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Restoring Stakeholder Trust – Lessons from Japan's Consensus Capitalism

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(summary)

What capitalisms are there? What kind of capitalism is best (and will it prevail)? What objectives should ultimately drive a company?

These questions arise in wake of the financial meltdown, which has revived a public debate about government's role in business, reflecting a pattern of institutional changes affecting industrial societies in recent decades - ideological oscillations between "welfare" (i.e. Japanese) and "stock-market capitalism" (i.e. Anglo-Saxon).

My discourse revolves around the notion of what a company is/should be, in a world struggling with the heritage of unrestrained market fundamentalism, i.e. "marketization plus finacialization", "shareturner" dominance, distrust of business, alienation of government, wealth disparities, and lost stakeholder dignity.

With changing opinions on deregulation, finance, management time horizons, and executive roles, shareholder capitalism no longer resonates within organizations, which realize, they function best when fairness becomes an instinctive priority - when committed people work in cooperative relationships based on respect, rather than competitive, adversarial patterns promoting reckless behaviors (nurtured by Anglo-Saxon short-term thinking) that harm the long-term health of whole economies.
This becomes paramount in an age of knowledge work, outsourcing, global supply chains, and activist interest groups, with stock price appreciations being - in the end - an outcome of management practices that embrace ALL stakeholders.

With its penchant for state intervention and industrial policy, Japan's capitalist model has proven to be effective in times of organizational turmoil, where public trust in government and business has to be restored. Workforce commitment (thru lifelong employment), supplier commitment (thru mutually obligating trading liaisons), clever organizational forms (thru patient, long-term capital), and a ubiquitous spirit of compromise, inspire Japanese corporations to contribute to the common good, giving a perfect example for Anglo-Saxon firms, which face an imminent ideological shift to a stakeholder-focused economy.

What follows for Anglo-Saxons, is learning how to respond appropriately to government initiatives, and participate in the progress of the global community towards a society, which

measures its welfare using more pluralistic criteria than stock price.

What follows for Japan, is advancing a concerted effort of institutional convergence of East Asian nations on components of its unique welfare capitalism, by demonstrating, i.a. that Japanese companies can be successful by embracing stakeholders first, and regarding business as a respectable pursuit that provides social goods. Developmentalism, *sanmi-ittai* and *keizai kyoryoku,* all set the necessary contexts for an emerging East Asian community, united by macroeconomic policy, governance, business philosophy, trade, investment, and (ultimately) single currency.

(full text)

Restoring Stakeholder Trust – Lessons from Japan's Consensus Capitalism

My quest for a compelling recommendation about Japan's role in tackling the defects of Anglo-Saxon capitalism in wake of the economic meltdown begins with a travel back in time, to shed light on the ideological paradigms shaping the geopolitical landscape during the last decades.

What capitalisms are there? What kind of capitalism is best (and will it prevail)? What objectives should ultimately drive a company?

These incredibly complex matters stand at the heart of the problem, and history shows us - in spite of numerous demagogues from opposing camps, who claim otherwise - that the right answers are anything but easy to find. Nevertheless, the solutions will leave a lasting impact on the very notion of what a company is/should be in a world fuelled by globalization and knowledge economies.

This essay attempts to address all these issues, and as the author, I invite you on a journey to rediscover patterns of gradual change common to all industrial societies, which have ultimately led to a phenomenon defined by Dore (2000, p. 3) as "marketization plus financialization".

The highlighted process must be seen within the historical context of repeated shifts of public trust in government and business (or stakeholder-favoring vs. shareholder-favoring firm).
To begin with, in the US of the 1950/60s the stakeholder was king, and the CEO's job - as industrial statesmen under an ascending government - was to maintain a sound balance among the interests of all constituents essential for organizational success: customers, employees, suppliers, shareholders, and the society at large.

Meanwhile, Japan and Germany were building institutional frameworks that were suitable for reconstruction after WWII, giving raise to Japanese developmentalism and the German consensus economy, which until today unite these two nations by the virtues of contrast and mutual defiance of the Anglo-Saxon model.

The latter emerged in the 1970s, when the US was suffering from an inflationary, over-regulated environment that undermined growth, as opposed to the concurrent Japanese and German economic miracles. Under the stewardship of Reagan and Thatcher - who have successfully planted the seeds of neoliberal radicalisms, praising the virtues of superior efficiency and allocation inherent in competitive deregulated markets - public sentiment in the Anglo-Saxon nations moved against government's role in business.

Deregulation first?

