Holding Company and Bank: An Historical Comparative Perspective on Corporate Governance in Japan

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In this paper I describe the historical evolution of corporate governance in Japan, and derive some insights on its future. In the 1920s, the Japanese economy suffered from a prolonged depression and inefficiency in corporate management, as in the 1990s. In this situation, two alternative systems of corporate governance, the holding company-based system and the bank-based system, were proposed for restructuring poorly managed companies, and in reality, the former system was proliferating. However, the experience during the Second World War made the Japanese corporate system choose the other fork in the road, the bank-based system. The changes in employment system and production management were complementary with the changes in corporate governance and finance. The Japanese corporate system, which was faced with a bifurcation in the 1920s and the 1930s, is now facing another bifurcation.

Keywords: Coporate governance, Holding company, Zaibatsu, Bank, Industral relation

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I. Introduction: Similarities between the 1920s and the 1990s

An historical perspective sometimes can be an aid to understanding current issues. Corporate governance, which has been attracting the attention of economists, lawyers and policy makers, is one of those issues. In this paper, I look back at the pre-war history of corporate governance in Japan, and discuss its implications for today.

It is often argued that there are similarities between the Japanese economy in the 1920s and in the 1990s. In the 1910s, the Japanese economy grew rapidly during the First World War, and at the same time, a sharp rise in asset prices took place. The stock price index in 1919 was 2.29 times higher than that in 1914, and the land price index in 1919 was 2.78 times higher than that in 1915.[1] However, asset prices collapsed in March 1920, followed by a long downward trend until the early 1930s. Asset prices and commodity prices at the trough of the depression in the early 1930s were only one-third to a half of those at the peak. Prolonged deflation seriously damaged the balance sheets of firms and banks, leading to a major bank panic in 1927.

Such phenomena as the asset price bubble, prolonged deflation and financial crisis impress on us the similarities between the 1920s and the 1990s, but these phenomena arguably reflect a more critical similarity. That is, in both periods the system of corporate governance in Japan was faced with a crisis and a bifurcation. The deteriorating financial states of banks and businesses in the 1920s suggest that the system of corporate governance, which had supported economic development since the late 1890s, had begun to fail. Economist Kamekichi Takahashi correctly stressed this point after the First World War. In his book, he comprehensively discussed the problems caused by the organization of the joint-stock company (Takahashi 1930). This book contains many insights that are still meaningful, today.

Takahashi attributed the crisis of the Japanese economy in the 1920s to the decay of corporate management, which, in turn, was attributed to the myopia and selfishness of large shareholders and the decadence of corporate directors. "Shareholder myopia" refers to

[1] Industry Promotion Bank (1937).

the fact that shareholders preferred dividends ahead of profit reserves, R&D and reinvestment. "Decadence of corporate directors" refers to lack of managerial capability, large executive bonuses, and breaches of trust (pp. 4-5). It implies that Takahashi correctly recognized the problems in corporate governance.

Here, I want to focus on the countermeasures that Takahashi proposed, based on the above recognition. He suggested two alternative systems of corporate governance. The first alternative was "transferring the governance of corporations to the major zaibatsu including Mitsui and Mitsubishi, and utilizing the their credit and managerial capabilities." The second alternative was "having financial institutions control industrial corporations, and utilizing the credit and managerial capabilities of their personnel" (*ibid*. pp. 8-9). This proposal implies that Takahashi regarded major zaibatsu and banks as candidates for the job of corporate governance. As history eventually would reveal, his thinking had great relevance.

II. Zaibatsu as a System of Corporate Governance

Takahashi grounded the first alternative in the fact that management of companies affiliated to the major zaibatsu was relatively sound, compared to that of non-affiliated companies. This viewpoint, seeing zaibatsu from the perspective of corporate governance, is noteworthy, but it has not influenced the literature about zaibatsu. This is basically due to research on zaibatsu focusing on the "monopoly" aspect.

For Marxist economists, who have been prominent in research on zaibatsu, it was almost self-evident that zaibatsu represented "monopoly capital." Also, the U.S. occupation authorities, which led the reforms after the Second World War, regarded zaibatsu as "large Japanese industrial and banking combines or other large concentrations of private business control," and therefore entities to be dissolved.[2] Indeed, in discussions about lifting the ban on holding companies in the 1990s, even those who were positive about such a move negatively evaluated the zaibatsu's pre-war role

[2]SWNCC, "Basic Directive for Post-Surrender Military Government in Japan Proper." (Financial History Section, Ministry of Finance 1982, p. 170).

