wire and Cable Works* in 1937 (Morck, Nakamura 2004, p. 24).

The example of *Yasuda zaibatsu* offers a different model of a pyramidal structure. The main area of *Yasuda* business was finance. *Yasuda Bank* was the biggest of all large *zaibatsu*. For instance, *Yasuda Bank* was established from the merger of eleven minor banks in 1913, and managed capital amounting to 150 million yens, as compared to *Mitsui Bank*, which disposed of capital of 600 thousand yens at the same time, *Sumitomo Bank* – 500 thousand yens, *Dai Ichi Bank* – 430 thousand yens, or *Mitsubishi* - 300 thousand yens. *Yasuda Bank* increased its activity even more as a result of mergers with other banks as well as development of relations with *Asano* and *Mori zaibatsu* (Morck, Nakamura 2004, p. 25).

Zaibatsu Mitsubishi of the *Iwasaki* family was one of the most dynamically developing pyramidal structures. *Mitsubishi* was distinguished by looser relations with direct subsidiaries as compared to other *zaibatsu*, and larger engagement of public funds in the structures development, which, in consequence, meant greater ease in getting involved in capital-intensive undertakings and winning a leading position in such areas of activity as engineering, heavy industry and sea transport. Moreover, *Mitsubishi* employed gifted managers from outside the family (Yamamura 1972, pp. 141-46).

Other *zaibatsu* groups were the so called *Industrial Zaibatsu*, narrowly specialized, operating in manufacturing industry, deprived of banks and financial institutions. This group included: *Asano*, *Kawasaki*, *Furukawa*, *Shibaura Manufacturing Works* (now *Toshiba*) and

Hitachi.

A group of so called “new” *zaibatsu* of pyramidal structures established in the first decade of the 20th century included: *Nissan*, *Nichitsu*, *Mori*, *Nisso* and *Riken*. The establishment and development of these structures is connected with the time of prosperity during the First World War and dynamic development of capital market in 1917-1919. The main area of their activity was heavy, chemical and power industries. This *zaibatsu* group was distinguished from other structures by the fact that the firms on top of the pyramidal structure frequently had shareholders from outside the structures, not related to the family of *zaibatsu* founders. The durability of these structures was guaranteed by unique skills and engineering competence in some areas of manufacturing industry. For instance, in the case of the *Nissan* creator, it was the founder Yoshisuke Ayukawa’s genius; in the case of *Nichitsu*, *Mori* and *Nisso zaibatsu* - outstanding chemists, whereas the founder of *Riken zaibatsu* was a well-known expert in machine industry. Most of these *zaibatsu* were not financially self-sufficient and had to use external that is outside the group, financial sources (Morc, Nakamura 2004, p. 27).

A separate group of *zaibatsu* were *local zaibatsu*, family groups territorially restricted to their activity within a specified geographical area of, for instance, prefecture, narrowly specialized and deprived of extended network structures essential for local development. *Nakano*, *Itaya*, *Kaishima* and *Katakura* belonged to this group.

More and more complex organizational structures of *zaibatsu* required professionalization of management. In a traditional family company before the *Meiji* Restoration professional hired managers (*Banto*) were appointed for the most important position. The *Banto* institution appeared in Japan during the *Tokugawa* period. In the 18th century merchants in Osaka, aware of the dangers resulting from excessive family control, made a pact banning handing companies over from father to son and obliging the use of *Banto* services. In the companies founded after 1868 a founder managed them with the support of middle managers. A second generation of owners, however, withdrew to the position of passive shareholders, whereas actual supervision was performed by professional managers.

In joint stock companies that were not controlled by one family, the manager bought dispersed shares of enterprises, thus winning promotion to hold a position of exclusive owners. Individual *zaibatsu* operated under professional management at various stages of their development, for instance in *Mitsubishi* this 1930’s, after Dan’s murder, all structures managed to abandon the practice of appointing members of the founder’s family to managerial positions.

Another tendency was moving from family to corporate structure of ownership. This process lasted longer than the professionalization of *zaibatsu* management. Members of the families controlling individual *zaibatsu* handed over management to professional managers quite early, whereas they were unwilling to relinquish the ownership and formal control over companies. Despite the introduction of legal regulations of joint stock companies in the period

of the *Meiji* restoration many families maintained their shares. Further relatives or not related employees of companies could buy shares; they were small lots, however, connected with the number of voting rights restrictions and stock resale.

Restrictions in the changes of ownership, which were the legacy of the past period, were abolished by the Commercial Code of 1893 and the Civil Code of 1898. Later, shares of the families' members were in many cases treated as collective ownership, which was to provide protection against the sale of shares outside scattered ownership. In the *zaibatsu* owners' families the rules saying that profit on investment could be re-invested only in the firms being a part of the network were binding (Yamamura 1972, pp. 168-98).

2.4. The Banking crisis, the Great Depression and the bankruptcy of some *zaibatsu*

Japan's economic system was characterized by the domination of large shareholders in a corporate structure of ownership as well as a relatively low level of financial system restrictions to the end of the 1920's. Banking sector barriers were not high, minimum capital equipments were determined at a low level; moreover, there was neither credit risk management nor a deposit security system. The relatively weak level of the state control referred not only to the banking sector but the stock market as well. Both these institutions played a similar role in financing companies and the public sector (Aoki *et al.* 1994, p. 40-1).

The liberal character of the Japanese financial system influenced the banking structure sector and the conditions of *zaibatsu* operations to a great extent. The banking sector was of a double structure as, on the one hand, large city banks operated, for instance *Mitsubishi*, *Mitsui* or *Sumitomo*, with an extensive base of top class clients, both from among corporations and individual subjects. On the other hand, there were a large number of small regional banks which focused on financing a narrow circle of companies specific for a particular bank. Some of them used collected savings to finance their own or befriended companies. This practice, however, was accompanied by a risk of insufficient diversification of bank assets and weakened control over the ways of using entrusted financial means.

Relatively low restrictions of the financial system led to its instability and evident defects in the system of banking control. It was expressed by several outbreaks of banking panic and massive withdrawals of savings. Such events took place, among other things, in 1920 and 1923. The banking crisis with the most severe consequences, however, occurred in March 1927.

The huge earthquake in Kanto in 1923 as well as the long recession in the second half of the 20s caused enormous damage and serious economic perturbation. Moreover, strong appreciation of yen worsened the situation of exporters, especially in the textile industry. These factors led to the insolvency of many companies, which in consequence led to the bankruptcy of the banks servicing them. Bad loans of the banks, occurring as a result of

numerous banking bills submitted to them for discount before the earthquake, became an additional problem.

In 1927, under a new Banking Act, banking reform was carried out which contributed to the sector's stabilization. The provisions of this act considerably tightened the capital requirements banks had to meet, the number of banks was decreased, and the Bank of Japan's position was strengthened. Thanks to the reorganization of the banking sector and the increase of the degree of its concentration banks gradually started to play a dominant role in the financial system.

In the 1920's, in accordance with a world tendency to reactivate the gold standard abandoned in 1914, Japan's government abolished its embargo on gold export, too and introduced this system again in January 1930. Coming back to fixed parity of yen exchange against the dollar at the level from before the embargo in 1917 (0.50 USD) required an approximately 10% revaluation against the current exchange rate (0.44-0.46 USD). Such considerable yen revaluation, however, could only lead to export decrease, worsening Japan's balance payments, and outflow of gold abroad. In these circumstances the Japanese government adopted a solution involving domestic price level decrease to a level not lower than revaluation rate. Deflation policy was implemented, among other things, through the decrease of public expenditures and interest rates increase. It coincided, however, with the outbreak of the Great Depression. The economic slump afflicted Japan as well, where nominal GNP decreased in 1929-1931 by 18%, whereas it actually increased at this time by 2%. The reason for this discrepancy was a drastic decrease of domestic price levels whose index amounted to minus 20%.

The Great Depression of 1929-33 caused much more serious repercussions than the stock exchange panic and banking crisis of the second half of the 20s. Its consequence was not only a deep economic crisis but a social and political one as well. It was most acute in 1931 when it turned out that *Mitsui Bank* and *Mitsui Bussan* had got involved in speculative dealings after the United Kingdom withdrew from the gold standard. In the atmosphere of allegations treason against the of national interest Takuma Dan, a co-owner and president of the largest Japanese *zaibatsu* – *Mitsui*, was assassinated. These events made family clans controlling *zaibatsu* resign from direct participation in management and entrust this function to hired managers.

Smaller *zaibatsu* suffered seriously at the time of the Great Depression in Japan. Some of them, for instance: *Nakazawa*, *Watanabe*, *Matsukata*, *Mogi*, *Kuhara*, *Masuda* and *Abe* went bankrupt, whereas others were forced to introduce radical changes in the organizational pyramidal structure and management (Yui 1988, pp. 56-87).

The indication of the role of banks in pyramidal structures is of essential importance in explaining the reasons for the bankruptcy of some *zaibatsu*. In *Mitsubishi*, *Mitsui* and *Sumitomo* placing banks on top of pyramidal structures enabled family clans of particular groups to concentrate power and economic influence. The banks of these groups disposed of

relatively diversified portfolio of credits, granting only 10-20% of loans to the firms within the group. The banks invested free financial means in the firms and industries from outside the group. Moreover, in the case of *Mitsubishi*, banks avoided financial investment in the period of the recession companies particularly vulnerable to crisis phenomena, especially including those from mining and heavy industry, recommending the use of direct financing. Capital relations between the holding company and the first-tier subsidiaries were loosened in *Mitsubishi* as well.

Other *zaibatsu* used their organ banks as the main source of financing the firms' activity, and their credit portfolios were poorly diversified. For instance, *Nakazawa Bank* financed 94% of the firms' activity within the group, *Watanabe Bank* 75%, *Jugo Bank* financed the firms of the *Matsukata zaibatsu* at the same level. Until the *Suzuki zaibatsu* bankruptcy in 1927, *Taiwan Bank* was the group's main lender, financing 72% of its activity.

2.5. Wartime economy and the reorganization of *zaibatsu*

The Quantun Army entering southern Manchuria in September 1931, and then their further expansion into the Asian continent against the central government was a breakthrough for Japan's form of socio-economic system in the 1930's and until the middle of the 1940's. Civil authorities lost control over the army and thus were presented with a *fait accompli*. In February 1932 the puppet state of Manzhouguo, controlled by the Quantun army, was created. This seemingly independent country, cut off from the control of the Japanese civil authorities, became an experimental area where the Japanese army command introduced the concept of planned economy (Hall 1979, p. 276).

In 1934, a group of army and navy officers coming from ultra-military and elitist circles, seized power in a coup. The military coup finished the period of democratic government in Japan (constitutional monarchy) and started an authoritarian regime. The new government increased expenses on the development of such branches of industry as the car, refinery, machines, shipbuilding and aircraft. At the same time military authorities in co-operation with formally ruling political parties led the parliament to pass several acts establishing a new economic system in industry in 1934-38.

The achievements in the realization of the planned industrialization of Manchuria made the government prepare a plan of strenuous industrialization for the whole of Japan. In 1936, a five-year plan of economic development was prepared. After the approval of *Zaikai* and political parties, this plan was adopted by the government as the *Plan of Production Powers Expansion*. It assumed target levels of increased production in selected lines of industry in the whole of Japan and Manchuria (Rice 1979, pp. 689-706).

The implementation of the planned priorities required the increase of state control over providing the companies with financial resources, raw materials and technology. In 1937,

**Table 2. Concentration of Fourteen Zaibatsu Subsidiaries in Heavy Industries
(Paid-in Capital, 000's Yen)**

	1937				1947			
	14 zaibatsu*		Total companies (within Japan)		14 zaibatsu*		Total companies (within Japan)	
Manufacturing and mining	2 039 348	25.3	8 056 601	100.0	10 440 200	100.0	22 089 231	100.0
Heavy industries	985 504	27.3	3 612 502	100.0	7 919 585	54.9	14 430 619	100.0
Metal	174 478	19.1	911 752	100.0	1 655 406	43.2	3 829 681	100.0
Machinery	385 312	29.4	1 311 471	100.0	4 302 777	56.4	7 632 409	100.0
Chemical	425 714	30.6	1 389 279	100.0	1 961 402	66.1	2 968 529	100.0

* the fourteen zaibatsu are: *Mitsui, Mitsubishi, Sumitomo, Furukawa, Asano, Okura, Yasuda, Nomura, Ayukawa (Nissan), Nitchitsu, Nisso, Mori, Riken, Nakajima.*

Source: H. Morikawa (1992, p. 234)

under the *Temporary Funds Adjustment Law*, the Economic State Planning Ministry (*Kikakuin*) was established. The increase of centralization was legally approved of together with the introduction of the *National Mobilization Law*, as well as the *Administrative Ordinance on Management of Bank Funds* and the *Law on Special Measures for Military Procurement*. The above mentioned laws let the government control industrial production, investment level and structure, profit allocation and foreign trade. In 1938, the compulsion to labour wages determined centrally and other terms of employment were introduced in Japan.

In 1937, the War Second Chinese-Japanese broke out. In December 1941, the Pearl Harbor attack started World War II in Eastern and South-Eastern Asia. In the period of the greatest war success in 1942, Japan conquered Hong Kong, Indochina, Singapore, Indonesia and Burma, proclaiming the new *Great East Asian Prosperity Sphere*.

At the time of war mobilization a rapid development of *zaibatsu* took place (Table 2). A group of “old” *zaibatsu* got strongly involved in the development of heavy and chemical industry, financing investment expansion from the group sources or by the issue of shares. Until the 1930's in first-tier subsidiaries in pyramidal structures, including the companies at the top, particular clan members of the group held almost entire ownership. In the 30s this group was sold in a public offer as well. It allowed conglomerates to finance new capital-intensive projects. These issues decreased the dominant position of existing family clans in the corporate structure of ownership.

So called “new” *zaibatsu*, particularly Japan Industries representing *Nissan*, Japan Nitrogenous from *Nichitsu*, Nippon Soda connected with *Nisso*, Mori Industrial Enterprises, belonging to *Mori*, and Chemical Research Institute, from *Riken* were listed as the most profitable enterprises. They were characterized by relatively high openness and flexibility;

what is more, they were involved in various branches of industry, mainly technology-intensive. On the other hand, in contrast to “old” *zaibatsu*, they were not financially self-sufficient and had to use banking loans and state funds (e.g. *Industrial Bank of Japan*) from outside the group (Yui 1988, pp. 72-83).

In 1940, the State Planning Ministry made a decision to implement the New Economic System. It was supposed to transfer private companies from profit-oriented entities into units carrying out national objectives. The New Economic System was actually a system of total mobilization; total in the sense that it did not only limit itself to the state influence in the economy, but covered all social relations, including political compulsion (Shiba 1994, pp. 1-25).

Together with starting total war mobilization the government limited the scope of economic freedom and competition, and market mechanism was substituted by planning and a system of orders following the model of the Soviet *Gosplan*. There was a considerable restriction of the rights of owners to manage capital and corporations. They had to strictly conform to the war-oriented economy and military and administrative authorities directives. The banking system was nationalized, and family clans lost control over *zaibatsu* in favor of military economic administration (Okazaki 1994, pp. 350-90).

Limiting ownership rights to choose investment decisions, production structure and price-shaping, the state imposed the development of employees’ patriotic labour unions at the same time. This way the role of managers and labour unions cooperating with administration and the army significantly increased, whereas the role of owners decreased. Actually, managers and labour unions created the model of a company carrying out the objectives of the state and their own, and not of the owners.

In the structure of the sources financing companies, an apparent tendency to refrain from direct financing (shares, bonds to a smaller extent) supported by the means coming from *zaibatsu* internal sources towards the model of indirect financing based on loans, was revealed. Together with the introduction of the decree, the Japanese economy was dependent on external sources of financing and so the institution of the consortium increased its importance. The *Industrial Bank of Japan*, which was recognized as a major bank financing the war economy before the War Bank was established, played a leading role in organizing it.

The process of banking sector subordination to the government reached its climax at the beginning of 1944, when the System of Financial Institutions for the War Industry was introduced. Individual companies belonging to this sector were assigned to one, sometimes two banks, one of which was the so-called designated bank. Designated banks were responsible for organizing credit consortia for the companies they were assigned to. In March 1945, the system of nominated banks covered other sectors of the economy. The institution of designated banks influenced the establishment of characteristic war time financial system relations between financial institutions and companies within *keiretsu* groups described as main bank system to a great extent (Aoki *et al.* 1994, p. 42).

3. Postwar Reforms and the Emergence of *keiretsu* Groups

3.1. Political and economic reforms and *zaibatsu* dissolution

Postwar political, social and economic reforms carried out under the auspices of American occupation authorities created a new perspective and chances of development. The peaceful constitution and demilitarization freed resources for civil development. The rejection of military legislation on total mobilization radically reduced military expenditures and the state control of the economy. The importance of market forces and competition mechanism increased. Moreover, the agricultural reform and dissolution of *zaibatsu* family conglomerates considerably changed the ownership structure by the elimination of large private capital.