By the 1990s, the tables have turned, and the Anglo-Saxon economies took off, while merely a decade ago, the Japanese way of governing business had been regarded as a promising model to be emulated by other nations. The reasons for this neoliberal resurgence can be seen in Japan's abrupt economic bubble deflation and West Germany's formidable task of rebuilding the East - domestic events which put a strain on these countries, triggering calls for institutional change and sparking a debate about a likely convergence of both capitalisms on the Anglo-Saxon liberal-market driven model.

Arguments, were derived from all the prospects, globalization entailed, i.e. international integration, technological innovation, unrestricted communication, making financial services, as Dore (2000, p. 3) claims "potentially the greatest of all export industries".

It seemed that the Anglo-Saxons have finally emerged victorious, as pundits were echoing that "firm's increased financial involvement with the foreign financial community, will undoubtedly be one further route on which the shift to Anglo-Saxon notions of economic rationality comes to permeate Japanese management" (Dore, 2000, p. 126).

Not yet…

Those anticipating an end of the debate about the best variant of capitalism, must have been extremely disappointed by the recent economic meltdown, which at its heart was an Anglo-Saxon offspring, nurtured by uncontained greed of "market-for-everything" fetishists and exported by the ubiquitous financial services industry to every corner of the world.

Consequently, the mood has shifted, and across the globe, governments are reshaping entire industries. Ironically, the intensity of state interventions is highest among the Anglo-Saxons, who - not long ago - have been eagerly dismissing it as a tool of the so much discredited socialism.

Clearly, the subprime crisis has taken some wind of the sails of the neo-liberal reformers, putting the spotlight on several trends, which are heralding the advent of Japanese style welfare capitalism, and setting the required institutional and environmental context for it to ultimately prevail in the long-term. To name two of them - deepening distrust of business, fuelled by scandals during the undisputed Anglo-Saxon reign (e.g. Enron), as well as increasing ties between the interests of government, business and society (now the public expects governments AND business to JOINTLY address pressing issues regarding energy, environment, technology, etc.).

As a direct outcome, we are currently witnessing a public and rightful questioning of core elements of Anglo-Saxon capitalism, more specifically its rationales for putting shareholder wealth ahead of creating value for other constituents, or stakeholders - in welfare capitalisms' nomenclature. Moreover, opinions on market deregulation, finance, management time horizons, and roles of corporate leaders are changing.

Such ideological realignment provokes shifts in organizational thinking; hence shareholder capitalism no longer resonates inside of companies. It doesn't engage the workforce in a way that sparks high performance. Similarly, business partners seek partnerships based on trust and long-term reciprocal commitment, while customers look for goods/services matching their quality and value expectations. This becomes paramount in an age of knowledge work, outsourcing, global supply chains, and activist interest groups, with the stock price, and share appreciations being, in the end, merely an outcome of management practices that embrace ALL stakeholders.

The embedded capitalism of the Japanese kind has historically proven to be extremely effective in times of organizational and institutional turmoil, where public trust in government and business has to be restored. In line with this, I argue that Japan's continuous efforts to humanize capitalism should be taken further and applied under a "better system for national coexistence" framework to the East Asian stage. In other words, it is time for Japan to take a stronger role in the process of building a new international order, replacing the United States as the principal leader in this hemisphere.

As a consequence of Japan's extensive *keizai kyoryoku*[1] with East Asia, many standard Japanese business practices have been transplanted and the regional economies are becoming increasingly intertwined. Besides formal bodies (e.g. ASEAN), the most important thread sewing them together is Japanese developmentalism, grounded in *sanmi-ittai* - a trinity of ODA[2], FDI[3], and trade.
Specifically, Japanese investments promote macroeconomic policies, intra-industry exchange and vertical integration, contributing to a regionalized cooperation network glued together by Japanese MNCs[4], shaped by a technology based division of labor and finally characterized by mutually reinforcing ties (between government/business/independent firms/management/labor).

As the region's innovative leader, Japan should advance this process of institutional convergence on components of its unique welfare capitalism, by demonstrating, i.a. that Japanese companies (driving progress in environmental technology and electronics in particular), can be successful by embracing stakeholders first and regarding business as a

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[1] Economic cooperation.
[2] Official Development Assistance.
[3] Foreign Direct Investment.
[4] Multinational Corporation.

respectable pursuit that provides social goods rather than "necessary evil"[5], as conceived of in the Anglo-Saxon world.

A useful foundation

At this point, the notion of developmentalism sets the stage to identify those peculiarities of Japan's cooperative capitalism, this nation should build on, in order to attain the aforementioned prominent goal. According to Hatch and Yamamura (1996, p. 193), developmentalism enabled Japan to realize its dream of becoming an *ittokoku*[6]. It has been a core policy under Japan's domestic political economy after WWII, when government allocated low cost capital to selected industries/firms to increase production capacity, technological efficiency, exports and promote consolidation into *keiretsu* networks. To attain international competitiveness, and conserve the *wa*[7] of social relations within a company, as well as between it and the environment, auspicious "administrative guidance" was applied.