(*The Small Committee for Basic Issues*, The Industrial Structure Council 1993). Williamson (1985) classified the literature on organizations and institutions into the "efficiency approach" and the "monopoly approach" (pp. 22-9). Using this framework, we can say that most of the literature on zaibatsu has been based on the monopoly approach. On the other hand, Takahashi (1930) was a pioneer of zaibatsu research based on the efficiency approach.

Reviewing the history of zaibatsu from the efficiency perspective, we find that it is replete with efforts to deal with agency problems, particularly those relating to corporate governance. Organizational reforms of zaibatsu for governing businesses can be traced back to the Tokugawa Era. Mitsui, which became the largest zaibatsu after the Meiji Restoration, had already diversified its businesses into kimono retailing and banking during the Tokugawa Era. Also, each of these businesses was carried on by a number of branches located in outlying areas (Yasuoka 1979, p. 68). The Mitsui family proprietors found it difficult to ensure that those branches were managed in accordance with their interests. In other words, they were faced with an agency problem.

To cope with the agency problem, Mitsui in the early 18*th* century established in Kyoto an institution called *Omotokata*. Every year, *Omotokata* would entrust a certain amount of capital to each branch, which invested it on behalf of the business. From the profit earned, each branch returned a fixed sum of money (*kudoku*) to *Omotokata*, 10% of the remaining profit was distributed among employees of the branch, and 90% reserved at the branch. While the branch manager had discretion in utilizing the funds, *Omotokata* administered his personal performance (Mitsui Bunko 1980, pp. 96-102). The efficiency of each branch was measured according to the amount of capital provided and the profit earned, and used to evaluate the branch manager. Thus, an incentive scheme for each branch to enhance its efficiency was built into this system. The organizational structure and the incentive system resembled the multi-divisional organization of the modern corporation.

After the Meiji Restoration, wealthy families, including Mitsui and Iwasaki (Mitsubishi), diversified their businesses into various modern industries, and thereby grew to become zaibatsu. Meanwhile, not only did the number of businesses increase, but also the scale of each business was expanded, and more complex technologies came to be utilized. These changes exacerbated the agency problem. In order to resolve the problem, major zaibatsu carried out organizational reforms. They established holding companies and made their businesses independent joint-stock companies, whose stocks were mainly owned by the holding companies.

The holding company of a zaibatsu not only held the stocks of the affiliated companies, it also had several devices to monitor them. Corporatization of the businesses in itself implied easier assessment of their performances. In many cases, holding companies assigned staff members to the affiliated companies as directors. With respect to Mitsui and Mitsubishi, every decision made in board meetings of affiliated companies had to be approved by the holding company *ex ante*. In addition, with respect to Mitsubishi, the budget and settlement of the accounts of the affiliated companies were approved by the holding company *ex ante*. On the other hand, the holding company had an internal organization for monitoring the affiliated companies. Mitsui Holdings had the Inspection Section, which examined the reports filed by auditors of the affiliated companies. And, Mitsubishi Holdings had the Monitoring Section, which was responsible for auditing the accounts and businesses of the affiliated companies.

How effective were those monitoring systems? This is a question to be tested empirically. Here, I would like to show the result of a regression analysis in Okazaki (2001). The samples are 135 firms whose paid-in capital in 1936-7 was greater than one million yen, and whose financial data from 1921 to 1936 are available. Of these, we can identify 30 zaibatsu-affiliated firms, according to classification by the Holding Company Liquidation Committee (1951). I pooled the data from 1921 to 1936 to arrive at 2,025 observations. Then, I regressed the return on equity (ROE) to paid-in capital, industry dummies, year dummies and a dummy variable capturing zaibatsu-affiliated firms (ZAIBATSU).[3] The result is reported in Table 1. As the coefficient of ZAIBATSU indicates, the ROE of the zaibatsu firms was 3.651% points higher than that of non-zaibatsu firms, on average. The difference in ROE between zaibatsu and non-zaibatsu firms is substantial, and the result is statistically significant.

[3]Here, we include nine major zaibatsu: Mitsui, Mitsubishi, Sumitomo, Yasuda, Asano, Nissan, Furukawa, Okura, and Nomura.