According to T.A. Bisson (1954, p. 39) the aim of *zaibatsu* dissolution was to create conditions for the establishment of competitive companies in modern sectors of the economy. *“In its choice of dissolution as the method of dealing with the combines, involving replacement of the Zaibatsu system by free enterprise economy, the occupation policy hewed closely to the line of American ideology and experience. In the wider field, it equated democracy with the individualism characteristic of American tradition [...]”*.

E.M. Hadley (1970, p. 19) proves that the occupation authorities aimed at the introduction of the economic deconcentration program which was *“[...] to give all Japanese businessmen the opportunity to engage in the modern sector of the economy, that is, to remove those conditions which preserved this for a chosen few, those conditions which in fact made it private collectivism”*. It was not, therefore, the manifestation of American idealism but rather a practical approach to solving economic problems.

The Holding Company Liquidation Commission (*HCLC*) appointed by the Japanese government on *SCAP*'s (Supreme Commander Allied Powers or “GHQ” for General Headquarters of the U.S. occupation of Japan) initiative selected ten large conglomerates (*Mitsui, Mitsubishi, Sumitomo, Yasuda, Furukawa, Nissan, Okura, Nomura, Asano* and *Nakajima*) and eighty-three holding companies which played a main role in the then system of supervision over the corporation. *HCLC* abandoned formal confiscation of *zaibatsu* stocks in return for compensation. Family clans shares were exchanged for ten-year non-negotiable government bonds. Postwar inflation reduced their value very fast. At the end of 1947 and in early 1948 the Japanese government enacted the *Law for the Exclusion of Excessive Concentration of Economic Power*, and the *Law for the Elimination of the Control Power of Zaibatsu Families* (Okazaki 2001, p. 245, Schaede 2000, pp. 72-8).

Zaibatsu dissolution radically changed the commercial and financial structure and management, and stimulated the development of entrepreneurship and competition. The firms which were previously a part of the *zaibatsu* conglomerates, deprived of their shareholders together with the share capital depreciation as a result of postwar hyperinflation, were not able

to finance their operational and investment activity on stock markets closed by the American authorities in the 1945-49 period. They were forced to use bank credits and loans.

Together with the dissolution of the largest *zaibatsu* (*Mitsui*, *Mitsubishi*, *Sumitomo*, *Yasuda*), large firms in machine and military industries were privatized, including *Toyota*, *Toshiba*, *Nissan*, *Hitachi*, *Nakajima*. In these companies the place of leading and active shareholders was substituted, to some extent, with a close cooperation of the board of directors with the employees who, *de facto*, took operational and strategic control over the companies.

Moreover, as it is emphasized by E. Sakakibara (1993, pp. 13-4), *zaibatsu* dissolution was also of key importance to the establishment of the so called Japanese-style mixed economy. Depriving leading clans of the control over holding companies as a result of the reforms had a considerable influence on the shape of later companies and the change of the managers' status from officials working for the head of a clan into the most important subjects of employee's organizations. In this sense the postwar organization of large Japanese corporations adopted a more public character. The place of large prewar merchant families in the structure of big corporations was initially taken by individual investors, and in the 1950s, together with the development of cross-shareholding, more and more share packets went to banks, other financial institutions and companies of the *keiretsu* groups.

Economic system liberalization and demilitarization, as well as access to foreign technologies, contributed to the establishment of many new family companies, such as: *Matsushita*, *Sony*, *Honda*, *Ohbayashi-Gumi*, and *Takeda*. Restrictions in the scope of settlements and payments in foreign economic trade, control of the goods and services and technology imports, limitations in stock market activity and the shortage of capital which followed postwar inflation, together with the dissolution of the largest *zaibatsu* conglomerates led to extremely high dependence of the companies on indirect financing, particularly by large city banks.

Wide scale system reforms, however, did not lead to the breakdown of the instruments and mechanisms of the state influence on economy that had developed at the time of the total war mobilization. These mostly included the control of interest rates and limited large private city banks' access to household's savings. The system of the state postal savings controlled most household savings. An extensive network of postal savings, tradition, trust, government contributions and tax preferences were conducive to this. Collected savings were deposited in the Trust Fund, which invested them on stock market available for public banks implementing industrial policy determined by the *Ministry of International Trade and Industry (MITI)*.

Private banks gave credits and loans to the firms and refinanced themselves in public banks, including the Bank of Japan. Access to these funds was conditioned by the observance of *MITI* industrial policy principles. The subjects that accepted the system of government recommendations could take advantage of conditionally granted tax preferences, after first meeting technological, production scale, production export share and other criteria.

Bank-centered financing of the corporations' activity, accelerated accumulation and maintenance of labour unions and their close cooperation with the board of directors was a new form of paternal employment relations from the period of the total war mobilization. The dominant share of loans in financing investment led to the marginalization of shareholders' importance and the increase of the board of directors and employees' importance. The lack of legal basis changing the role of the company organs, *de facto*, led to the substitution of shareholders with lenders, and the position of the boards of directors and the employees supporting them was strengthened. Harmonious labour relations enabled the introduction of modern foreign management methods adjusted to traditional Japanese customs and relations, for instance *Kaizen*, *TQM*, *OJT*.

In the 1950s, after Japan regained independence, *keiretsu* structures deriving from prewar conglomerates, that is *Mitsui*, *Mitsubishi* and *Sumitomo*, reorganized their structures, and within the next decade three new *keiretsu* (*Fuji*, *Sanwa* and *Dai-Ichi Kangyo Bank*) were formed with effective support of the banks.

In the 1960s the *keiretsu* which established vertically organized pyramids of suppliers passing into a recipient pyramid in the distribution sphere developed their activity. The most important vertical *keiretsu* focusing around large corporations include: *Toyota*, *Nissan*, *Mazda*, *Suzuki*, *Isuzu*, *Mitsubishi Motors* (except *Honda*), in the electrical industry: *Matsushita*, *Hitachi*, *NEC*, *Sanyo*, *Fujitsu*, *Canon*, *Toshiba*, *Sharp*, *Mitsubishi Electric*, in the steel industry: *Nippon Steel* and *Kobe Steel*, and in the chemical industry: *Shiseido* and *Kao-Hansha*.

Apart from financial and tax privileges, which were to stimulate their investment expansion, new technologies, structural changes and export development, *keiretsu* groups established a new way of fixed costs and financial risk reduction within the group.

3.2 Defining *keiretsu*

Economic literature on *keiretsu* quite often uses categories designed for the analyses of American or European corporations to describe their Japanese counterparts. It may lead, however, to not always true evaluations and conclusions. Analyzing Japanese corporations as single fully autonomous economic subjects is a frequently made mistake. Meanwhile, as *keiretsu* typology will reveal, the essence of Japanese corporations is the membership of corporate groups.

Keiretsu may be considered in two aspects: as to their ownership and function. The ownership aspect refers to the relations occurring between the companies on the basis of mutual capital cross-shareholding. In the functional aspect, on the other hand, the formula of relations between the companies enables optimal realization of production and distribution requirements of manufacturing processes.

E.M. Hadley (1970, p. 257) distinguishes four types of *keiretsu* in one of the first interpretations of the Japanese corporate groups' essence and importance:

- (a) Capital groups formed after *zaibatsu* dissolution (the network of companies owned by family clans and trading houses),
- (b) Corporation groups related by credit relations,
- (c) System of final goods suppliers,
- (d) Combines (“*combinatos*”), the network of companies connected by technological relations.

A narrower *keiretsu* classification, partly including Hadley's proposal, as well the evolution these structures underwent in the 1950s and 1960s, presented by R. Komiya (1990, p. 185) distinguishes:

- (a) Traditional *keiretsu* deriving from “old” *zaibatsu* (*Mitsubishi, Mitsui, Sumitomo*),
- (b) Financial *keiretsu* focused around banks (*Dai-Ichi Kangyo, Fuji, Sanwa*),
- (c) Industrial *keiretsu* formed by the biggest production corporations (*Matsushita, Toyota, Hitachi*).

K. Imai (1990, pp. 16-22), who distinguishes five types of *keiretsu*, postulates an extended classification of *keiretsu*:

- (a) *Zaibatsu* (loosely related and strongly diversified, for instance *Mitsubishi*),
- (b) Single production *keiretsu* based on a strong leading corporation, for instance *Hitachi*,
- (c) So called spin-off *keiretsu* formed as a result of the most innovative parts of the core company becoming self-dependent, for instance *Matsushita*,
- (d) Regional *keiretsu* formed by regional subsidiaries becoming self-dependent, for instance *NEC*,
- (e) *Person-oriented keiretsu*, networks of companies created by charismatic owners, for instance *Seibu, Softbank*.

In the first work of the Polish subject literature on the Japanese corporate groups J. Bossak (1975, p. 1104-1111) distinguishes their four basic types:

- (a) The so-called “big three”, that is *Mitsubishi, Mitsui* and *Sumitomo*, differing from *zaibatsu* by the lack of a holding company,
- (b) *Kinyu keiretsu*, with dominant banks and their connections through share capital (*Fuji, Dai-Ichi Kangyo* and *Sanwa*),
- (c) *Shihon keiretsu*, composed of one large enterprise and numerous small subsidiaries related to it by capital, technology and management (*Matsushita, Nippon Steel, Toyota, Nissan, Hitachi*),
- (d) Combines, that is complexes of companies being mutual suppliers and recipients of raw materials and semi-products to one another.

The most frequently presented division, particularly in the research on the system of corporation supervision, is the one into horizontal *keiretsu* (*Kinyu*) and vertical *keiretsu* (*Shihon*). Horizontal *keiretsu* are non-hierarchical groups of the main companies deriving

from prewar *zaibatsu* conglomerates, (for instance *Mitsui, Mitsubishi, Sumitomo, Yasuda*), connected by credit relations with a common main bank (for instance *Dai-Ichi Kangyo, Fuji*), and providing other members of the group that are commercial partners or *joint-ventures* with preferences. Vertical *keiretsu*, on the other hand, are networks of subsidiaries operating within large corporations and subordinated to them by means of capital and long-term production-distribution relations (for instance *Toyota, Toshiba, Hitachi*) (Grabowiecki 2002, p. 81).

The division into horizontal *keiretsu* and vertical *keiretsu*, however, does not fully reflect the character of the relations occurring in both types of the analyzed structures. The term *Kinyu keiretsu*, in other words financial *keiretsu*, suggests that the main binder of the group's companies are financial relations. Actually, however, although the position of the city bank and, in consequence, the importance of credit relations and main bank system are crucial here, production and trade relations are of great significance as well. Whereas, in the case of *shihon keiretsu*, the term *shihon* means "capital", which, in consequence, suggests a dominant role of capital relations. A distinct feature of this type of *keiretsu*, however, is the production and distribution relations between the main subject of the group and the network of subsidiaries. However, capital relations, although extremely important, play a role analogous to the one they played in horizontal *keiretsu*. They are not, therefore, a distinguishing feature differentiating this type of *keiretsu* from the alternative form. What is more, they are characteristic of both types of corporate groups.

3.3. Types of *keiretsu* groups

The term *keiretsu* covers two fundamentally different types of groups. One is horizontal (intermarket) *keiretsu*; the other is vertical *keiretsu*.

Horizontal *keiretsu* were formed around a large city bank being the group's main bank. They also include general trading companies (*Sogo Shosha*), life insurance companies (*Kanji Gaisha*) and other financial institution, large industrial companies and a network of subsidiaries (see Figure 2). Such groups bear some of the most famous names in Japanese industry - *Mitsui, Mitsubishi, Sumitomo* and differ from the vertical *keiretsu* in scope, number, and structure.

Where the vertical *keiretsu* operates within an industry, broadly defined, the horizontal *keiretsu* consists of firms from virtually every major industry in the economy, with especially strong representation in the key industries of the postwar high growth period that was the era of its greatest strength (heavy industry, petrochemicals, materials processing, and banking and trading) (Gerlach, Lincoln 2004, Flath 2005).

While virtually every large Japanese firm heads a vertical *keiretsu*, there are only six horizontal *keiretsu*, which were formed in the 1950s. Three are direct descendants of the

prewar zaibatsu (*Mitsui, Mitsubishi, and Sumitomo*), and three were formed at the initiative of banks and also have their roots, less directly, in the prewar zaibatsu (*Fuji, Sanwa, and Dai-Ichi Kangyo*).

Figure 2. Structure of Keiretsu

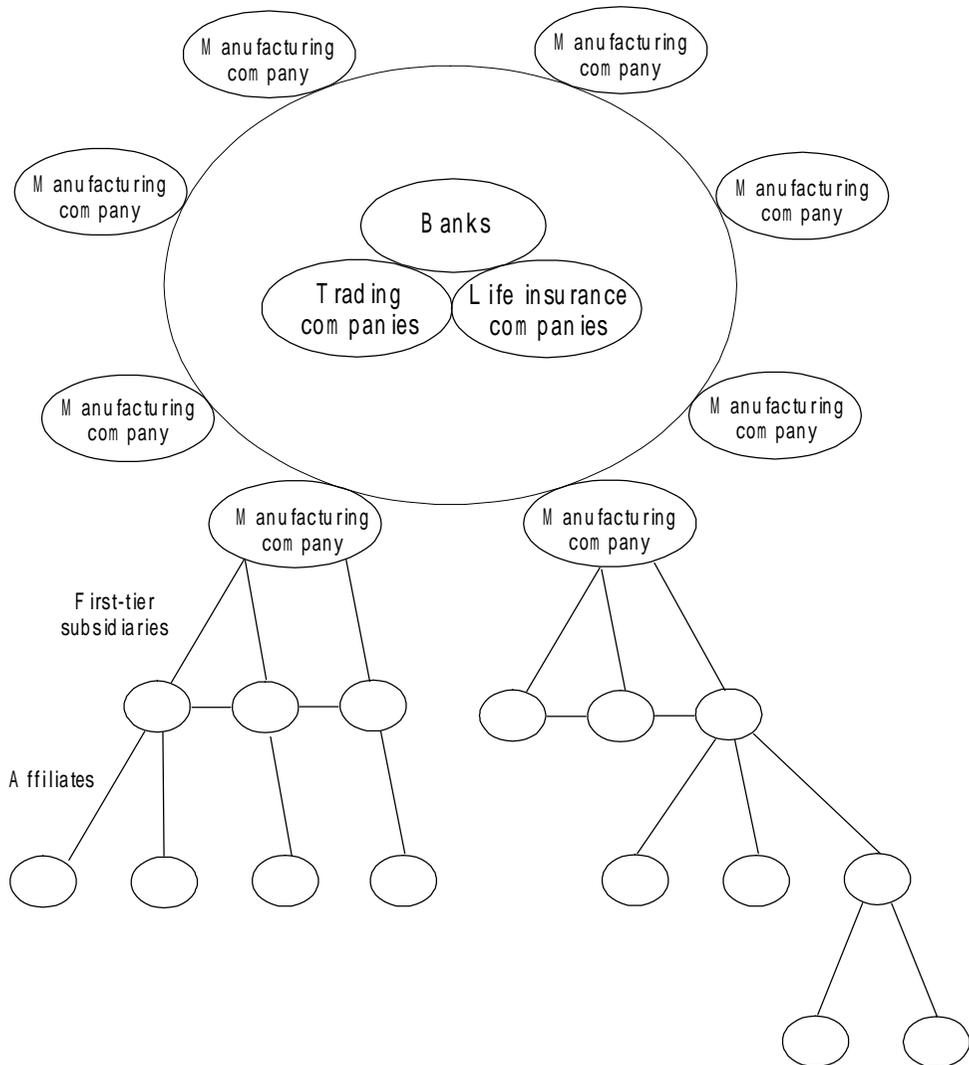
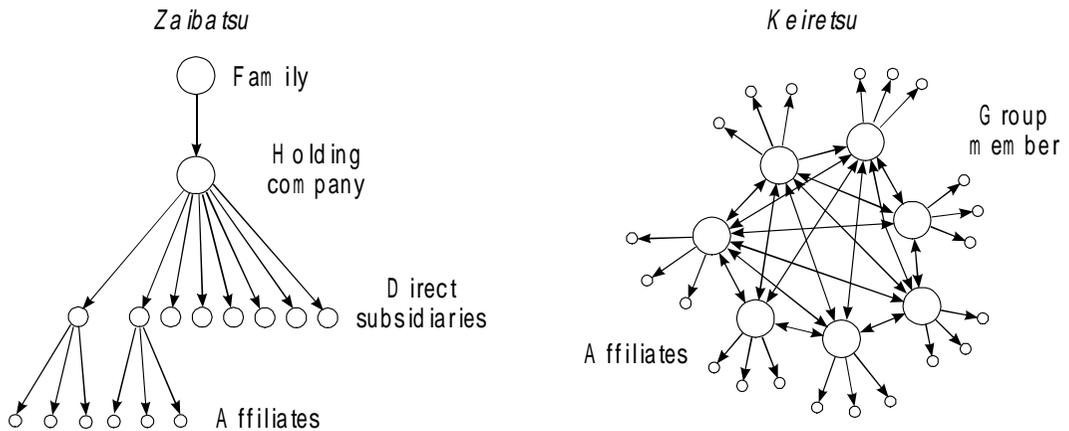


Figure 3. Zaibatsu vs. Keiretsu



Source: S. Yonekura (1985, p. 64)

The horizontal *keiretsu* are much less tightly coordinated than the vertical *keiretsu*. Whereas the vertical *keiretsu* has a pyramidal structure of shareholding and of personnel transfers (from core company to first-tier suppliers, from first-tier to second-tier, and so on), the horizontal *keiretsu* is characterized by cross-shareholding among various member companies, and personnel movements are much more limited, concentrated at the level of the board of directors. The flows of goods are also more limited: according to Japan's Fair Trade Commission, the average horizontal *keiretsu* firm relies on other members of its group for approximately 13% of purchases (a much lower level than in the vertical *keiretsu*) and 15% of sales. The principal coordination mechanism is the president's club, a regular meeting of the top managers of the group companies. It is mirrored by sets of parallel (and less frequent) meetings of functional managers (finance, personnel, R&D) (Okabe 2002).