With the salient feature of a penchant for state intervention and industrial policy, developmentalism stands at the heart of Japan's welfare corporatism. Its Confucian legacy surrounding the concepts of work, authority, loyalty and the employment relationship, evokes a "productivism" paradigm implying that "a culture geared to serving one's fellow-citizens by providing good and services - is more worthy than, ethically superior to, a culture geared to "mere" self-enrichment unlinked to any concern with the service or disservice one might be doing to one's fellow-citizens in the process." (Dore, 2000, p. 8). Moreover, it explains Japan's oscillation between being both receptive and resisting for Anglo-Saxon demands (i.e. the "global standards" argument) of converging on market fundamentalisms.

Thus, Japan's political elite has carefully selected those dynamic Anglo-Saxon aspects that were identified as suitable for adoption, giving rise to an institutional amalgam which was vital in Japan's economic resurgence after the 90s' bubble deflation, and enabled Japanese companies to: maintain close cooperation with employees yet concurrently flirt with shareholder value; remain committed to lifetime employment yet offer performance-based pay/share options; internationalize operations through FDI (i.e. replicating some Japanese practices) yet retain certain activities in Japan.

In wake of the current crisis, many ideological uncertainties about the distinctiveness of Japan's capitalism, and its adequacy as a viable global alternative to the Anglo-Saxon model have been verified, dismissed, and ultimately replaced by blatant defects of neoliberal market-fundamentalism.

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[5] In terms of bottom-line trade-offs.

[6] First class nation.

[7] Harmony.

Owners first?

In conformity with Friedman's opinion that social issues are peripheral to the challenges of corporate management: "So, the question is, do corporate executives, provided they stay within the law, have responsibilities in their business activities other than to make as much money for their stockholders as possible? And my answer to that is, no, they do not" (as cited in "Chemtech", 1974, p. 72), the Anglo-Saxons widely considered that the definitive purpose of business is maximizing owner value by selling goods and services.

This belief, which ultimately transformed the perception of managerial responsibilities in line with the neoliberal doctrine, is attributable to the aforementioned phenomenon of "marketization plus financialization". Accordingly, the concentration of stock ownership in insurance companies, investment trusts, compounded by growing competences of investment banks (e.g. to mobilize funds; exert direct influence on Boards; play a decisive role in takeovers), has made shareholders more powerful in the Anglo-Saxon world.

The ascendancy of shareholders translated into skyrocketing demands on capital returns placed on domestic industries, harnessing national economies by the stock market index as the ultimate measure of corporate success.

Intimidated by persuasive share price monitoring, hostile takeover threats, and alternative investment opportunities in high-yield emerging markets, corporate management became obsessed with not disappointing its shareholders. Effectively, an increasingly large portion of output was reserved for the owners of equity, many of them institutional investors, resembling more "shareturners" rather than "-holders" and pressuring Anglo-Saxon corporations to drive up short-term stock prices and dividends.

Still, firm's executives remain aligned with owner interests through stock-based compensation, and exposed to incentives of boosting individual financial rewards by taking excessive risks and manipulating share prices. What follows for management is to do best for the owners, which entails i.a. buying as much high-quality labor as required, as cheap as possible, and getting the best deal on raw materials. Others are reduced to fungible commodities - human resources are to be downsized at the drop of a share price, with dismissals restrained in their ruthlessness only by legal controls, and fear of negative reputational effects; worker unions are seen as directly opposing shareholders' interests; business partners are to be kept on a tight leash and subjected to constant market-testing.

Essentially, managers can justify practically any course of action by declaring it to be in the name of owners, even if it imposes great costs on remaining constituents, including society.

Not so fast...

In my opinion, this style of short-term thinking promotes mindless and reckless behaviors, nurtures competitive, adversarial patterns of communal relations, which harm the long-term health of companies and thus Anglo-Saxon economies, with a recent result most notably known as the subprime crisis that has brought the global economy to its knees.

How could it have come about, and how could it have spread to so many financial institutions? I argue that most entities involved were intent on driving up sales as quickly as possible to maximize their own financial rewards (e.g. boost stock price), irrespective the consequences.