TABLE 1
REGRESSION ANALYSIS OF ROE

	(1)		(2)		(3)	
Constant	10.559	(7.001)***	4.310	(1.693)*	4.169	(1.589)
CAPITAL	-0.019	(-1.876)*	-0.025	(-2.490)**	-0.003	(-2.499)**
ZAIBATSU	-0.233	(-0.257)	3.651	(3.125)***	3.836	(2.682)***
ZAIBATSU*HCI					-0.558	(-0.224)
INDUSTRY						
Finance			2.386	(1.040)	2.476	(1.062)
Mining			2.125	(0.774)	2.503	(0.776)
Metal			-0.717	(-0.249)	-0.288	(-0.083)
Machinery			2.194	(0.923)	2.534	(0.899)
Chemical			5.919	(2.231)**	6.007	(2.239)**
Paper			11.635	(2.410)**	11.794	(2.416)**
Ceramics			5.846	(1.864)*	5.872	(1.871)*
Textile			8.966	(3.697)***	9.115	(3.612)***
Food			10.384	(3.957)***	10.535	(3.888)***
Electlicity and Gas			8.392	(3.692)***	8.54	(3.608)***
Land Transportation			5.532	(2.373)**	5.681	(2.343)**
Shipping			0.904	(0.321)	1.019	(0.356)
Commerce			5.417	(1.985)**	5.458	(1.995)**
ad-R^2	0.0099		0.0311			

Notes: 1) Each equation includes year dummies, but not reported.
2) *t*-values in parentheses.
3) *** Significant at 1% level.
** Significant at 5% level.
* Significant at 10% level.
4) HCI refers to the dummy variable which equals 1, if a company was in the heavy and chemical industries (metal, machinery and chemical), and 0, otherwise.

This result suggests that zaibatsu holding companies effectively governed the affiliated companies to ensure that they maintained high profitability. There might be an alternative interpretation that the high profitability of zaibatsu firms reflects their monopoly powers. However, because we controlled for industry dummies here, at least if we focus on the effect of a monopoly in raising market prices, this alternative interpretation does not hold, because the effect of the raised market prices was exerted on all of the firms in the same market.

It is noteworthy that the monitoring function of the zaibatsu holding company worked not only inside the zaibatsu group, but also affected companies outside the group. In the 1920s and early 1930s, during a prolonged depression, zaibatsu actively took over poorly performing companies, and assigned directors to restructure them. In other words, zaibatsu contributed to resolving problems attributable to weakness in the system of corporate governance. Interestingly, Gisuke Ayukawa, founder of the Nissan zaibatsu, likened the corporate restructuring function of Nissan to the function of a gardener. In his analogy, Nissan bought various seeds and young plants, and raised them by letting them bathe in the sun, and by supplying water and fertilizer. If the plantings bore flowers and fruit, Nissan distributed these to its shareholders. And, if a rare tree or a potentially good plant stagnating in the shade were identified, Nissan bought it cheaply for cultivation by changing soils and grooming. Furthermore, it possessed the skill of grafting to enable plum flowers to blossom on a peach tree. (Ayukawa 1937, pp. 165-6).

Let me illustrate the restructuring function of zaibatsu, using the example of Nippon Flour Mills (Okazaki 2001). Nippon Flour Mills, established in 1896, was a major player in the flour industry, along with Nisshin Flour Milling. In the early 1920s, Nippon Flour Mills developed a relationship with Suzuki Shoten, a major trading company, which had flourished during World War I. As its financial situation worsened, the company became dependent on Suzuki. In 1922, Suzuki became the major shareholder with a 13.1% holding.

In the 1920s, the return on equity (ROE) of Nippon Flour Mills was around 10%, but this was lower than the average return for the overall food industry and that of Nisshin Flour Milling, another major flour company. Furthermore, failure of wheat speculation in 1924 adversely affected Nippon Flour Mills' business. To address this situation, the company entered into a merger contract with Nisshin Flour Milling in October 1926, but shortly afterward Nisshin refused to merge, on the grounds that Nippon Flour Mills' debt was larger than expected. The stock price of Nippon Flour Mills fell from 54.0 yen in October 1926 to 13.4 yen in January 1927. Also, it became difficult to have Nippon Flour Mills' bills discounted.