The prewar conglomerates *zaibatsu* are crucial to the understanding of the postwar horizontal *keiretsu*. The former had far greater structural similarities to the postwar horizontal *keiretsu* than to the corporate groups that have developed in most economies outside the Western societies, especially, but by no means exclusively, in Asia: they were family-controlled conglomerates with a formal coordination mechanism, the holding company, which was largely family-owned (Figure 3). It held significant blocks of shares in the most important companies in the group, appointed top executives of the top-tier member companies, and allocated resources for new industrial companies within the group. And like the corporate groups in many countries, their formation was linked to and encouraged by government policy. The "old" *zaibatsu* (including *Mitsui*, *Mitsubishi*, and *Sumitomo*) spread their reach across industries in the sell-off of state-owned enterprises in the 1880s; the "new" *zaibatsu* of

the 1920s and 1930s were heavily involved in the expansionist policies of the government in Taiwan, Korea, Manchuria, and China (Morikawa 1992, Lynn and Rao 1995).

The close links of the *zaibatsu* to the military state and their dominant role in the wartime economy led the American occupation authorities to target the *zaibatsu* for dissolution as agents of Japanese militarism and imperialism. General MacArthur said in 1948, describing the *zaibatsu*: “*The world has probably never seen a counterpart to so abnormal an economic system. It permitted exploitation of the many for the sole benefit of the few. The integration of those few with government was complete and their influence upon government policies inordinate, and set the course which ultimately led to war and destruction*”¹. One mechanism for attacking the *zaibatsu* was the purge of top managers, which affected virtually all companies in the Japanese economy; another was the confiscation of shares held by the designated *zaibatsu* families. Another, specifically targeted at the *zaibatsu*, was the prohibition of the use of the famous *zaibatsu* company names (for several years *Mitsui* and *Mitsubishi*, for example, were banned from the mastheads of Japanese companies) and the forced break-up of key companies. *Mitsubishi Heavy Industries*, for example, was divided into three separate regional companies; the *Mitsui* trading company was broken into over a hundred separate entities. But another mechanism, more lasting in its effect, was legislation that outlawed holding companies, which in one blow eliminated the key element of the vertical control structure of the groups. This prohibition lasted until the late 1990s, when the Diet finally passed legislation to make holding companies legal.

The groups reemerged during the 1950s: the old names reappeared once the Occupation ended, the dismembered companies merged again, and a formal group identity was created through the presidents’ clubs. The coordination structure was, however, of necessity very different from the prewar pattern. The family ownership of the prewar period had been thoroughly eradicated, but even in the 1920s and 1930s professional managers had been developed to occupy key administrative positions. A more radical change was the associational character of the group, by which was meant apparently stable grouping without any hierarchical control system.

Economic analyses of the development of the horizontal *keiretsu* have stressed the advantages of group membership in the environment of the 1950s and 1960s. The group bank played a key role, not only in providing loans directly but also in mobilizing other financial institutions to make financing available to the group companies. The trading company was also a key player, particularly in the 1950s, when foreign exchange controls were stringent and knowledge of international markets was scarce within the management ranks of the member companies, especially after years of war, and occupation.

In the postwar high-growth period, the group provided a kind of mutual insurance system, in which the interlocking shareholding protected member companies both from any threat of

¹ Quotation from S. Tsuru (1994, p. 73).

takeover by foreign companies trying to enter the Japanese market by acquisition and from pressure from equity markets (Tezuka 1997). In times of crisis, group firms could be counted on to step up and help: when *Mazda* was on the brink of bankruptcy in the mid-1970s, for example, not only did its group bank, *Sumitomo*, intervene to provide a new CEO and financial guidance for the company's turnaround, but *Sumitomo* group-company employees were urged to place orders for *Mazda* vehicles, with substantial financial inducements to do so (Rohlen 1983). The shielding of member companies from shareholder pressures is reflected in a study by I. Nakatani comparing matched pairs of group-member companies and independent companies in the 1980s: he found that group companies had lower growth rates and lower profitability, but greater returns to employees and greater stability in performance across the fluctuations of the business cycle (Nakatani 1984, pp. 227-58). These explanations for the persistence of the horizontal *keiretsu* groups, which are grounded on attributions of economic rationality, can be augmented by institutional explanations that emphasize the importance of the historical legacy of interpersonal networks and shared identity within the *zaibatsu* groups. Only the groups in which these features were strongly entrenched made the transition to the postwar system. By the end of World War II, there were about eighty *zaibatsu* in Japan; despite all the advantages postulated by the economic analyses, there are only six horizontal *keiretsu* in postwar Japan, and their number has not changed since the 1950s (Lynn, Rao 1995).

On the other hand, it is possible to argue that the horizontal *keiretsu* had an effect on the Japanese economic system well beyond the confines of their own groups, in the form of the role of the main bank. The role played by the *zaibatsu* banks of the prewar years evolved in the postwar *keiretsu* into a central role in mobilizing loans from other financial institutions and, as noted above, holding the legally permitted maximum of 5% of shares outstanding and acting as a monitor on the performance of management. Other banks who were not involved in the horizontal *keiretsu* emulated the key elements of this role in acting as main bank for their largest and most important customers.

The vertical *keiretsu* is a fundamentally different type of group from the horizontal *keiretsu* previously described. In contrast to a relatively loose relation of different size and different branch enterprises which occurs in the horizontal *keiretsu*, vertical *keiretsu* is of a tight pyramidal relation character with clearly centralized executive managers. An apex core company holds controlling shares in the first tier of key subsidiaries. Each holds controlling shares in its subsidiaries, which hold controlling shares in yet another tier of subsidiaries, and so on. Moreover, it is characterized by a high degree of branch specialization.

Some vertical *keiretsu* derive from prewar industrial *zaibatsu* which avoided dissolution, for instance *Shibaura Manufacturing Works* (now *Toshiba*) or *Hitachi*, other developed their activity in the 1960s.

Vertical *keiretsu*, for most companies, is composed of two types of subsidiaries: *Kogaisha*, which are firms created by the core company, usually by spinning off a division,

department, or factory from its own organization, and *Kanren Gaisha*, which is a formerly independent firm that has developed a long-standing relationship, usually as a supplier, with the core company, and has been brought into the group. Either type of group firm can belong to another category: the consolidated subsidiary, in which the core company owns a set proportion of the equity. This is a category created by internationally accepted accounting standards, in which the performance data from such subsidiaries must be consolidated with the data from the owning company in the formal reports required of publicly listed companies. Companies differ in the extent to which the core company owns a controlling share of their group firms. Some, like *Hitachi*, *Sony*, and *Suzuki*, own actuarially significant stakes in over 80% of the companies in their groups; for others, like *Toshiba*, *Sanyo*, or *Toyota*, fewer than 20% of their group companies are consolidated (Westney 2001).

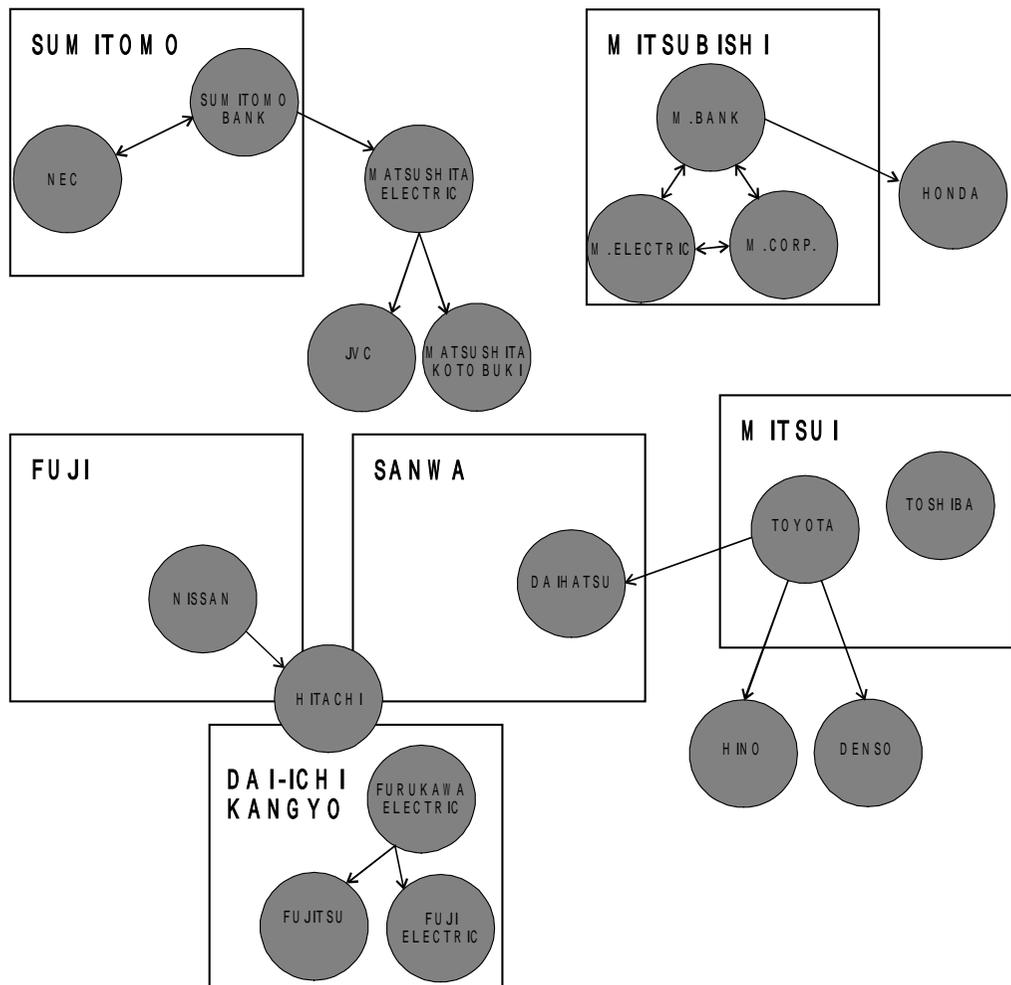
The core company of the vertical *keiretsu* itself contains both a corporate headquarters and a range of business divisions. The core company of the *Toyota* group, for example, produces most of the company's models of autos and trucks; *Matsushita Electric* contains over forty business divisions producing a wide range of products, from office equipment to home appliances. The core company in the group concentrates on high-value-added manufacturing (usually but not exclusively final assembly) and R&D for the core businesses of the group. The group companies engage in one of three types of activities: the manufacture of components and subassemblies (or in some cases lower-value-added final products); sales and distribution; and quasi-related businesses.

Unlike most of the manufacturing corporate groups, the second type of vertical *keiretsu* subsidiary, the sales and distribution companies, are completely dependent on the core company: they are dedicated to handling the group's products. The core companies in most industries have put much of the sales and distribution function into separate firms, often on a geographical basis (Hokkaido, the Kanto region, etc., for domestic sales; and separately incorporated country sales companies for overseas operations). These firms concentrate on the activities involved in getting the final products produced by the core companies to the customer.

The third kind of group company has considerably more independence: the subsidiaries in quasi-related businesses. Japan's core companies have been much less diversified than their American competitors. However, one reason for this is the proclivity of those firms for putting new businesses into separate subsidiaries. The core company assiduously pursues new business opportunities that are closely related to its core capabilities, a quest for new business that is driven primarily by the need to maintain employment and to make the company attractive to new recruits because of its growth potential. But the core company also has a high propensity to spin-off businesses that are not directly related to its central technologies and markets. For example, both *Toyota* and *Matsushita* have a subsidiary in their group engaged in producing and marketing prefabricated housing. For *Toyota*, this business builds on its capabilities in structural engineering and production (the housing is steel-frame

construction); for *Matsushita*, housing provides a “container” for its consumer electronics products, and its subsidiary, National Home, has been particularly active in the marketing of the “intelligent house”. But the development, production, and selling of prefab houses is sufficiently removed from each company’s core capabilities that the activity has been spun off into a separate “child company”. The vertical *keiretsu* structure gives this “entrepreneurship” a range of organizational strategies for developing new businesses, and helps explain why new industries in Japan have so often been fostered by existing companies.

Figure 4. How Horizontal and Vertical *Keiretsu* Interconnect



Source: M.C. Gerlach, E. J. Lincoln (2004, p. 22)

The horizontal and vertical *keiretsu* were portrayed above as quite distinct from the intercorporate network. In fact, the two are highly intertwined, as depicted in Figure 4. The *Toyota* group is a vertical *keiretsu* linked mainly to the *Mitsui* horizontal *keiretsu*, as is *Nissan* within *Fuji*, *NEC* in *Sumitomo*, *Furukawa* in *Dai-Ichi Kangyo*, and so forth. By the same token, where vertical *keiretsu* span horizontal *keiretsu*, they thereby tether them together. *Toyota* is a *Mitsui Nimoku-kai* member, and most *Toyota* group companies deal with *Toyota's* primary banks, *Mitsui* and *Tokai*. *Daihatsu*, however, is a *Toyota* affiliate that uses *Sanwa* as main bank and maintains a seat on *Sanwa Sansui-kai*. Prior to a bailout by *Toyota* in the 1960, *Daihatsu* was a separate automaker aligned with the *Sanwa* group (Lincoln, Gerlach 2003).

The size of this network creates the overall impression, that “the whole of Japan is one big *keiretsu*”, in which a few indefinable, apparently boundless edifices have the capacity to directly influence Japan’s economy and even to indirectly influence society, while the “traditional sector” of the national economy, described by general theories of clearly identifiable definable legal rights, price paradigms, identical organizational structures and power hierarchies, becomes less and less significant (Kensy 2001, p. 218).

3.4. The Functions of the *keiretsu* groups

Keiretsu groups served, especially in the high-growth period, a number of significant economic functions,² including:

- (a) Information function
- (b) Organization of overall business procedures function,
- (c) Risk-distribution function,
- (d) Strategic group coordination function,
- (e) Internal financial market function,
- (f) Symbolic function.

(a) Information function

Within Japan’s industrial structure, the *keiretsu* groups particularly the former *zaibatsu* trading companies (*Sogo Shosha*) have traditionally performed the role of information agencies and matchmakers. Companies specializing in foreign trade have historically acted as the information agency on the rest of the world and, consequently, as major information generators, gatherers, processors and distributors within Japan’s economic system (Kensy 2001).

Better access to relevant key information, increased information turnover, as well as improved analysis and evaluation methods are the key features of this capability. Market data

² See R. Kensy (2001).

and, specifically, foreign data are fed into the network from the sales oriented firms and trading houses; financial information from financial and trading links which is coordinated by the main bank. Finally, the clubs, company-wide committees and councils disseminate informal and strategic information.

(b) Organization of overall business procedures function

The most important function of a *keiretsu* is to organize the operational activities of all group members, which primarily involves the provision of infrastructure-related services. This function encompasses all sectors from goods procurement and marketing, logistics, transport, warehousing, insurance, distribution and outlet management to ancillary administrative services and other general organizational functions. The joint deployment of special capabilities prevents redundant procedures and multiple expenses.

The trading companies undertake the major portion of this comprehensive organization function. They are not solely engaged in trade, egoistically pursuing profit-maximization, but serve to coordinate and generate supply and demand on the home market within *keiretsu* groups. Their secondary role, as supplier and customer, is to balance out all possible intra-*keiretsu* transitions on the external goods and services market.

This organization function cannot be assigned to any particular firm but is one of the most important principles affecting the structure of the *keiretsu* itself. Apart from long-term stability, this coordination generates economies of scale which can result in considerable cost reductions. When combined with lower fluctuation levels, they can also generate other benefits, for example minimizing risk management costs and increasing strategic efficiency. The aim of these measures is to increase overall efficiency within the group which, in turn, improves its chances of prevailing in the struggle for market share, growth rates and new markets.