In response to a petition by Suzuki, Taiwan Bank, a semi- public bank that had a close relationship with Suzuki, provided a rescue loan. Nippon Flour Mills reduced its capital by 75% to clear the deficit, then increased the capital again to cover its debt to Suzuki. This process resulted in Suzuki's stockholding rising to 72.8%. At the same time, Komakichi Kubota, head of Suzuki's Tokyo branch, was installed as president of Nippon Flour Mills, and two directors were assigned from Suzuki and Taiwan Bank. Nippon Flour Mills embarked on a restructuring exercise under the control of Suzuki and Taiwan Bank.

However, almost immediately, the 1927 financial crisis sent both Suzuki and Taiwan Bank bankrupt, and the restructuring scheme for Nippon Flour Mills collapsed. In response, Nippon Flour Mills sought help from Mitsui & Co. (Mitsui Bussan), with which it had a trade connection. In March 1928, a new board of directors was installed, with Yunosuke Yasukawa, executive director of Mitsui & Co., as chairman. Five of the seven directors were affiliated to Mitsui & Co., including chairman Yasukawa and executive director Toichi Nakamura. The shares in Nippon Flour Mills held by Taiwan Bank were bought by Mitsui & Co. for 25 yen each. Consequently, Mitsui & Co. became the dominant shareholder with over 60% of the stock.

Under the control of Mitsui & Co., Nippon Flour Mills reformed its organization, concentrating power in the head office, which assumed control of procurement, marketing and finance for the whole company. Also, the head office system for monitoring branches was reinforced. Following acquisition by Mitsui & Co., the performance of Nippon Flour Mills improved sharply. In 1929, ROE surpassed the average for the food industry, and in 1932 it overtook that of Nisshin Flour Milling. The stock price also rose substantially. Using 76.3 yen as at 1935 as a benchmark, it is calculated that the 48,000 shares Mitsui & Co. bought in 1928 achieved a capital gain of 2,460 thousand yen.

The role of zaibatsu in takeovers and corporate restructuring is worth emphasizing in the following sense: Neoclassical economics sets high store by the role of capital market in corporate governance. The stock price of a poorly performing company declines, which increases the probability of a takeover. Actual and potential takeovers help to make a company more efficient. However, as Williamson (1975) stressed, for this mechanism to works effectively there need to be potential takeover raiders able to evaluate and take over the poorly performing businesses. Williamson believed that M-form companies were raider candidates. In pre-war Japan, zaibatsu with holding companies fulfilled this role. Zaibatsu not only built the internal capital market, but also enhanced the efficiency of the external capital market (Okazaki 2001).

TABLE 2

PERFORMANCE OF NIHON FLOUR MILLS

	Paid-in capital	ROE	Difference from the average of the foods industry	Difference from the average of Nisshin Flour Milling	Stock price	Stock price of Nisshin Flour Milling
	thousand yen	%/year	%/year	%/year	yen	yen
1922	5,625	10.0	-2.7	-11.0	42.7	85.6
1923	6,810	9.2	-7.8	-9.1	40.7	101.8
1924	8,296	13.3	-6.7	-11.8	44.0	99.8
1925	8,390	12.6	-2.9	-8.4	53.6	104.3
1926	10,720	-76.2	-90.6	-91.3	47.8	99.3
1927	11,075	-154.1	-170.5	-168.5	12.7	91.5
1928	11,075	0.5	-1.8	-14.5	...	103.2
1929	3,938	7.6	0.1	-7.7	55.5	88.8
1930	3,938	9.7	3.3	-3.6	40.3	75.5
1931	3,938	11.0	5.7	-0.9	41.9	79.1
1932	3,938	20.2	9.5	8.6	59.0	85.6
1933	3,938	25.2	11.5	12.1	71.2	83.2
1934	5,953	13.1	-2.2	1.0	69.2	78.7
1935	7,969	17.7	-0.1	2.3	76.3	76.8
1936	7,969	15.5	-3.4	0.6	71.6	81.7

Note: The shadow denotes the year of acquisition.

III. The War Economy: Choosing a Fork in the Road

What has occurred in the Japanese corporate sector since the 1920s implies that the system of corporate governance actually started to proceed in the first direction, suggested by Takahashi (1930). While the system centered on individual shareholders no longer worked well, a new system based on zaibatsu holding companies was emerging. However, this process suddenly ceased, and the system of corporate governance began to proceed in the alternative direction, *i.e.*, toward a system based on banks. As I discussed in several earlier papers, the incentive for a change of direction in the system of corporate governance was the experiences of the Second World War (Okazaki 1994, 1997, 1999a).

In order to prosecute the war, the government implemented a number of strong measures that had not been available in peacetime. These measures altered the constraints on private companies, and thereby changed their behavior. The changes transformed the corporate system in Japan. Effects of the war economy on the evolution of the corporate governance system were twofold: It impeded the first alternative (zaibatsu holding companies-based system), and simultaneously promoted the second alternative (bank-based system).

During the war, the system of corporate governance wherein shareholders commanded significant power conflicted with management of the war economy with respect to income distribution and productivity incentives. As a result, the government criticized the conventional view of companies being centered on shareholder sovereignty, and promoted the alternative view that management should be separated from capital, and that a company was an organic entity comprising shareholders, managers and employees. In reality, dividends were regulated, and the link between the executive bonus and corporate profit was severed by regulations on the executive bonus. Finally, in 1943 the *Munitions Corporation Law* restricted the rights of shareholders as prescribed in the Commercial Code, and protected the positions of corporate executives against the shareholders. While the power of the shareholders was restricted, many employees were promoted to directorships.

These reforms had a significant influence on the financial system. Restriction of the powers of shareholders reduced incentives for investors in the capital market, which in turn resulted in market contraction. Meanwhile, the government urgently needed to expand the production capacities of the munitions industries. Therefore, it promoted an alternative system for corporate finance, namely, indirect finance through banks.

However, major banks, seeking to avoid risk, were not enthusiastic about providing large loans to a limited number of companies. So, the government introduced the following new method of indirect finance: The Industrial Bank of Japan (IBJ), which was a semi-public bank and had expertise in industrial finance, joined with leading private banks to establish an organization for offering syndicate loans, *Jikyoku Kyodo Yushidan* (Emergency Joint Lending Group). A company wishing to raise funds would apply to one of the Group's branches. The IBJ and the bank that was already a major lender to the applicant company, would jointly examine the application. Then, based on the examination, a syndicate loan was organized by the member banks of the Group (Teranishi 1999). This system was superseded in 1942 by the system of syndicate loans mediated by *Zenkoku Kin'yu Toseikai* (the National Finance Control Association), which was led by the Bank of Japan. While syndicate loans enabled banks to diversify credit risk, delegated monitoring contributed to maintaining the ability to oversee their performance. Corresponding to the increasing role of banks in corporate finance, major banks from 1941 progressively introduced credit analysis sections, separate from their loan sections, since 1941. This series of events suggest that a new system of corporate finance, centered on banks, emerged, substituting for the capital market, which had played the major role before the war.

Policies in the latter stages of the war had a further impact on the financial system. In 1944, the government designated a specific bank for each munitions company, and *de facto* obliged the bank to provide loans on request (Designated Financial Institution System). At the same time, the profitability and security of the munitions companies were protected by the government through price control with subsidies. These policies altered the attitudes of banks that had not been keen to concentrate loans with a small number of companies. Major banks competed to be the designated banks of munitions companies, and supplied massive amounts of funds to those companies (Okazaki 1999a, 1999b).

What impact did the post-war reforms by the U.S. occupation authorities have on the evolution of the system of corporate governance? The reform action directly related to corporate governance was dissolution of zaibatsu. As stated above, the occupation authorities, regarding zaibatsu as monopoly capital, totally dissolved them. The holding companies were liquidated, and, in order to preserve the effects of the reform, an article banning holding company was inserted into the Antitrust Law in 1947.

Dissolution of zaibatsu and the ban on holding companies destroyed the organizational basis of corporate governance that had worked and was developing in the pre-war period. Numerous small shareholders, who emerged as a result of the zaibatsu dissolution, had neither incentive nor ability to monitor companies. On the other hand, banks, alternative candidates for governance of companies, not only had accumulated know-how in corporate governance and finance during the war, but had also become deeply committed to certain companies through the provision of massive loans under the Designated Financial Institution System.