(c) Risk-distribution function

The information and organizational management are only one way of reducing risks within the *keiretsu* groups. Of greater significance are the secondary risk distribution effects. Whilst the prewar *zaibatsu* maximized mutual profits, the primary objective of *keiretsu* is risk minimizing.

Their fundamental procedural principle of this risk management is the creation and maintenance of long-term, implicit arrangements between members, leading to shared risk and reduced risks for individual members.

In addition, the overabundance of mutual business relationships acts as a natural hedge or offsetting of risk, since, in principle, only external risks have to be secured, not intra-company group risks. When we perceive the company group as a unit and consider the extent of sales diversification, the creation of this portfolio can be described as a risk minimizing exercise, an option unavailable to one firm. The extent to which these two

principles, that of an internal natural hedge and the other of external diversification, have contributed to the risk limitation objective becomes clear when the preference given to intra-group trade is interpreted not simply as a transaction cost limitation measure but also as a risk limitation strategy.

In Japan, contrary to the United States and Europe, this risk management technique is a firmly established feature of industrial network organization. The structure of the *keiretsu* demands that business transactions between group members are conducted on the basis of transfer prices which differ significantly from market prices. The implicit objective is to even out the aggregate profits of the group as a whole. These transfer prices represent the average marginal costs of the whole group, and contra payments are made to those *keiretsu* members who fail to profit. From the Japanese perspective, it actually represents a rational strategy of maximizing the success of the company groups as a whole.

(d) The internal financial market function

This function is easier to exemplify as an institutional structure, since the bank forming its nucleus naturally plays an important role. In this connection, two fundamental tasks can be identified. On the one hand, differing credit and investment requirements can be coordinated internally, which reduces total risk and frees up more financial resources for the nucleus bank, which can then provide a powerful risk management tool during periods of crisis. The second task is to provide access to international money and stock markets unavailable to individual, smaller and less known member companies. The bank bundles these individual capital requirements together and endeavors to satisfy them efficiently, either from its own funds or via the global capital market. This reduces interest charges to smaller companies. The extraordinary strength of the *keiretsu* main banks guarantees the availability of relatively cheap financial resources for expansion purposes. The financing function will still be mainly internal though maybe not centralized at the bank.

To this extent, the financial aspect of the existential justification for the *keiretsu* groups, apart from its above mentioned stabilization function, should be perceived as the provision of risk capital at minimal capital cost at any given point in time (i.e. not just at opportune and favorable moments). However, this responsibility does not rest with the main bank alone. The second core company, the trading house, also performs an important role in this respect. While the bank pursues financial resources externally, the aim of the trading house is to expand *keiretsu* groups markets. However, these core *keiretsu* group companies are not antagonistically interdependent but are, in fact, mutually complementary. For the main bank, the trading house is an optimum borrower (low risk, minimal supervisory costs associated with a single loan); the *Sogo Shosha*, in general, makes attractive customers (foreign currency, export finance and monetary transactions).

From the point of view of the trading house, the main *keiretsu* bank is the optimum partner since its concentrated market strength ensures that it can always offer optimum terms

and is inclined to arrange special terms. The financial relationships of the trading house are diverse. They range from favorable terms for other group members, to loan and guarantee provisions when available funds are invested in new major projects, new products and the R&D required by most of the numerous small *keiretsu* firms. Just as the bank acts as the leading financier during periods of expansion, the trading company is able to ameliorate recessionary effects *via* intra-group trade, for example by granting loans to suppliers, providing extended payment terms or credit to the members of *keiretsu* groups for material purchasing. This “quasi-banking function” is one of the major features of a *keiretsu* and thus serves to explain, more precisely, why the definition “financial conglomerate” is used to define them (*kinyu keiretsu*).

(e) The strategic group coordination function

The numerous service companies within the *keiretsu* perform special associated functions, which are placed at the disposal of the *keiretsu* groups as a whole (banking, commerce, insurance, shipping, warehousing, and property). The provision of clear internal functions is also apparent when one considers the particularly small proportion of non-*keiretsu* business transacted. These factors produce an internal system equivalent to a vertical distribution of labour, within the framework of which each link in the production chain can be supplied with the correct level of input, and optimum input prices.

This, however, can be achieved more efficiently than by a fully integrated company, as system openness produces otherwise unachievable flexibility. The “umbrella” of the company group protects smaller firms from excessive risks. As its management and product efficiency grows, the firm attains greater independence and becomes more flexible and dynamic. This constitutes another advance for the *keiretsu* groups in their role as a highly diversified network of products and markets, since both these parameters are currently undergoing a massive period of splintering, stratification and “decommodification”. Economies of scale are reducing in size, optimum company sizes are decreasing rapidly, and the proportion of product know-how is rising. The *keiretsu* groups are equipped to face these challenges, which, in fact, constitute an opportunity as far as Japanese corporate groups are concerned due to the importance placed on input-output relationships, their orientation on anticipated long-term growth and the sustained transfer of know-how.

In order to prevent any unwanted externalization of the positive effects to outsiders, it is of paramount importance to keep the network “introverted”. The *keiretsu* provide environment protection against the intense competitive pressures prevailing in Japan, and also against foreign market investors. Although precedence is usually given to group members as far as business is concerned, empirical analyses prove that the formation of cartels and intra-company trade tends to optimize the use of resources, rather than reduce competitiveness.

Apart from their role as an introverted cooperative network and general protector, they

also protect members from voluntary or “enforced” departures from the group. The network of company interrelationships basically prevents speculators, corporate raiders and hostile take-over. These are all familiar side effects in the United States of an open, efficient capital market. The absence of a large merger and acquisitions market does not imply that the company market is inefficient or that company controls are ineffective. These duties are performed internally within *keiretsu* groups by their financial institutions, which perform management control and monitor company performance. Thus the efficiency enhancing pressure to perform is generated not by means of Western mechanisms (earnings per share, growth rates, market prices) but by using specific Japanese methods (endogenization, informalization and diffusion).

(f) Symbolic function

By looking at the symbolic function of *keiretsu* company associations, all the indirect and subtle signs indicating the tightness of group cohesion can be perceived: membership of a president’s club (or other club-like societies), permanent (i.e. non-commercial) credit relationships, share lock-ups, the awarding of directorships, shared foreign organizations, joint corporate images (logo, house style, brand names) and corporate identities, and symbolic gestures (donations, crisis aid, measures to support government policy) coordinated group wide, and many more.

The symbolic, flexible partnership presented by company associations has led to superordinate cohesion aimed at preventing a decline into excessive flexibility, fashionable chaos management and “speed management”. On the one hand, the role of these associations is to act as a vague benchmark in terms of company policy and, on the other hand, to robustly present heightened brand awareness and a coordinated public image, which also positively enhances the commercial success of its members.

The bond between individual companies, which stretches from routine coordination to strategy cooperation and culminates in the comprehensive integration of the social clubs, is becoming ever tighter. In addition to the previously-mentioned assimilation of the symbol of the family by Japanese firms, particularly strong community-building measures have been encouraged over the centuries, particularly among the *zaibatsu* company groupings, and these measures continue to produce a proverbial “*zaibatsu* sense of community” even today. This symbolic cohesion can be considered the most important asset of the *keiretsu* groups in terms of structural content. It is the only element which does not form part of the relevant environmental adjustments required, but manages them instead. The aim of this approach is to manage and lead the economic system of a company or company association – that is, the overall political, commercial, social and cultural links between the firm and its labour force – that is, both inside and outside the confines of the company. The vagueness and openness of these indicators is seen as strength, since it basically permits a collective sharing of long-term visions without the danger of being side-tracked by short-term contradictions which may arise

during their actual implementation. The symbolic and long-term coordination of group members also reinforces the final role of the *keiretsu*, since management by symbols, whilst making use of traditional symbols, is always forward-looking in nature.

4. Corporate Governance System

4.1. Institutions and mechanism of corporate governance

Corporate governance refers to the system through which the behavior of a company is monitored and controlled (Cheung, Chan 2004, p. 1). The main objectives of corporate governance include:

- providing shareholders and stakeholders with effective monitoring procedures and methods, as well as supervision of the capital companies' boards of directors,
- providing consistency of management and owners' objectives accepted by supervisory boards,
- harmonizing the interests of the parties involved in the company,
- providing investment attractiveness and the supply of finance for the company's development,
- maximizing the company's value from the owners' point of view as well as other stakeholders; employees, creditors, suppliers and executive staff providers.

The corporate governance system in Japan includes not only the relations between shareholders and managers, but first of all, stakeholders as well. The institutional frameworks, structures and mechanisms of Japanese corporate governance are the result of historical, social, political and economic conditions. All of these conditions have an influence on the

Table 3. Insider Type Governance and Open Type Governance

	Insider type corporate governance system	Open type corporate governance system
Characteristics	Based on long-term relations and mutual reliance Not taking opportunity principle mutually Monitoring is taken on by a main bank and cross-shareholders Insufficient disclosure	Based on law, contracts, and self-responsibility A lot of bearers of corporate governance Various kinds of monitors Assuming the existence of the market, with free entry and free withdrawal Sufficient disclosure Price mechanism works
Strengths	Stable management and stable employment Retrenchment of monitoring cost Internalize adjustment cost	Incentive mechanism works for managers Easy to promote business restructuring
Limitations	Uncertain management system The system becomes invalid when the management is unstable	Burgeoning monitoring cost Generate free riders of monitoring Promote rent-seeking activities
Examples	Japan, Germany	United States, United Kingdom

Source: based on H. Saki, H. Asaoka (2003, p. 2)

scope of possible behaviors of the company operating within the *keiretsu* group, thus being an essential subsystem of the socio-economic system.

Unlike the Anglo-American open type corporate governance system, the Japanese system is insider type corporate governance, where ownership and management focus inside the *keiretsu* groups thanks to capital cross-shareholding, long-term transaction relationships and mutual reliance (Table 3). Insider group “financial economy” isolates the companies belonging to the group from the control mechanisms of the stock market, particularly from hostile takeovers. Thanks to this the companies of the group may freely shape their long-term strategies free from market competition. The essential consequence of such a closed organizational structure is, however, relatively low transparency of decisions being made, as well as the risk of opportunism of the boards of directors of individual group companies (Saki, Asaoka 2003, pp. 2-6).

The Japanese corporate governance system is bank-oriented. Similar to the Anglo-American model stock market and the corporation’s ownership shares being the subject of its turnover are of key importance. In the Japanese system indirect sources of financing (bank loans) are of more importance. In consequence, the Anglo-American model of corporate governance is mainly a domain of shareholder governance, whereas in the Japanese system a lender aspect of corporate governance is more important (Baba, Hisada 2002, p. 5).

Japan and Germany share certain features as stakeholder models of corporate governance (Jackson 2005). Some key similarities include:

- (1) Ownership stakes are held among shareholders having a strong commitment to a specific firm and focusing on their strategic interests. This stability of ownership serves to limit an open market for corporate control.
- (2) Banks play a central governance role and are the main providers of external finance to industry.
- (3) Strong employee voice in corporate decision-making that supports the commitment and integration of labour as a “citizen” within the corporation, as reflected in longer periods of employment and the lower sensitivity of employment to the business cycle.
- (4) Management mediates between these stakeholders by pursuing strategies that focus on markets for high-quality products and utilization of high-skill workforces and stable inter-organizational relationships. Management careers were largely internal to their firm, with less division of strategic and operational tasks.

Despite these broad similarities, Japan and Germany institutionalize the roles of stakeholders in very different ways:

- (1) In Japan ownership within *keiretsu* groups is more diffused through horizontal cross-shareholding. By contrast, in Germany ownership tends to be concentrated among blockholders, such as families’ ownership and vertically-organized conglomerate holding companies (*Konzern*).
- (2) Japanese main banks are linked to companies through lending and cross-shareholdings,

but play a lesser role on boards and proxy voting. German universal banks are involved in lending, holding large blocks of shares, representation in the boardroom, and the exercise of proxy voting rights.

- (3) In Japan, employee participation rights are weaker and less formalized in law. In Germany, employee participation is vested in the institution of codetermination (*Mitbestimmung*) that specifies legal rights to information, consultation, and codetermination for works councils. In addition, employees hold between one-third and one-half of the seats on the corporate supervisory board, placing them alongside shareholders in appointing and monitoring management, giving business advice, and ratifying important strategic decisions.
- (4) In Japan, collective bargaining, wages and training are strongly company-centered and reinforce the segmentation of firm-internal labour markets. In Germany, labour relations are less centered on the individual firms. Industry-wide unions conclude uniform collective bargaining agreements with employers' associations, making wages more similar across firms, and link them to occupation more than seniority. Training is similarly done in a standardized fashion according to publicly recognized occupational profiles.
- (5) In Japan, supervisory functions fall mainly to the statutory auditor, who lacks powers to appoint and dismiss management. Board of directors in Germany follow a two-tier model where the supervisory and management roles are legally separated and strong rights are given to the supervisory board whose members include numerous people from outside the firm.

Table 4. Corporate Governance System: Japan vs. Germany

Characteristics	Japan	Germany
Ownership structure	Diffuse cross-shareholding	High concentration among blockholders
Role of Banks	Loans, shares	Loans, shares, board representation, proxy voting
Employee participation	Usually information and consultation Enterprise labour unions Informal interpersonal relationships with board	Information, consultation and codetermination Legally mandated works councils, and industry-wide Board representation
Wages	Seniority-related Company based bargaining	Flat age-wage profiles, linked to occupational qualification Industry-wide collective bargaining
Board of Directors	Single board, little separation of function	Two-tier board with separation of supervisory and management functions

Source: based on G. Jackson (2001), G. Jackson *et al.* (2002), G. Jackson (2005)

The details of the comparison between Japan and Germany corporate governance systems are provided in Table 4.

The Japanese corporate governance system may also be considered from the point of view of its individual elements depending on the financial situation of a corporation. It is commonly believed in the economic literature that this system is of two-tier corporate governance or state-contingent corporate governance. The state-contingent corporate governance of the Japanese system means that depending on the financial situation of the corporation being monitored, one of the two monitoring components becomes active. If the state of the company finance does not evoke the stakeholders' concern, the main bank does not become involved in its active monitoring, and cross shareholding relations of the companies being a part of the *keiretsu* group are their own mutual monitoring subjects. The main bank takes the responsibility of rescuing the corporation if financial problems become a real threat to it. Independent of these two components corporate governance in the Japanese system is also held by the employees (Yafeh 2000, p. 77).

Comparing traditional Japanese companies to their Anglo-Saxon counterparts, R. Dore (2000) claims that in the Japanese corporate governance the community view prevails in contrast to the property view; the entity view as distinct from the profit view; the corporate membership view as opposed to the matrix of contact view; finally, the shareholder against stakeholder view. Moreover, R. Dore additionally introduces the division describing Japanese corporations as employee-favoring firms, whereas Anglo-American corporations act as shareholder-favoring firms, which is particularly essential from the labour relations analysis's point of view (Dore 2000, p. 26).

4.2. The financial system and corporate governance

The financial system plays an important role in the process of economic growth because it provides necessary means for capital accumulation and technical and organizational progress diffusion (OECD 2004, p. 36). Institutions and mechanisms of the financial system provide information about investment possibilities and capital allocation directions, enable investment monitoring, influence the corporate governance system, mobilize savings, enable investment funds division, and enable risk diversification and management as well.

The banking system plays a key role in the course of capital allocation in Japan with credit being its main instrument. In the United States and Great Britain this function is carried out by capital market where securities, including shares, bonds, and optional contracts, are the most important financial instruments (Jackson 2001, pp. 122-8). Differences between the systems cause household savings to be directed to banks and Postal Savings in Japan, whereas in the United States and United Kingdom they are invested in

shares and bonds.

Differences in the character of the financial systems are of decisive influence upon the whole economy operation, company's behavior and corporate governance in particular. In Japan main banks, other shareholders of the corporation and their employees are responsible for the companies monitoring. The United States and United Kingdom developed a different mechanism of corporate governance. In these countries the stock market provides a control mechanism disciplining managers to effective management of the company.

The basis of the Japanese financial system based on the banking sector started to be formulated in the 1920s and 1930s. Stock exchange panic and the banking crisis in 1927 led to the fall of many banks and some *zaibatsu*. Aiming at strengthening the banking system and its concentration the Japanese government passed a banking law tightening control over the banking system. In the second half of the 1930s, together with the introduction of direct government control over capital flow, the banking system became the main channel of capital allocation and the importance of the stock market was gradually restricted. Postwar reforms of the economic system did not lead to considerable changes in the structure of the financial system. Many prewar solutions were adopted and improved in new conditions of economic development. In the postwar period the financial system was a tool implementing industrial policy (Hoshi, Kashyap 2001, pp. 91-124).

The postwar banking system was exposed to strong influence of the economic authorities, the Ministry of Finance and Bank of Japan in particular. It was expressed by a high level of state sector share, considerable restrictive practices and the authorities interfering in the system operation as well as crisis situations management from above (banks "convoy"). (Van Rixtel 2002, pp. 99-135).

The public sector share in the Japanese financial market is of an extent not happening in other developed countries. Deposits and life insurance premiums are accumulated in Postal Savings (*Yucho*) and Postal Life Insurance (*Kampo*) managed by the state that were used to finance the *Fiscal Investment and Loan Program – FILP*, which is the largest and the most important source of financing government capital investment and investment credits except the state budget³.

At the beginning of the 1990s the Japanese financial system was characterized by a high level of restrictive practices and strong intensity of the economic authorities control as well. The limitation of the stock market role and concentration of the capital allocation in the banking system that started in the 1930s continued in the postwar period. Until the middle of the 1950s the corporation bond market was under the control of the Ministry of Finance and the Bank of Japan, later the committee of eight banks representatives, which determined the

³ Japan Post is the largest financial institution in the world. The assets of the postal savings system have risen from 10% of GDP in FY 1970 to a peak of more than 50% of GDP in FY 1999. Postal Life Insurance, the world's largest life insurer, has experienced a similar rise in its contracts over the past three decades. Despite some decline since 1999, their combined assets amounted to 80% of GDP in FY 2003 (OECD 2005, p. 149).

principles of these securities issue and trade, held this control. In connection with the policy of balanced budget carried out by the government until the middle of the 1970s, the government bond market was of marginal importance. The slowdown of Japan's economic growth in the second half of the 1970s and moving from the phase of structural excess of investment demand into the phase of savings excess resulted in increased issues of bonds to cover growing expenditures, including social ones. The growing supply of the government bonds forced development and liberalization of the debt securities market

In the banking system exposed to rigorous segmentation, long-term credit banks, big city banks and regional banks, as well as trust banks, credit cooperatives, agriculture credit cooperatives and the Bank of Tokyo played a key role. Life and property insurance companies belonged to financial agents as well. Stock brokers' houses servicing securities transactions made a separate group. Institutions assigned to particular segments could not run the activity typical of another segment.

Basic instruments of pecuniary policy which significantly influenced the functioning of the Japanese financial system included: artificially lowered interest rates, administrative credits rationing and administrative management. The administrative interest rate regulation for all participants of the market at the level lower than market values, carried out until the end of the 1980s, let the Japanese corporations access credit cheaper than in full market conditions. This instrument was a sort of specific credit subsidy granted to the Japanese corporations operating within *keiretsu* groups. Administrative credits rationing applied by the Bank of Japan until the beginning of the 1990s involved the establishment of permissible credit levels in a given period while these limits were established by the specification of the maximum growth rate of the credit portfolio against its value in a previous period. An informal instrument introducing obscurity and arbitration, maintained in the spirit of administrative guidance to the Japanese system was the regulation of a geographical network of branches and product strategies control.

The Japanese financial system formed after the war functioned in the conditions of international financial and capital market isolation. In practice it did not let Japanese companies access foreign capital and households – more favorable capital accumulation. The autarkic and closed system prevented foreign entities from penetrating the Japanese market (Malcolm, 2001).

A significant instrument of the Japanese monetary authorities' interference in the mechanism of the financial system operation applied all through the second half of the 20th century, was strict control of the banking sector risk and crisis situations active management. The Ministry of Finance policy aimed at not allowing the bankruptcy of the financial market subjects. In case of financial problems suffered by any bank the Ministry launched a multi-stage rescue procedure, which in fact involved taking over weak banks by the banks that were in a good financial situation. Banks "convoy" ended together with the loss of the majority of tools which could be used by the ministry officials to influence the market participants, and

with the increase of the banks independence⁴.

The specific structure and character of the Japanese financial system influences the whole economy functioning, it also holds significant implications for the banking sector, companies and households. In the postwar period the financial system assured financing accelerated growth based on investment expansion and export development. In the conditions of insufficient capital accumulation and marginalization of the capital market importance the financial system based on banks contributed to the efficient transformation of household savings mobilized by the government into cheap and easy-to-obtain investment and loans for the companies within the *keiretsu* structures. It allowed investment expansion as well as risk allocation and control, and, in consequence, the whole economy development lasted to the end of the 1980s.

Thanks to administrative regulation of interest rates, the economic authorities control over the process of capital allocation, market segmentation, banking sector competition elimination as well as strict control of a product and geographical strategy of the financial institutions the banks could establish close, stable and long-term cooperation with the companies within the main bank system.

The main bank system and cross-shareholding became a main joining component of the *keiretsu* groups. It provided the companies operating within the *keiretsu* networks with the access to loan as the basic source of external financing. The development of capital relations with the firms made the main bank become a creditor and shareholder at the same time. In addition, the bank offered a full range of banking services, that is financing, deposits, foreign exchange transactions, payments and securities sub-issue. The main bank carried out permanent monitoring of the companies on behalf of other moneylenders as well. At the time of stable development the bank refrained from interfering in the company's activity, and in case of financial problems it actively became involved in the sanative actions. The main bank's involvement in rescuing the company from bankruptcy and its acting as an informal agent of other lenders was the equivalent of the Ministry of Finance system of managing crisis situations of the financial system maintenance.

The main bank system became one of the basic components of the Japanese system of corporate governance. The economic authorities' control over capital allocation, stock market importance marginalization and the companies "dependence" upon permanent and cheap banking loans as the main source of external financing, allowed managers to build long-term strategies of sale and market share increase at the expense of short-term profit. Cross shareholding relations, on the other hand, separated the companies belonging to the *keiretsu* groups from the stock market mechanism. In these conditions a so-called practice of ignoring shareholders developed, that is to say the companies were not subject to hostile takeovers and

⁴ It became apparent at the end of 1997 with the first, since 1920s, bankruptcies of the *Bank of Hokkaido Takushoku* and Stock Brokers house *Yamaichi Securities*, in 1998 *Long Term Credit Bank* announced bankruptcy. See Hoshi (2002, pp. 164-78).

their managers did not have to strive for short-term profitability and earnings per share of the firm and the increase of the securities market valuation.

4.3. Components of corporate governance

The Japanese system of corporate governance is made up of three basic components: the main bank system, capital cross-shareholding relations, and labour relations.

4.3.1. The main bank system

An essential feature of the Japanese companies distinguishing them from the American and, to a smaller extent, the European ones, is a long-term character of the relations connecting them with the banks within the *keiretsu* groups. The most important determinants of these relations include: the banks combining the function of a lender and shareholder, the key role of indirect finance, particularly loans provided by the main bank, in the company capital structure, and the dominant role of banks in the process of the companies' monitoring in the situation when their financial results get worse.

The main bank is a strategic investor for the *keiretsu* group. The prevailing share of banking loans in the structure of external sources of the companies financing, as well as capital relations between the banks and the companies within the group, make the main bank fulfill a double role that is of the lender and shareholder at the same time. Combining the function of the lender and shareholder favors the establishment of close, stable and long-term cooperation with the companies. The main bank provides the group companies with a full range of banking services, including: financing, deposits, foreign exchange transactions, payments, securities sub-issue and others. The main bank carries out permanent monitoring of the companies on behalf of other lenders as well (not fulfilling the function of a main bank towards a particular company). At the time of stable development of the companies the bank does not interfere in their activity, whereas in crisis situations it becomes actively involved in sanative actions.

According to M. Aoki (2000) monitoring the companies by the main bank is carried out in three stages: that is *ex ante*, *interim* and *ex post*. *Ex ante* monitoring covers the evaluation of the company's credibility and the efficiency of planned investment projects. This monitoring stage allows a melioration of the problem of adverse selection and preventing the lack of completeness of undertaken investment projects (Aoki 2000, pp. 76-9).

At the second monitoring stage (*interim*) the investors check the way transferred financial means are used to reduce moral risk occurring in the situation when the investor's interest, and action taken by the company managers are inconsistent and against the capital suppliers' intention.

At the third monitoring stage (*ex post*) the verification of the investment intention from the point of view of the company's financial situation, conditioning further long-term action of the investors is made. The announcement to start or abandon action supporting the enterprise disciplines managers at the *ex ante* and *interim* monitoring stage.

Carried out at different stages of investment, monitoring may be delegated to specialized financial agents, other financial institutions or agents by the investors, which leads to the decrease of information acquisition costs. Depending on the economic system institutional frames governing this type of authority transfer may differ. In the Anglo-American system characterized by prevailing direct sources of financing *ex ante* monitoring is carried out by the investment banks acting as sub-issuers of shares and bonds, *venture capital* funds supplying capital to newly created firms (start-ups) or commercial banks crediting small or medium enterprises. *Interim* monitoring may be carried out by specialized rating agencies and boards of directors subject to direct supervision of most shareholders, investment funds managers and market arbiters. *Ex post* monitoring, on the other hand, is carried out by the capital market mechanisms. A decline of the company market value and threat of hostile takeover discipline managers to provide efficient management of the companies.

In contrast to the Anglo-American system, the Japanese centralized and multi-stage monitoring is made by the particular company's main bank, which acts as a lender and shareholder. Monitoring carried out by the leading bank is activated in case of financial difficulties. If company finance does not evoke concern, the leading bank does not become involved in active monitoring because it is already done by the cross-related companies belonging to the same *keiretsu* group.

The main bank system contributes to the enjoyment of many benefits, among other things, including mostly (Aoki 2000, p. 86):

- the possibility of the main bank interference on the basis of the information obtained at individual stages of monitoring creates a complete, externally disciplining mechanism required for the team-oriented production,
- exclusive delegation of the main bank to monitor companies prevents double *ex post* and *interim* monitoring in case of standardized information,
- rescue action taken by the leading bank removes the threat of bankruptcy of the companies suffering from financial difficulties that may potentially be efficient subjects,
- the possibility of realizing risky and at the same time highly profitable investment projects.

Efficient functioning of the main bank system depends on rigorous control exercised by the Ministry of Finance and Bank of Japan over the financial system, including: maintaining low level positive interest rates, inflation control, limitation of shares issue and secondary market development, limiting the possibilities of new banks entering the city banks group to finance industry, employing ex bureaucrats in the banking system as a form of award for licensing banking activity. Not fulfilling these conditions threatens the efficient operation of

the whole system of the main bank as an element of corporate governance. It will be the subject of further consideration.

4.3.2. Cross-shareholding relations

Although they are not formally and legally connected, the companies belonging to *keiretsu* groups enter complicated systems of dependence of the interlocking shareholding, intragroup transactions and personal relations.

Japanese shareholders are grouped into separate categories, including financial institutions (main banks and other banks, trust and life insurance companies, stock broker's houses), industrial corporations, individual investors and external institutional investors, as well as foreign investors. Due to long-term business relations and management scope the first two groups of shareholders make a group of so called stable shareholders.

Mutual exchange of stock capital (intragroup shareholdings) within *keiretsu* is of significant importance for corporate governance as it protects the firms within the groups against hostile takeovers, allows the companies' monitoring and creates conditions for stable development of long-term production, trade and personal relations (Okabe 2002, pp. 37-9).

Along with an active market for corporate control in the 1950s, hostile takeover bids became high profile events and several were launched against former *zaibatsu* firms. In response to this threat, the managers of firms from each former *zaibatsu* began to act as a group coordinating "white knight and white squire" defensive arrangements to protect their former affiliated companies from hostile takeovers. In the white knight defense, the target of hostile bid arranges to be taken over instead by a friendly company that safeguards the positions of the target's top executives. In the white squire defense, the target arranges for a friendly company to purchase temporarily a large enough block of target stock to prevent the hostile takeover from succeeding (Morc, Nakamura 2004, p. 61).

Cross-shareholding between the companies within *keiretsu* groups significantly increased in the second half of the 1960s after Japan's government decided to liberalize foreign portfolio and direct investment. Fearing hostile takeovers by foreign investors many Boards of Directors of the companies appealed to other *keiretsu* firms not to sell mutually owned shares ("*stockholder stabilization operation*") (Goto, 1982, p. 56).

W.C. Kester (1989) emphasizes that by dismissing hostile takeovers, risk capital cross-shareholding relations strengthen the position and autonomy of the Boards of Directors of the companies, creating a risk of their opportunistic behavior not consistent with the interests of other shareholders of the corporation. On the other hand, strong intragroup relations decrease transaction costs to a great extent. Moreover, W.C. Kester points out that the most important consequence of capital cross-shareholding within the *keiretsu* groups is diversity and a mutual mixture of different types of corporate ownership (claims against a company), held by various stakeholders of the corporation. The economic benefit resulting

from the tendency to maintain financial differences and other contractual rights towards the corporation is the decrease of friction that may appear in other circumstances between the corporation shareholders because each of them holds distinct and different rights (Kester 1989, pp. 24-44).

According to I. Nakatani (1984), thanks to cross-shareholding, the intragroup type of finance and intragroup capital market diversification or “internalization” was formed. This internalization of the capital market by means of intra-group financing and reciprocal shareholding is effective in insulating group firms from the threat of competition in the capital market. And although rates of profitability and sales growth are lower for companies with extensive cross-shareholdings, the variability of these profits is also lower. Therefore, cross-shareholding is argued to serve as an implicit mutual insurance scheme, “*in which member firms are insurers and insured at the same time*” (Nakatani 1984, p. 243).

R.J. Gilson and M.J. Roe (1993) emphasized a double function played by cross-shareholding in the Japanese corporations, that is monitoring and production supporting functions. They postulate to treat *keiretsu* cross-shareholding relations not only as the mechanism of monitoring managers, but production structure as well. Production processes effectiveness requires the involved parties to substantially invest in relation-specific assets, that is to say such assets which are difficult to use in another economic relation without a considerable loss of their value. It is the task of the industrial organization, therefore, to create such a structure which provides the parties with the stimuli inducing them to optimal investment in just such assets. The situation where the parties make long-term investment of this type, however, creates the risk of opportunistic behavior of the other parties of the transaction. The aim of contractual corporate governance is, therefore, apart from the production efficiency maximization, the minimization of opportunism as well. By the decrease of the risk of opportunism, cross-shareholding between the companies does not only serve enterprises monitoring but influences the increase of investment in specific assets as well (Gilson, Roe 1993, pp. 871-906).

The Japanese pattern of shareholding is substantially different now than in the early 1990s, in respect overall of companies listed on all domestic stock markets and *keiretsu* groups. An indication of the decline in cross-shareholding facing horizontal *keiretsu* is highlighted in a survey of cross-shareholding by Nippon Life Insurance Research Institute (2001). The survey’s main conclusions are shown in Table 5, which reveal that between 1987 and 2000 there was a significant fall in horizontal *keiretsu* cross-shareholding both on unit and value basis. In detail, cross-holding ratios fell 2.01 percentage point to 9.15% for *Mitsubishi* group, 1.67 percentage points to 4.81% for *Mitsui* group, 2.49 percentage points to 8.46% to *Sumitomo* group, 0.68 percentage points to 4.07% for *Sanwa* group, 1.57 percentage points to 3.70% for *Fuji*, and 1.12 percentage points to 5.87% to *Dai-Ichi Kangyo* group (Table 11). However, the overall cross-shareholding ratio on value basis of the six corporate groups was higher than that of the overall market at the end of 2000.

**Table 5. Cross-Shareholding of Major Horizontal *Keiretsu*
(On Unit and Value Basis, Percent)**

Group ^a	1987	1999	2000	Change ^b 1987-2000
<i>Mitsubishi</i>	11.16	11.62	9.15	-18.01
<i>Mitsui</i>	6.35	6.95	4.78	-24.72
<i>Sumitomo</i>	10.95	9.43	8.46	-22.73
<i>Sanwa</i>	4.75	4.79	4.07	-14.31
<i>Fuji</i>	5.27	4.31	3.70	-29.79
<i>Dai-Ichi Kangyo</i>	6.99	6.32	5.87	-16.02
Cross-shareholding ratios of the six corporate groups (value basis)	28.01	20.36	16.71	-40.34
Cross-shareholding ratio of overall market (value basis)	18.4	10.6	10.2	-44.56
Intra-group cross-shareholding ratio (value basis)	12.10	9.39	7.47	-38.26

^a Group firms as identified by Nippon Life Insurance

^b Percentage change in cross-shareholding from 1987-2000

Source: NLI Research Institute (2001, pp. 30-1)

In addition to the decline in cross-shareholding, the problems for *keiretsu* identity are compounded by fact that some main banks of the groups merged. In postwar Japanese corporate governance, the main bank was at the center of each of the six horizontal *keiretsu*. Today, mergers among the main banks at the center of several *keiretsu* have weakened the identities of the corporate group.