Most of the loans carried over from wartime to the post-war period became non-performing, because the government canceled payments to the munitions corporations, on the instructions of the occupation authorities. In order to dispose of these non-performing loans and restructure the balance sheets of banks and companies, the Emergency Measures on *Corporate Accounting Law*, *Corporation Reconstruction Law*, and *Financial Institution Reconstruction Law* were enacted in 1946. Under these laws, banks took control of the companies for which they had worked as designated financial institutions, for the purpose of restructuring those businesses.

Separating existing non-performing loans from the accounts of those companies, the banks provided new funding to the companies by way of syndicate loans. If a company needed a loan, the bank that had the closest relationship with the company examined the loan application, and then asked the Bank of Japan (BOJ) to mediate a syndicate loan with other banks. Through mediation by the BOJ, a network of delegated monitoring was created (Okazaki 1996).

The governance function of the banks worked most dramatically in the process whereby the Japanese economy transitioned to a market economy, after 1949. Before that time, most companies were overstaffed as a result of labor union pressure of labor unions, and of soft budget constraints, due to government controls and subsidies. When government controls were removed and soft budget constraints disappeared, the banks participating in the syndicate loans actively intervened with corporate management to reduce overstaffing. The fact that banks, rather than shareholders, took the initiative when companies ran into problems indicates that banks had greater incentive and ability to govern businesses. It can be interpreted as a natural selection of mechanisms of corporate governance (Okazaki 2004). It is well known that the function of corporate governance has been carried out by main banks in post-war Japan (Aoki and Patrick 1994). The system of corporate governance characterizing post-war Japan can be viewed as an historical consequence of the divergence that appeared during the Second World War.

IV. Institutional Complementarity and Path Dependence

The changes in corporate governance and finance were complemented with changes in other facets of the economy, particularly in the employment system. From 1936, the employment system faced serious problems, including a shortage of skilled workers, active inter-company transfer of workers and labor disputes. In order to increase the supply of skilled workers, the Factory and Establishment Skilled Workers Training Act in 1939 obliged large factories to offer three years' training to a certain number of young workers. It is noteworthy that the Act set forth the attributes skilled workers were expected to acquire. They were not specialized workers but multi-skilled workers, and were expected to perform their work efficiently without supervision. Thus, the skilled workforce that the government aimed to foster was similar to the workers with "intellectual skills" in today's Japan (Koike 1994). Toyota Automobile Co., in 1939 launched a three-year training course in accordance with the *Factory and Establishment Skilled Workers Training Act*. Toyota (1958, pp. 213-4) wrote, "we had as many regular trainees as the Act prescribed, and other newcomers were given training of two to three months' duration. This practice continued until the end of the war."

In order to maintain the incentive for companies to train employees, it was necessary to restrict inter-company transfers of workers. Therefore, the government suppressed inter-company transfers of skilled male workers by means of the *Employment Restriction Act* in 1939, and the *Workers Transfer Restriction Act* in 1940. However, this policy produced an unintended side effect. The restriction of inter-company transfers deprived workers of an option for resolving grievances against the firm. That is, they could not resolve their grievances by way of "exits" from the company. As a result, their grievances accumulated within the company, which in turn sparked active labor disputes. It was necessary to introduce an alternative mechanism for resolving workers' grievances. This was *sangyo hokokukai* (*sanpo*, industrial patriotic society) established in each factory in accordance with government guidelines. The major function of *sanpo* was to organize committees, comprising all employees and managers for discussion of such issues as labor conditions and productivity. We can interpret *sanpo* as a mechanism for providing a "voice" to workers who had lost the option of "exits." Actually, prefecture level data confirm that the proportion of *sanpo* members among total workers was negatively associated with the proportion of participants in labor disputes. It was also found that *sanpo* enhanced the productivity of the business (Okazaki 2003).

The influence of restrictions on labor transfers ranged further. The restrictions necessitated introduction of a mechanism to determine wages that was alternative to the market mechanism. In 1939, wage control was introduced, initially as regulation of the wages of unskilled workers. In 1942, the government replaced direct wage controls with a system of approving the internal wage regimes of individual companies. The government provided guidelines for companies to develop their own internal promotion rules, and to give all employees an annual raise. This measure led to proliferation of wage seniority structures among companies (Odaka 1999).