By the 1990s the six horizontal *keiretsu* had transformed themselves from production group into financial groups. The increasing “financialization” of the six groups is seen in the fact that their share of sales in the non-financial corporate sector stayed at 15% from 1970 to 1990, but fell to 12% in the late 1990s. By contrast, looking just at the banks and insurance companies, the groups’ share of total assets rose from 42% in 1970 to 51% in 1980 and 58% in 1990 (Tandom 2005, p. 120). During the 1990s, the share fell somewhat and was volatile. In early 2000, all six groups announced mergers involving their main banks or forming holding companies that brought their financial institutions together. This reduced the six major groups to four: *Mizuho Financial Group (Dai-Ichi Kangyo Bank, Fuji Bank, Industrial Bank of Japan and Yasuda Trust and Banking Co. Ltd)*, *Mitsubishi Tokyo Financial Group*

(*Bank of Tokyo Mitsubishi, Mitsubishi Trust and Banking Corporation, Nippon Trust Bank Ltd*), *Sumitomo Mitsui Banking Corporation (Sumitomo Bank and Sakura Bank)*, and UFJ Group (*Sanwa Bank, Tokai Bank, Tokyo Trust and Banking Co.*). These mergers often mine the financial integration between previous rivals.

4.3.3. Labour relations

The high position of the managers and the employees is a characteristic feature of the Japanese corporate governance system. Such arrangement developed in the middle of the 1940s and at the beginning of the 1950s. In the situation of high unemployment and escalation of social unrest, apart from action aiming at the recovery of the economy, American occupation authorities together with the Japanese government searched for efficient ways of reducing labour unions' and left-wing party's influence. One of the actions undertaken for this purpose was the support of the enterprise labour unions and the corporate model of cooperation between the Boards of Directors and employees established during the Second World War (Learmount 2002).

A dominant share of banking loans in financing investment and ensuing shareholders importance marginalization, managers' and employees' importance increase, and the search for the ways of harmonious relations between the employees and the Boards of Directors led to the establishment of a characteristic model of Japanese corporate culture. Despite the lack of legal basis changing the role of authorities, in large corporations belonging to *keiretsu* groups shareholders were *de facto* substituted by creditors, and the position of the Boards of Directors and the employees supporting them was strengthened.

The increase of the employee's rights and the expansion of the employment scope changed labour relations in large corporations belonging to *keiretsu* groups into more partner-oriented. These are characterized by lifetime employment and seniority-merit wage systems. The lifetime employment tradition is based on mutual benefits and duties (balance of rights and duties). An employee starts working in the enterprise he/she is bounded with until retirement age, and the company, on its part, provides continuous employment even in times of economic recession. Thanks to this the sense of security and trust is relatively high. At the same time a sense of participation and identification with the firm increases. It enables the harmonious cooperation between managing staff and employees upon the principles similar to paternal ones. According to J. Abegglen (1958), comparing the social organization of Japanese and American companies there is one significant feature differentiating both those systems. It is the employee's obligation to pursue their professional career in one firm. The company, on the other hand, provides employment stability even at the times of passing difficulties. Permanent relations between the employees and the firm implicate mutual obligations and responsibility – of the firm for the employee's fortune and the employee for the firm's operation (Abegglen 1958, p. 11).

Harmonious cooperation between the managing staff and employees increases a sense of belonging and encourages undertaking common effort in order to improve the conditions of the enterprise development, and wage levels at the same time. The financial situation of the company decides a wage and other allowances for the employees. Close dependence between the level of additional elements of remuneration (*bonuses*) and company profitability binds together wage levels, work efficiency and the economic situation. That is why for Japanese employees their wage depends not only the changes of prices but also of the economic situation and achieved economic efficiency (Mouer, Kawanishi 2005, Debroux 2003).

Full awareness of co-dependence between the company's economic results and wages, as well as the necessity to provide conditions for future development influences the moderation of these demands. In consequence, active interest of the employees in the company development, its profitability, fast increase of labour productivity rather than wages, allows the decrease of unit costs and the increase of internal accumulation. The advantage of Japanese labour relations is the system of the enterprise labour unions, which lets conflicts between labour and capital, be neutralized (Sako, Sato 1997).

Japanese corporation's management adopted a different character due to a different model of industrial relations from the Anglo-American one. Traditional management from above transformed into decentralized team co-action. It differs not only in aims, which are usually defined in the context of the firm value measured by development perspectives, market position strengthening and value for stakeholders. Despite a formal hierarchical structure, Japanese corporation's management is characterized by decentralization of decisions connected with operational activity. Thanks to numerous rights employees are not alienated and they willingly get involved in the firm's matters. Traditionally harmonious relations at a working place enable the introduction of modern management methods in *keiretsu* groups, adapted to traditional customs and relations, for instance *JIT*, *Kaizen*, *TQM* or *OJT*.

5. *Keiretsu* Groups and Corporate Groups in Other Countries

5.1. Corporate groups in historical perspective

Corporate groups were first formed as early as the first half of the 19th century. *Société Générale des Pays-Bas pour Favoriser l'Industrie Nationale* was established in 1822 and transformed into *Société Générale de Belgique* in 1905, directly or indirectly controlling over 1200 companies, is considered to be the first corporate group of economic activity. *The Nobel Dynamite Trust Company*, established in 1886, is considered the first British corporate group. The first structures of this type were formed in Switzerland in 1879 and 1890: *Bank für orientalische Eisenbahnen* und *Schweizerisch Eisenbank*. In Germany corporate groups developed at the time of dynamic economic growth after the French-Prussian War in 1871. At this time corporate groups *Krupp*, *Stinnes*, *Stumm*, *AEG*, *IG-Farben* and *Siemens & Halske*, partly operating until now, were established. Some time later corporate groups developed in France.

Pennsylvania Railroad Company, established in 1870, is considered the first corporate group in the United States. The law regulating the operation of such structures (the law of holding), which was in force in the state of New Jersey already in 1889, proves dynamic development of corporate groups operations in the United States at the end of the 19th century.

Economic literature points to different reasons for the creation of corporate groups in Europe and the United States. In Europe corporate groups of economic activity were connected with searching for new sources of capital in the initial period of industrialization. In the United States, however, corporate groups' establishment was connected with the defense of some companies against increased competition in the final period of industrialization (Keller 1990, pp. 39-47).

Notwithstanding the reasons for their establishment, corporate groups played a very important role in the world economy. Together with the development of economic activity, this form of economic activity structure found more possibilities of application and a stronger position in developed countries and emerging economies.

Common and extensive use of corporate groups has been taking place since 1960s and, on the one hand, it is connected with processes of economic concentration occurring at this time, whereas, on the other hand, with a negative evaluation of efficiency and profitability of large, organizationally integrated companies.

In Poland and Central and Eastern Europe, countries' conditions to create corporate groups appeared together with the process of the system transformation of the 1990s, that is a breakup of old authority structures, change of market institutions, deregulation and liberalization of the economy.

5.2. Keiretsu groups and corporate groups in developed countries

There are essential differences, as far as ownership structure, objectives, decision-making and labour relations are concerned, between large Japanese corporations belonging to *keiretsu* groups and their American and European competitors (see Table 6). Moreover, in the era of globalization Japanese corporations have many features hindering their penetration by outsiders.

It is a characteristic feature of the large Japanese capital companies ownership structure that corporation goals are specified, first of all, by active stakeholders: managers and employees, and not by shareholders, as is the case in the Anglo-American model. This tendency is strengthened by the model of corporate governance, which confirms executive manager's position and, to a great extent, makes it independent of the influence and control of shareholders, at the same time providing the employees with significant but conditional rights. The model of the company operation and the large scope of the employees' operational autonomy form a contractual arrangement characterized by the balance of rights and duties between managers and employees.

Japanese economists emphasize the social importance of the corporation and the fact it is not a common technological and financial "black box" where the efficiency of the use of resources decides the high share value. According to this concept the company share value is most of all connected with the quality of organization and types of management of long-term contracts between managers, employees, shareholders and business partners. The company share value is evaluated, therefore, not only through the prism of financial estimate of shares by investors and shareholders as it is in the Anglo-American model, but wider – as value for all stakeholders interested in company development. Japanese companies favor building

Table 6. Corporate-specific Features; Comparison by Country

	Japan	Anglo-American	Continental Europe
Company's goals specify	Active stakeholders (e.g. managers and employees)	Shareholders	Shareholders Stakeholders
Nature of companies	Social importance corporation	Financial importance corporation	Social importance corporation
Corporate governance institutions and mechanisms	Main banks Cross-shareholding Employees	Stock markets	Banks Stock markets
Labour relations character	Harmony and balance between interests of managers, employees and shareholders	The primacy of interests shareholders over employees	Balance between interests of shareholders and employees

Source: based on: R. Dore (2000), J. Bossak, W. Bienkowski (2004)

human resources and competitive organization. At the same time financial decisions and recruitment matters, key for cohesion of action, are strongly centralized in Japanese corporations.

The passive character of shareholders and the high dependence on banking financing enable the realization of the so called “golden banking rule” which states that long-term banking liabilities decrease financial risk. Such a type of financing investment expansion of the companies increases the relative role of banking and external sources of financing, and allows to decrease the importance of temporary fluctuations of return on equity in the evaluation of strategic goals realization by the company. This is how a Japanese company operates in more predictable conditions, and, at the same time, in the conditions of lower investment, operational and financial risk. A strategic goal of Japanese corporations, therefore, is not really maximization of current earning per share and value for shareholders measured by discount methods, but the realization of strategic objectives measured by competitiveness and a change of the company market position. It means that managers work not as much for the shareholders as for the benefit of all those who create a positive value. Such an approach creates the stable basis of the company’s progress, where managers and employees act for the benefit of the organization, and identify the organization interest with their own.

In the Anglo-American model of the company goals, efficiency and quality of management are strictly connected with the maximization of the company’s share value. American corporate governance is strictly connected with the active role of stock markets, the leading role of institutional investors, and extensive dispersion of ownership of large American corporations. A dominant share of financial investors and their low share in the capital companies’ ownership structure decide the essential importance of financial liquidity, the ease of buying and selling minority shareholding, as well as financial instruments, such as takeover, buyout and merger. Due to a limited degree of involvement in single companies, financial investors are not interested in direct influence upon the improvement of management quality. They mostly analyze the level of shares liquidity, their listing and transparency of the company’s strategy. If these parameters worsen, then they make changes in the structure of their financial involvement.

In the case of the European model of a continental company, the stock market plays a smaller role in financing and evaluating the company’s value. At the same time the share of financial investors is smaller and that of strategic and institutional investors is larger. Strategic investors, involved in the capital company due to their competence, are generally interested in influencing types of management. In contrast to financial investors, strategic investors are interested in majority shareholding, and quite often make a decision on listing a company on a stock exchange. A strategic investor influences the quality of management and the company’s development. They supervise the Boards of Directors, evaluating the degree of the realization of financial goals specified in a business plan. It contributes to the company’s operation horizon extension. It reduces the risk of misjudged decisions and decreases the pressure of the

current share value. A social model of the European (continental) company, as well as the large share of banks in the company financing makes creditors and employees aims be additionally realized, apart from building value for shareholders.

The relatively lower importance of current share value listing on a stock exchange, good information and cooperation between creditors and employees, as well as the company financial support of medium and long-term banking credits and loans, favor the Board of Directors prolongation of operation horizon, on the one hand, and, on the other hand, guarantee more harmonious relations with stakeholders. Moreover, good mutual inflow of information and contact with the Board of Directors subordinated to the Supervisory Board make the Supervisory Boards become more involved in the control of the Board of Directors quality of management than in the case of the Anglo-American model of the company. As far as the level of satisfaction with management in the Anglo-American model of the company is connected with the shares listing, in the European - continental model - it is connected with the firm's value measured by the level of satisfaction of not only shareholders but stakeholders as well (including creditors and employees).

Differences in the systems of corporate governance are of essential influence upon goals and type and efficiency of management of companies. Examples of financial scandals of large American corporations (among other things *Enron*, *Worldcom*, *Arthur & Anderson*) in 2000-2002 point out that their supervision was financial and dependent on information and specialist analyses, which are commissioned by the Boards of Directors, not by shareholders. Such a situation creates a multitude of action difficult to control. That is why in the European model more extensive rights of Supervisory Boards and system access to information, as well as the right to order the Board of Directors to make specified analyses, as well as carrying them out on one's own, increase the degree of shareholders and stakeholders protection against the negative phenomena which occurred in corporate governance in some of the leading American firms.

The stock market assures institutional investors of a continuous estimate of their investment in the companies listed on the stock exchange. This estimate takes into consideration development perspectives, market analysts' and rating firms' opinions, and the quality of the firm's strategy to a certain extent. Superiority of the estimate based on predicted cash flows and the evaluation of the firm operation's risk is not based on direct contact and knowledge of the firm. Events beyond the control of the Board of Directors significantly influence such an estimate.

Estimate changeability, strong pressure of economic situation factors and type of financing development activity (through the stock market) force the maintenance of high flexibility, and put constant pressure fixed costs reduction. At the same time they increase the degree of risk connected with investment plans realization. They force companies to search for solutions significantly decreasing investment risk.

This fact encouraged American firms, to a greater extent, to use the *IT* technological

breakthrough of the 1990s to launch restructuring and introduce outsourcing of specialist business services on a large scale. These actions allowed American firms to get rid of the activities which were not directly connected with the domain deciding about their competitive advantage, and which just absorbed capital, work and increased the fixed costs level. Until the time of restructuring, supportive activity of vertically integrated corporate groups in particular, was of negative influence upon their general efficiency and increased the level of employment. Excluding the least efficient activities of the firm's value chain, and moving resources towards their basic competitive activity enabled a significant increase of their competitive capability (lower operational costs, higher efficiency, lower risk connected with a decreased level of profitability).

Labour relations in Japan are of a distinct character as compared to labour relations in the United States or Europe, where the owner's interest is superior to employees' and other stakeholders' interest. These relations are not the rights won in antagonistic conditions (as in Europe), which negatively influence accumulation and development possibilities of the enterprise. In Japan they relatively harmoniously reconcile the company's development interest with employees', managers', shareholders', banks' and other business partners' interests. An employee becomes the subject and has a sense of his/her own value and treatment consistent with the contribution he/she makes to the enterprise's development. In the company, however, not only individual achievements of the employees are evaluated, but also the results of collective effort. It strengthens the tendency for action and teamwork harmonization. In such an enterprise the employee's involvement is observed, the conditions of teamwork improve, initiative, entrepreneurship, non-selfish attitudes, thinking in the categories of collective interest and future are freed. Thanks to this the firm's willingness to invest in corporate culture and raise employees qualifications increase.

In the era of globalization Japanese corporations have many features making penetration by outsiders difficult. Strong intra-corporation bonds between managers and employees, as well as stable shareholding and low liquidity of shares connected with it, decrease the possibility of using the stock market as a mechanism increasing the efficiency of corporate governance by the threat of hostile takeovers and exchange of managers. As opposed to the United States and Europe the level of takeovers is relatively low.

5.3. Keiretsu groups and corporate groups in emerging markets

5.3.1. Corporate groups in East Asian economies

Corporate groups are ubiquitous in emerging markets, including East Asian economies. In South Korea, the business sector is increasingly diverse; its most important aspect was the organizational form of the *chaebol*. Those corporate networks dominated, directly and with

widespread normative influence, the economy and large business. According to A. Amsden (1989, p. 119) “like the multidivisional enterprises of United States, Germany, and Japan, the *chaebol* can be said to have acted as the agents of industrialization”. There were more than 60 *chaebols*, although a few dominated: in the 1990s the top five (*Hyundai, Daewoo, Samsung, LG, SK*) accounted for almost one-tenth (9%) of GDP, and almost one third (32%) of corporate sales and assets (29%). Some became major businesses in the world economy, engaged in mergers and acquisitions, investments and employment abroad (Rowley, Bae 2005, p. 71).

The Korean corporate groups were characterized by family control and management, paternalistic leadership, centralized planning and coordination, entrepreneurial orientation, close relations with government and strong school ties in hiring policies (Steers *et al.* 1989, p. 37). They were held together by cross-shareholdings, subsidies and loan guarantees with inter-group competitive tension.

Underpinning *chaebol* were a variety of elements explained by a range of theories. For some, the state-military link and interaction with *chaebol* was the most important external factor, producing politico-economic organizations substituting for trust, efficiency and the market. The state both owned banks, and promoted *chaebol* as a development strategy, even intervening to maintain quiescent labour. These connections have been damned as nepotism and “crony capitalism” (Huang 2005).

Organization structures and human development resource systems also have some unique features. Companies were centred and hierarchical, with formal structures and vertical organizational principles and a family-style relationship. The hierarchical principle made for more predictable behaviour; obligations and indebtedness, contributing to vague roles between personal and public relations. Founders organized and managed on the basis of principles governing family life. There was both authoritarianism and paternalism, with companies as “parents” and employees as “family” (Rowley, Bae 2005).

After the Asian Crisis *chaebol* started reconfiguration of organizational structure and mode of operation. The reconfigurations included: downsizing (changes in labour relations), restructuring (introducing by government various laws to push companies in the direction of improving corporate governance, capital structure and redirection of business focus, with less diversification and concentration on core competence area), privatization and M&As, and changes in human resource development (reducing “rigidities” and fostering “flexibilities”).

The corporate groups in Taiwan (*guanxi qiye*) possessed elements similar to both Japan and Korea. They were typically owned and controlled by single family, at least through the second generation of its life, with each generation being measured by approximately twenty years. Usually a group was characterized by some form of holding company at the top, which controlled the various subsidiaries, even if the equity shares of a given subsidiary were traded on a stock exchange. While most businesses were mainly family-dominated, as in the case of Korea, they failed to demonstrate the same level of dynamism to expand as legally

independent entities, or form a corporate group. The *guanxi qiye* has been much less dominant in Taiwan, compared with the *keiretsu* in Japan or the *chaebol* in Korea. Moreover, like corporate groups in developed countries, the corporate headquarters of groups were small. Corporate groups in Taiwan based mainly in the electronics industry had barely a dozen professionals and family members presiding at the top and taking key decisions on expression (Amsden, Chu, 2003, p. 186).

P. Buckley (2005) studies the nature of the network firm in general and formulates a classification of network types and life-cycle analysis of networks. The analytical framework is applied to Asian network firms using *keiretsu*, *chaebol* and *guanxi* as specific examples. These three network firms types were shown to be very different in their characteristics (see Table 7).

The corporate group in China arose against a very different historical background from the above-described corporate groups in Asian countries. Under the socialist model, before the reforms starting in the late 1970s and early 1980s, the organization of production was “incorporate” at the national level, where government acted as the management of the national corporation. There were no legally independent entities as such. Legally independent corporations now operating in China come from two sources. One is the rapid growth of the private sector since the 1980s, including joint ventures and completely independent corporations, initially based upon foreign investment. The other source is the gradual process of restructuring and transforming state-owned enterprises since the 1990s. Many corporate groups, today, emerged from the second process – a form of de-corporation of state enterprises. Internal relations between government ministries, banks, and enterprises have been broken-up. Formal government ministries have been transformed into semi-governmental “associations or *giye jituan*”. Banks’ relationships with corporations have

Table 7. Types of Asian Network Companies

	<i>Keiretsu</i>	<i>Chaebol</i>	Overseas Chinese <i>Guanxi</i>
Factor Ownership	Cross-shareholding	Family (often disguised)	Family
Products	Specialized	Diversified	Diversified
Finance	Ingroup bank	State, debt	Family
Market	Global sales	International Expansion	International Expansion
Technology	Group development (incremental)/Innovative leaders	Group development (incremental)	Licensed-in

Source: based on P. Buckley (2005, p. 36)

undergone substantial change, now resting upon the bases of commercial operations, rather than administrative ones. Legal instruments, such as tax, fees, and monetary and fiscal policies, have been gradually replacing administrative ones, such as directives, quotas, and profits in corporations' relations with the state (Huang 2005, pp. 143-44).

S.Y.L. Cheung and B.Y. Chan (2004) examine the state of corporate governance in some countries in the Asia-Pacific region. Since the early 1990s, corporate governance has been receiving attention from regulatory bodies and practitioners worldwide. A key aspect of improving corporate governance in Asian countries is improved investor protection and more transparent information, enhancing the development of local stock markets and promoting foreign investment to provide funds for long-term economic development. The authors suggest that some countries, including China, Japan, South Korea and Thailand, adopt the concept of stakeholders in their governance principles, whereas Singapore and Malaysia stress the social importance of corporations, but do not emphasize stakeholders in the concept of governance (Cheung, Chan, 2004, p. 9).

Most recently T. Khanna and Y. Yafeh (2005, p. 52) describe corporate groups in twenty emerging markets, as well as prewar Japan "*perhaps the most promising comparison between Japan and present-day emerging markets can be done using historical data on the prewar Japanese zaibatsu which operated in an institutional environment which is much closer to the one present in many developing countries*". They analyze many aspects of corporate groups functioning and mode of operations, including diversification and performance of the pyramid structure of group-affiliated vs. unaffiliated firms. However, the comparative analysis of the origins of corporate groups in individual countries is the most interesting (see more Appendix, Table 1).

5.3.2. Corporate groups in Central and Eastern European transition economies. The case of Poland

Corporate groups in Poland and in other Central and East European transition economies are a new type of organization created in the process of transition from the socialist model to the market economy in the 1990s (Romanowska *et al.* 2000). The short period and stormy circumstances of their establishment in Poland prevented the possibility of recognizing the results of Polish corporate groups, as well as the way of their operation as satisfactory.

The problems of Polish corporate groups result, most of all, from limited practical and theoretical knowledge. Practical experience in the scope of managing corporate groups are scarce indeed; there is no comprehensive research on corporate group's phenomenon, whereas the possibilities of foreign experience transfer and application are poorly recognized.

Compared to *keiretsu* groups Polish corporate groups differ in origin, size, scope, number, organizational structure and mode of operation, as well as corporate finance and governance systems.

The formation of corporate groups in Poland is connected with:

- restructuring and privatization of a number of state owned enterprises, being of so-called strategic importance to the Polish economy,
- privatization of foreign trade centers,
- consolidation in the banking sector,
- realization of the National Privatization Program, which resulted in the formation of fifteen National Investment Funds,
- family controlled, which are not rooted in the socialist model economy.

There are approximately 1200 corporate groups operating at present in Poland. Their number, however, does not decide their importance, but economic strength:

- 120 (51%) of the enterprises listed on the Warsaw Stock Exchange are core companies corporate groups,
- 375 (75%) enterprises out of the 500 largest Polish firms are members of corporate groups.

Table 8. Development Stages of Polish Corporate Groups

	Development conditions	Development action
Pre-transformation stage, before 1988	Monopolistic position Lack of significant competition Limited area of activity Stable cooperation with home partners Economy and system crisis	Limited organizational changes Expecting radical system changes
Transformation shock stage 1989-1990	Economy and transformation crisis Economic activity liberalization Competition growth Partial loss of so far existing markets Worsening effectiveness	Employment and superfluous property reduction Undertaking action within existing structure Commercialization and preparation for privatization
Privatization stage 1991-1994	Economic post-transformation stability Privatization Enterprises market growth Motivation for intensive development Banking conciliation proceedings	Privatization (also partial) Development mainly based on own means Privatization of state enterprises, first takeovers Separating activity from enterprise structure (capital outsourcing)
Capital accumulation stage 1994-1998	Economic growth Capital market development Introducing shares on a stock exchange Winning considerable means in capital markets	Development based on external means Intensive takeovers New investment Activity diversification Active shareholding formation
Restructuring stage after 1998	Worse economic situation Worse financial results Active shareholding formation	Shareholders pressing on efficiency improvement Board of Directors substitution Change of strategy Group structure subordination, New investment Activity concentration Managing systems improvement

Source: base on M. Trocki (2005), Romanowska *et al.* (2000)

The largest Polish economic organizations, for instance PKN Orlen, Telekomunikacja Polska, Polskie Sieci Elektroenergetyczne, PZU, PKO Bank Polski, Polskie Gornictwo Naftowe and Gazownictwo, Elektrim, Huta Katowice, Impexmetal, Polska Grupa Farmaceutyczna, and Agora, operate in a form of corporate structure.

According to a report on corporate groups in 1997, they operate in almost all sectors of the Polish economy, in different scope, however. They run manufacturing activity in the widest scope (36.5%), trade (20.6%) and construction (19.4%). Transport (7.6%) and financial services (2.2%) make a significant part of Polish corporate groups' activity as well (Trocki 2005, p. 46).

Enterprise clusters were a characteristic feature of the command economy in Poland after 1956. Their meaning significantly increased in the second half of the 1960s, when the role of enterprise unification and combines establishment was strengthened. Enterprise clusters underwent an evolution: next to unifications and combines, Big Economic Organizations (WOGs) and associations operated as late as 1990. Even though they played an administrative function in the command economy, individual attempts to change these enterprise clusters into modern economic arrangements were indeed made. The enterprises' efficiency was very low. In the event of the lack of foreign competition and national enterprises activity rationing, and despite the worsening economic condition, the strengths forcing enterprises to restructure did not work.

The change of the political and economic system in 1989 put an end to the operation of these enterprise groups and opened the possibility of establishing economic groups based on specified ownership rights and capital corporate ownership as the basis of forming complicated organizational networks (see Table 8). State owned enterprises privatization was the main process creating corporate group structures.

Starting state owned enterprises privatization caused the creation of the enterprises market. State owned enterprises that were in a difficult economic situation but which, in many cases, disposed of valuable development potential, got to this market. The privatization of the companies that were in a good economic situation, for example some previous foreign trade centres, boosted motivation for intensive growth not restricted by the state owner's policy.

Fast growth of corporate groups in Poland started from 1994. It was mostly connected with a better economic situation, which allowed designating more internal group's own means for the needs of corporate groups, as well as stock market development. The accumulation phase was mainly characterized by extensive development of corporate groups. Some groups carried out considerable diversification of their activities. Capital accumulation was accompanied by the process of stable and strong shareholding formation.

In 1998, together with the Asian Crisis, and most of all the Russian Crises, economic results of most Polish corporate groups got worse. External factors, connected with, for example, lack of adjustment of corporate groups' organizational structure to their strategic goals, wrong takeovers, excessive diversification of activity, and, above all, lack of efficient

and effective management, played an essential role here as well. Worse results resulted in shareholders pressing for improvement of efficiency. This pressure was particularly acute in corporate groups of strong shareholding. Numerous corporate groups took up restructuring action involving withdrawal from doubtful investment, limitation of activity diversification, and management improvement. The restructuring phase is still in progress and it is expected to continue in the next years. The restructuring phase *de facto* means moving from quantity to quality development of Polish corporate groups.

Organizational structure of Polish corporate groups

Corporate groups in Poland make a diversified set of economic subjects as far as activity area, kind of relations, scope, complex organizational structure, as well as type of ownership are concerned (see Table 9).

Manufacturing is a dominant area of Polish corporate groups' activity. Horizontally or vertically integrated corporate groups are dominant as far as organizational structure is

Table 9. Characteristics Selected Polish Corporate Groups

	Dominant area of activity	Kind of relations	Scope	Structure	Type of ownership
Bumar Warynski	Manufacturing	Vertical	International	Simple	State owned
Mostostal Warszawa	Construction	Vertical	International	Simple	Private
Netia	Telecommunication	Horizontal	Domestic	Simple	Private
Polskie Sieci Elektroenergetyczne	Energetic	Vertical	Domestic	Simple	State owned
Computer Service Support	ICT	Vertical	Domestic	Simple	Private
Polska Grupa Farmaceutyczna	Trade	Vertical	Domestic	Simple	Private
BRE Bank	Finance	Vertical	International	Simple	Private
PZU	Insurance	Horizontal	Domestic	Simple	Mixed
Agora	Media	Vertical	Domestic	Compound	Private
Kulczyk Holding	Finance	Conglomerate	International	Simple	Family controlled

Source: based on M. Trocki (2005)

concerned, less dominant are those running activity that is poorly integrated or not integrated at all. Capital relations are a dominant form of relations in Polish corporate groups, whereas property and contract relations play a less significant role. Personal relations play a relatively insignificant role.

The level of internationalization is relatively low in the activity of Polish corporate groups. From the beginning of the period of system transformation no corporate group that would include a home transnational corporation has been established in Poland. Poland's EU membership creates possibilities for activity development in the Single European Market.

Corporate governance

At the time of development corporate groups were undergoing transformation of their ownership structures: from the dominant role of the State Treasury through the dominant role of employees and managers shareholding, and dominancy of passive financial investors to dominancy of active strategic investors (see Table 10). In result of legislative changes of the Commercial Code corporate governance system has been adapted to EU laws to a great extent.

Table 10. Changes in Corporate Governance of Polish Corporate Groups

	Characteristics	Dominant stakeholders	Managing problems
Pre-transformation stage	Enterprises operated in a form of state enterprises, which are in practice self-government	State enterprise Directors Employees Board as employees representative	Maximization of internal stakeholders' interests Neglecting needs and expectations of the surrounding environment Low efficiency, worsening economic situation
Commercialization stage	State enterprises transformed into one-man State Treasury companies	State Treasury as the only owner Board of Directors Supervisory Board including representative of employees Labour Unions	Poor and unprofessional owner's supervision Dominance of political interests over economic ones Limited Board of Directors self-dependence Maximization of internal stakeholders interests
Privatization stage	Privatization of one-man State Treasury companies carried out in different ways envisaged by the legislation	New shareholders or stakeholders State Treasury Local authorities Supervisory Board Board of Directors Employees Labour Unions	Controversy concerning privatization method Reluctance to accept new ownership arrangement and new business relations resulting from it conflicts connected with the change of business relations

Restructuring stage	Taking up restructuring action and searching external capital for its implementation	New shareholders or stakeholders Lenders Local authorities Stock market institutions Supervisory Board Board of Directors Employees Labour Unions	Problems of market reorientation of the company activity Controversy and conflicts connected with employment restructuring and rationalization Aiming at the increase of activity efficiency
Development stage	Active shareholding formation	Active/strategic shareholders or stakeholders Stock market institutions Business partners Supervisory Board Board of Directors Labour Unions	Pressure on new shareholders or stakeholders to increase activity efficiency Deep restructure Executive staff substitution Activity strategic reorientation managers and employees' resistance to changes

Source: base on M. Trocki (2005), Romanowska *et al.* (2000)

Table 11. Strategic Investors of Polish Corporate Groups

	Corporate groups	Strategic Investors Core Company (percent shares)
1.	Agros	Pernod Ricard (98.42%) - branch investor
2.	Bank Handlowy	Citibank N.A. (92.00%) - branch investor
3.	BIG Bank	Banco Comercial Portugues (46.18%) - branch investor
4.	BRE Bank	Comerzbank (50.00%) - branch investor
5.	Budimex	Valivala – Ferrovial (58.72%) - branch investor
6.	Exbud	Skanska Europe AB (95.92%) - branch investor
7.	Grupa Onet	ITI Holding SA (59.99) - branch investor
8.	Kredyt Bank	KBC Bank NV (66.53) - branch investor
9.	Mitex	Eiffage Construction SA (74.79) - branch investor
10.	Mostostal Warszawa	Acciona SA (49.00) - branch investor
11.	Mostostal Zabrze	Bank Handlowy SA (34.44) – financial investor
12.	Netia	Telia AB (47.60%) - branch investor
13.	Pekao	UniCredito Italiano (53.17%) - branch investor
14.	PIA Piasecki	Bank Handlowy SA (42.00%) - financial investor
15.	PKN Orlen	Bank of New York (23.10) financial investor
16.	Rolimpex	Provimi Polska Holding (24.45%) - branch investor
17.	Telekomunikacja Polska	France Telecom (33.93) - branch investor Kulczyk Holding SA (13.57%) – finance investor
18.	Zywiec	Heineken Int. Beheer BV (61.78%) - branch investor Harbin BV (31.07%) – finance investor

Source: base on Poradnik inwestora, “Parkiet”, June 2000

Corporate governance is the weakest element in the system of Polish corporate groups' management. In Poland and other Central and East European Countries undergoing system transformation the corporate governance system, as an essential economic subsystem, should be harmoniously related to the target economic model of the country. Lack of a specified model of economic system may have a negative influence upon the development and efficiency of the corporate governance system, and in consequence, investment attractiveness and company competitiveness.

The Polish corporate governance system is based on historical experiences of the interwar period and amendments, applying most of all German solutions as the point of reference.

In the second half of the 1990s essential changes in the ownership structure of Polish corporate groups took place. Many groups acquired strong active strategic investors, mainly from EU countries (see Table 11).

Adjustment process of Polish corporate groups to integration with the EU and globalization

Corporate groups in Poland are at present bound by adjustment processes to two main processes: integration with the EU and globalization. Among these processes there are multi-dimensional relations, e.g. the process of integration is to harmonize the law, and structural adjustments. The process of globalization causes weaker and weaker designations of corporate groups are their "Polishness" or "Europeanness".

The process of Poland's integration with the EU was mainly carried out in the area of law harmonization, and structures and management adaptation.

In the scope of Polish corporate groups' law harmonization with the European law, legal regulations existing in Poland are sufficient for these groups operation in the conditions of the EU. It can be confirmed by the changes regarding commercial companies included in the Commercial Code resolved in 2000, as well as the changes in the Act on Accountancy which have been in force since 1st January 2002. Enforcing existing regulations, however, should be considered a crucial problem.