How was production organized on the shop floor during the war? Aoki (1996) proposed a hypothesis that severe wartime conditions, such as shortages of labor, capital and raw materials, required workers on the shop floor to take appropriate steps according to their own judgment, which led to ambiguous job demarcation and team-oriented shop floor organization. This hypothesis is consistent with actual production management practice during the war. In aircraft manufacturing, the largest wartime industry, a production management system called *suishinko* (propelling warehouse) method was introduced. This involved organizing the shop floor on the basis of units called *suishinko*, which were entrusted with considerable authority in production management. The background to this decentralized management system was that the existing method, whereby the central management unit hierarchically controlled production, could not respond to frequent design changes (Wada 1996, pp. 102-5). Just as the planning system of the national economy was decentralized in the latter stages of the war (Okazaki 1997), shop floor management was also decentralized.

The shop floor situation described above was dependent on workers being multi-skilled. In fact, a 1942 survey by the Japan Society for the Promotion of Science revealed that workers were capable of moving between tasks to compensate vacancies on the shop floor. One factory reported that it had workers with the skills to handle more than two jobs.[4] Blue-collar workers arguably closed the gap with white-collar employees in the sense that they had intellectual skills (Koike 1994). Conversely, white-collar engineers needed to have detailed knowledge of the shop floor, in order to be able to adjust designs to suit actual production conditions.

Those wartime experiences gave a path-dependent characteristic to the evolution of the corporate system in the post-war period. Following enactment of the Labor Union Law in 1945, labor unions proliferated rapidly. Although the Law did not prescribe what form a labor union should take, most unions were organized by establishment or by company, and included white-collar employees as well as blue-collar workers. It is hard to explain this phenomenon without taking into account wartime experiences. First, employees were familiar with the organization for "voice," comprising both white-and blue-collar workers, through the experience of *sanpo*. Second, they shared a common interest. Not only white-collar employees, but also blue-collar workers had firm-specific skills, as a result of various experiences during the war, when they were locked into their companies, and received training inside those companies. Using the legal framework provided by the occupation authorities, they set up organizations to protect

[4]The Sixteenth Special Committee for the Improvement of Industries, Department of Science, Japan Society for the Promotion of Science, "Research on the Conveyor System in Japan and Application of its Principles," in Okuda and Sasaki (1997).

their company-specific assets.

Many of the companies that were restructured through interventions by banks grew rapidly in the 1950s and 1960s. During this process, the Japanese economy periodically faced tightening of monetary policy, due to the current account deficit. Firms weathered the tight-money conditions with supported from the banks, which resulted in bank-company relationships becoming closer. Loan syndicates, which initially had been explicit, came to be implicit by the early 1960s (Okazaki 1996, pp. 51-2). Meanwhile, companies were cautious about recruiting new employees, because the labor unions strongly resisted employment adjustment in the early 1950s. This caused companies to operate short-handed, which, in turn, necessitated fostering workers with multiple skills, and making job demarcation ambiguous (Fujimoto 1996, pp. 259-363).

Developments in the systems of corporate finance and governance, and in the employment system, complemented each other. On one hand, the fact that a company's competitiveness flowed from the intangible firm-specific skills of employees, made the bank-company relationship more advantageous than the arms-length system of corporate finance. On the other hand, it was difficult for a company to commit to long-term employment without having a long-term financial relationship.

V. Concluding Remarks: The 1990s, Another Bifurcation?

When we look at the Japanese economy in the 1990s, keeping in mind the history described above, we find that at least two significant events occurred during this period, the financial crisis and lifting of the ban on holding companies. First, while the financial crisis was caused by the decline of banks' monitoring capabilities, it weakened the capabilities of banks even further. Second, the holding company system has proven to be able to work, due to revision of the Antitrust Law in 1997. These events suggest that the system of corporate governance in Japan has been faced with a bifurcation, just as it was in the 1920s. If so, will the system in Japan converge with the U.S. type? I want to conclude this paper with a couple of remarks.

There remains the problem of how to govern the holding company itself. In pre-war zaibatsu, while the holding company governed the affiliated companies, the holding company was governed by the owners, the zaibatsu family. It has not yet been clarified who will govern the holding company in present-day Japan. Finally, path dependence and institutional complementarity will, arguably, still work. Firm-specific skills are still the source of competitiveness of the Japanese industries, particularly the manufacturing industries. Any system of corporate governance that compromises this source will not be able to proliferate. This is because those firms governed by that system will decline, which, in turn, will damage the system itself. In other words, "natural selection" mechanism will work to preserve the path-dependent nature of the Japanese system (Okazaki 2004).

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