Structural adaptations and the ones in the scope of managing Polish corporate groups are reduced to two issues: group competitiveness and the quality of management. These adaptations were made mostly from the point of view of transformation requirements from socialist model economy to market economy, and not challenges connected with Poland's membership in EU. We can even state a thesis that adaptation of strategies, structures and human factor to conditions of operation in the EU are merely a background for the transformation processes in Polish corporate groups. This thesis is confirmed by the action taken in some corporate groups (for example Exbud, II NFI S.A.). The management of Polish corporate groups does not see the perspective of adapting to the requirements of EU integration as the assignment that should be fulfilled. Their attitude is characterized by

passivity sometimes supported by the conviction that they themselves as managers and the enterprises they manage – will manage successfully in a uniform EU market.

Managing a corporate group requires managers to have qualifications and skills that are different from those necessary to manage single enterprises, even of a developed structure. Due to the short period of corporate groups' operation in Poland, their management staff have not acquired the ability to manage these complicated economic structures. At the same time, the lack of a managers' market makes any staff changes at the highest level of group management likely to fail.

The period of corporate group managers who built the positions of their organizations on past experience and personal contacts preserved from the centrally planned economy system is over in Poland. At present managers of corporate groups in their management are required to have new competence and skills, included those connected with management in the EU.

The lack of knowledge and capital structure management techniques, as well as the habit of cooperation with key investors, results in the situation where corporate groups are less popular forms of conducting economic activity in Poland among large companies. It is a significant institutional gap in the Polish economy.

Globalization leaves an apparent stamp on Polish corporate groups. It manifests itself, among other things, in a continuing process of concentration expressed by the increasing number of M&A. Similar to the EU, where the term "European group" is slowly losing its importance, in Poland as well so called Polish capital groups will less and less frequently have a *raison d'être*. More and more often, on the other hand, we will deal with corporate groups of a global character, where one of its elements will be groups established in Poland and even managed by Polish managers.

In Poland corporate groups that develop are mainly those whose owners are global corporations located in EU countries, less often in the US and Japan. Active operation of foreign, especially union corporate groups, may approximate Polish corporate group managers with systems and procedures allowing efficient activity in the uniform EU market.

Transformation of Polish corporate groups into European branches or global economic groups allows stabilizing technological ties and the cooperative export of national producers. On the other hand, it deprives Poland of the chance for necessary changes in economic structure.

6. Conclusions and Recommendations

Were there conditions to establish corporate groups of keiretsu type in Poland after the system changes of the 1990s?

The establishment of corporate groups of *keiretsu* type in Poland at the beginning of the system transformation was rather impossible. Thus the usefulness of *keiretsu* groups in Poland was limited in several ways:

- (1) Lack of home capital, when at that time key foreign investors had such significant so called capital advantage that they were able to hostile takeover of every national capital group.
- (2) Lack of industrial policy (for instance financial privileges, excessive fiscalism).
- (3) Lack of family controlled firms.
- (4) Lack of managers (Polish transformation of the 1990s did not educate managers able to manage corporate groups with skill and competence).

Even if there were possibilities of establishing corporate groups of keiretsu type in Poland, their operation at present would have been limited because:

- (1) Processes of globalization and regional integration force are searching for competitive advantages on microeconomic rather than group level.
- (2) Establishment of *keiretsu* type groups is blocked by EU anti-monopolistic laws because capital and management concentration in corporate groups evokes fears of forming monopolistic structures that are harmful for competition.

Can we use Japanese experiences of corporate groups of keiretsu type in Poland?

The Polish economy is just now in the process of large structural modernization in the field of productive capacity. The production structure is obsolete and doesn't reflect the requirements of global competition. In Polish corporate groups there are changes carried out that aim at the increase of competitiveness by the following means:

- building innovation strategy,
- strengthening R&D activity,
- re-orientation from the domestic market to international markets,
- implementation modern methods of management.

Apart from the fact that *keiretsu* groups have been seen as a distinctively Japanese form of industrial organization, the result of a specific economic and institutional environment, they provide an interesting normative model for Polish corporate groups in organizational as

well as technological innovations, including: supply hierarchy as a trust-based system, intra-group human resources development, and R&D activity.

Supplier system

The *keiretsu* supplier system has been generally acknowledged to represent the leading edge of organizational technology in industry, capable of achieving the highest levels of productivity in combination with the use of flexible production system, and *Just-In-Time* supply schedules. The key advantages of the *keiretsu* in terms of supplier links would include the following:

- The disaggregation of activities along the value chain made costs more transparent and therefore controllable.
- The core company focused on main area of activities, which were primarily the high-value-adding activities of technology development and the high-value-added manufacturing. These technology-intensive activities made technology a more salient element of corporate strategy and contributed to the technological dynamism of the firm.
- Even large firms stayed relatively small. The smaller size contributed to the flexibility and dynamism of the firm, helping it move quickly into new related technologies and product markets.
- The core company was able to achieve greater efficiency in wages, keeping only primarily the high-value-adding activities on its employment roster and rewarding its high commitment, high-value-adding employees appropriately.
- The “rational contracting” characteristic of the supplier networks of the *keiretsu* – management by “contact, not contract” – reduced transaction cost, fostered the expansion of supplier capabilities and “co-specialized assets”, and lowered production cost.

The benefits of applying supply hierarchy systems within *keiretsu* groups should encourage corporate groups in Poland to attempt to imitate and search for better and more effective solutions.

Intra-group human resources development

P. Drucker in the early 1970s paid attention to specific features of Japanese-style human resources management as well as those of its aspects which could serve as a model to follow for managers and economic strategists in other countries as early as the 1970s. He emphasized such elements of Japanese management as: employment stability, effective system of employee’s motivation, efficient process of decision making, constant qualifications improvement, as well as flexibility of labour costs (Drucker 1971). Some of these solutions, for instance firm-based training for employees that serve both as ignition reties and as mechanisms to build a sense of membership, commitment, and loyalty and self-sacrifice for the good of corporate group, are still applicable and practical and may be used in Polish corporate groups to improve the quality of human capital.

Moreover, membership in the *keiretsu* group, especially in the vertically integrated, is symbolized by the core company's ownership of some shares in the group firms, either directly or indirectly (through its subsidiaries' ownership of shares in their suppliers). But as the variations in the level of core company shareholding in group companies suggest, ownership is not the only or even the primary means of coordination and control in the *keiretsu*. It is one of five mechanisms, the others being the interconnections of the value chains; the flows of financial resources in forms other than equity (both direct loans and the support of the parent company for affiliates seeking bank loans); the flows of information and technology; and, most importantly, the flows of labour.

Workers move from the core company to the suppliers and from the suppliers to the core company. The latter type of transfer, however, differs from the first in being overwhelmingly and unambiguously temporary: workers are transferred to work on specific projects or to learn specific skills that they take back to their home firms. The core company, in contrast, transfers its workers to its subsidiaries on permanent as well as on temporary assignments, at all levels of the organization. This outflow serves several purposes:

- it maintains strong communication links across the network;
- it eases the transfer of technology and know-how from the core company to its subsidiaries;
- it enables the core company to stay "lean" and to select only the high-commitment and high-performance employees from its labour pool;
- it provides senior management positions for those of its managers who have plateaued in the core company.

R&D activity

In an increasingly globalized economy and with the shift to knowledge-based economy, Japanese experiences in Industrial Innovation Systems (IISs) in *keiretsu* groups are particularly interesting. R&D investment in the future generates innovation, and drives up a country's GDP through the process of commercialization and product development. R&D intensity for Japan (3.15 in 2003) was one of the highest and clearly distanced from the rest of the OECD countries. The business sector plays a leading role in R&D activity in Japan. The business sector shares in total funding were highest among developed countries (73% in 2001). R&D activity is mainly concentrated in *keiretsu* groups. For instance, R&D spending of *Toyota Motor* surpassed 5.6 billion dollar. By way of comparison, in Central and Eastern European Countries total gross expenditure on R&D is close to 5 billion dollars (UNCTAD 2005, p. 120). Moreover, *keiretsu* companies belong to the world's most inventive (The Economist, January 14th-20th 2006, p. 62-3). Some characteristics of IISs in *keiretsu* groups include:

- close collaboration within firms and between firms (in-house cross-functional integration and close supplier relationships),

- long-standing in-house development facilitated by low labour mobility (existing firms change, evolve, and overcome technological discontinuity rather than new firm coming in),
- highly skilled production and engineering workers.

Poland remains one of the least innovative countries of the now enlarged EU. This is probably the result of the obsolete institutional setting, which doesn't reflect the requirements of modern international competitiveness. It is the heritage of the socialist model economy, where the creation of the IISs was not considered a priority factor of economic development. Additionally, Poland still undergoes (as is the case of other Central and East European Countries) intensive modernisation of its production capabilities. Their structure is in a way outdated and does not guarantee to close the huge the gap between the Polish level of productivity and technology and EU productivity frontier.

The development of innovation capacity, both in financial and creation aspects and the improvement of competition abilities are the main problems for the Polish economy. The low level of R&D intensity (0.56% in 2004) does not allow supporting R&D capacity and makes creating technology impossible. Moreover, R&D expenditures in Poland are mostly financed by the state budget fund (65% in 2001). Business sector share in R&D financing is relatively low and amounts to approximately 30%. It proves, on the one hand, innovation weakness, and on the other hand, the important role of innovation policy in creating the competitiveness capacity of the Polish economy. The increase of the companies a share in financing research would be desirable because the business sector is mostly interested in development works which connect development and research activity with the market to a greater extent, which, on the other hand, favours the improvement of effectiveness of borne outlays and the increase of the company's competitiveness.

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Appendix

Table 1. Comparative Origins of Corporate Groups in Emerging Markets and Prewar Japan

Country	State-backing (general)	Privatization-related	Ethnic Policies and Family Issues
Brazil	State protection (through tariffs and non-tariffs barriers and through targeting of priority sectors) benefited groups, as did extensive state financing. In the 1990s protection decreased (although there is still some state backing in the form of technology and research grants and support).		Family ties have always been at the center of groups and groups today are still owned and sometimes run by the families that created them decades ago.
China (since the 1980s)	Government encouraged the formation of many business groups and protected them from foreign competition because they were regarded as essential for development. However, government sentiment waxed and waned depending on neighbouring countries, particularly South Korea. In addition, People's Liberation Army has historically been involved in several business ventures, many of which are organized as corporate groups.		
Chile	Some groups benefited from the consolidation policies following the crises of 1970's and 1980's.	Some groups benefited from privatization during the Pinochet regime.	
Costa Rica	A limited role of the state combined with a historically homogeneous distribution of land and coffee plants. However, government protection of some sectors (e.g. sugar, meat, rice) led to growth of certain groups.		Family groups evolved, typically as a result of the success of specific firms, especially in commodities.
Czech Republic	Industrial holding companies emerged out of former Communist planning units, sometimes with 15-30 horizontally and vertically linked plants and subsidiaries. These companies were voucher-privatized and restructured using government subsidies. The remaining shares were bought at discount by the new management team and consortia of	Voucher privatization led the creation of large diversified investment funds, often indirectly run by banks, which control linked enterprises.	

	Czech banks.		
India	Favored entrepreneurs formed groups during the License Raj of the 1960's and 1970's (although other groups date back to early twentieth century). This was despite the existence of <i>de jure</i> legislation that was anti-big business (e.g. the Monopolies and Restrictive Trade Practice –MRTP-Act).	Some entrepreneurs who formed groups benefited from the transfer of assets formerly held by the British to Indians during the Independence movement (<i>de facto</i> privatization).	Clusters of business groups formed around ethnic, religious and social communities, for example, the Marwaris of Rajasthan formed business in Bengal and elsewhere: the Gujeratis in West, the Chettiars in South, etc.
Indonesia (under Suharto)	Some groups run by members of the Suharto family. Others, such as the Salim group, were granted monopoly over mills. Close government involvement in business. State-sponsored cement and other monopolies benefited groups.	The Salim group received assets seized by the army.	Suharto viewed the involvement of his children in business groups as a way of righting the Pribumi-Chinese imbalance in the top ranks of the business community (although most groups are identified as ethnic-Chinese, including the state-supported Salim group).
Israel	State backing of preferred groups in the early decades after independence.	Privatization-transfer of some government assets to families and new groups in the 1990's.	
Korea (1960-90)	Preferential credit and protection from foreign competition to entrepreneurs following government guidelines, especially with political contacts to General Park. The government, through its control of the financial system, often encouraged group diversification, mergers and consolidation (acquisition of ailing firms and groups), and investment in certain industries.	Sale of assets formerly controlled by the Japanese and state assets to some favored groups and entrepreneurs.	
Malaysia (under Mahathir)	Preferential credit to businessman with close ties, including members of Mahathir's family. Political parties explicitly involved in business. Consolidation has often been used a remedy to salvage distressed firms, particularly by grouping companies under favored Malay entrepreneurs.	Privatization (of colonial assets and of failed government investments) – buyers have political contacts and state patronage.	President Mahatir supports Bumipeutas entrepreneurs in the privatization processes. Some ethnic Chinese groups operate in Malaysia and across its borders (to diversify political risks).
Mexico	Until the mid 1980's the government supported business groups by protecting many sectors through tariffs and trade restrictions, as well as by granting discretionary concessions (for example in media, mining, and other sectors) as well	The privatization period (mostly 1988 to 1994) benefited many business groups which bought the national phone company and Banks. Some new groups were created	Family ties are crucial for business groups in Mexico. The largest industrial conglomerates in certain regions are still run by the families who started the business in the

	direct and direct subsidies to certain goods and industries (e.g. sugar). Groups also enjoyed monopolies, state-induced consolidation and certain protection from FDI. Since 1973, groups and conglomerates have enjoyed certain special tax incentives.	following the privatization of the 1990's.	mid-nineteenth century, often with very strong ties to the government.
Nicaragua	The government of the Somozas (father and son) controlled directly a large number of industries. At the end of the Sandinista government many firms were bankrupt and a few groups acquired them, leading consolidation.		Connection in family groups, inherited from colonial time.
Pakistan (starting around 1960)	Foreign exchange licenses given primarily to rich families. Combined with restrictions of imports.		
Russia	Some (limited) government support of industry-led FIG's which evolved with the collapse of communism; much more support of the bank-led FIG's which enjoy political clout, lobbying power for various privileges (e.g. restrictions on foreign investors), and influence the media.	Industry-led financial-industrial groups (FIG's) emerged early in the privatization process. Bank-led FIG's emerged later, in relation to auctions initiated by President Yeltsin favouring (some) buyers; state assets sold at low prices to "Oligarchs".	
Singapore	Government-linked business groups established in the 1960's and 1970's in order to make economic investments jointly with private investors.		Ethnic Chinese, who felt threatened by the government, formed private, family controlled groups, diversifying across industries and borders to reduce risk.
South Africa			During Apartheid, major groups were associated with the whites; In the post-Apartheid period, the adoption of Black Economic Empowerment policies induced a transfer of assets from whites to blacks, and the formation of conglomerates by select black entrepreneurs, some of whom had political contacts to the ANC.
Taiwan	Not much government support and encouragement; family-groups formed endogenously (but benefited from certain tax advantages starting		

	in the 1960's).		
Thailand	Some groups originated in the 1940's; politicians and military officers often involved in business groups; restricted competition in many sectors favors groups.		Groups are often dominated by ethnic Chinese, some of whom operate in neighboring countries as well.
Turkey	Between 1923 and 1980 some groups were supported through preferential input prices, low- cost credits, tax, rebates, foreign exchange licenses, import licenses, government contracts, as well as through export-specific measures allowing business groups to establish large export companies in 1980's. The government also encouraged diversification and internationalization of business groups via various economic incentives.	Relatively larger business groups are the favored participants in the privatization of state owned enterprises, especially those with strong political ties. Smaller family groups participate in privatization efforts of smaller state assets.	The 19 th century business elite were mostly composed of ethnic minorities and foreign investors. With the foundation of the new Turkish republic in 1923, the economic agenda stressed creating an indigenous business class: bureaucrats, merchants, and professionals were encouraged to become entrepreneurs.
19 th Century Japan	Some "political merchants" received state credit and grants. Ailing government businesses privatized and sold to the zaibatsu. Government contracts encouraged group growth around major wars.		

Sources: T.Khanna, Y.Yafeh (2005, pp. 80-2)

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Selected Publications and Research

- 1) Japanese Postwar Economic Growth – Its Dynamics and Problem of Equilibrium, Warsaw School of Economics, Warsaw 2000
- 2) *Keiretsu* – The Japanese Financial and Industrial Groups: Organization, Modes of Operation and Directions of Changes, “*Economist*” 2002 No.1
- 3) Innovation Capacity Adjustment. The Case of Poland, *International Journal of Technology Policy and Management*, Vol.3, 2003 No.2, (Harvard University), co-author
- 4) Poland's Cross-Border Co-operation with Baltic Countries, Belarus, Russia-Kaliningrad District Under the Conditions of the Integration with the European Union, University of Bialystok, Bialystok 2003, editor and co-author
- 5) Innovation and Technological; Competitiveness to Central and East European Countries, in: *The Knowledge-Based Economy in Transition Countries: Selected Issues*, K. Piech (ed.), School of Slavonic and East European Studies – University College of London, London 2004, co-author

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