By the same token the current predicament of US automaker's can be explained. GM, for instance, funneled billions of its profits to shareholders (as dividends and share buybacks), lining investors' pockets and neglecting crucial long-term reinvestments in capital improvements as well as R&D. Similarly, it failed to nurture a strong industrial commons with its supplier base, which was offered mainly short-term contracts based on price, and threatened with terminations in case of problems.

This discourse reveals one fundamentally wrong assumption, central to Anglo-Saxon capitalism – that short-term, return sensitive capital is the scarcest of all productive inputs, and a resource deserving the utmost attention. Labor, for instance, is taken for granted, as being available in abundant supply and equated with a mere commodity. Likewise, trading practices rest on a mobile, auction market based perception, with ruthless benchmarking applied for the sake of "a greater good" i.e. financial efficiency affecting stock performance.

Ironically, the same developments which have led to the ascendance of financial services (elevating the significance of owner's capital), make the before mentioned premise extremely easy to dismiss.
Specifically, in a world of globalizing markets - implying skill shortages arising from a progressively complex technology and increased mobility of ALL factors of production - motivated, competent employees as well as dedicated, loyal and relational trading partners, are far more of a scarce resource vulnerable to disillusions, than speculative "shareturners" who can funnel out their ownership share over-night in search for higher-yields on a different continent.

Essentially, the loss of stakeholder trust makes doing business significantly more difficult than a short term drop in stock price. It is my strong belief that a contentious environment entails for an individual company higher transaction costs, impairing an effective allocation of its labor, capital, and other resources. Organizations function best when fairness becomes an instinctive priority that is when committed people work in cooperative relationships based on mutual respect, rather than competitive, adversarial patterns, subjected to the market scrutiny of capricious "shareturners".

Rebuilding a sense of community

Within the context of the current economic meltdown, which has, in the words of China's premier, Wen Jiabao "fully exposed the existing international financial system and governance structure defects" (as cited in "HBR", 2009, p. 49), the strategic imperative for most Anglo-Saxon companies is to apply the utmost efforts aimed at rebuilding credibility among their stakeholders and to ultimately dispense with Friedman's opinion about businesses' primary objective.

A good place to start rethinking is one of the "Toyota Way" principles: "Base management decisions on a long-term philosophy, even at the expense of short-term financial goals" (as cited in Liker, 2004, p. 6).

In line with this, Japan's corporate capitalism does provide lessons for the Anglo-Saxon world in more than one fundamental aspect. Its institutional framework rooted in the before mentioned developmentalism, shapes and guides the course of the economy as a whole in the spirit of compromise and consensus. These two virtues - often quoted as the foundations of Anglo-Saxon democracies - are enshrined in the Japanese business world, and inspire corporations to contribute to the common good rather than to compete with it.

First, Japanese companies are seen as social organizations, providing cohesion for as Dore (2000, p. 10) argues "*sha-in*", the members of the enterprise community" - who join them early, with long-term commitments for a sustainable professional career. This clearly contradicts the Anglo-Saxon view of companies as money-making machines that can be freely bought, sold, merged and dissolved in order to maximize shareholder value.

Second, Japanese management is pursuing the tactic of retaining and reinvesting earnings, pouring profits into new product/skill development to expand the firm's market share. A large company in Japan is less likely to lay off employees or cut pension benefits, simply to lift its stock price or distribute higher dividends. This relative equanimity of Japanese managers to stock market performance, however, is partly explained by the consequent absence of takeovers due to cross-shareholdings and relational banking practices.

Third, Japanese companies can effectively discern the advantages of cooperation, which can be of mutual benefit for all constituents involved (even competitors) and are equally swift in devising organizational forms to maximize the benefits of such long-term relationships - with suppliers for instance, where not looking for a short-term horizon allows the latter to make people and capital investments for high-quality research, product development and operational expertise. This set of relational trading skills was undoubtedly nurtured in the last decades by the Japanese government which - thru its "administrative guidance" - has continuously assigned high importance to industrial associations, as well as investment, and (whenever necessary) recession cartels.

The striking features of Japanese cooperative capitalism, which emerge from this part, and should inspire Anglo-Saxon companies in their attempts to go beyond their opaque "corporate social responsibility" paradigms are: workforce commitment (thru lifelong rather than mobile employment relationships), supplier commitment (thru mutually obligating, cooperative trading relations rather than adversarial, auction style contracting patterns), and clever organizational forms (thru patient, long-term capital and a stakeholder mentality, rather than financial metric based estimations of shareholder value enhancement).

Perceiving government as a partner

I argue that the geopolitical importance of these salient trademarks of Japanese capitalism has been elevated to a new dimension by the financial meltdown, which has set precedents for government initiatives in the Anglo-Saxon world, and sparked a public debate about what government can/should do for next generations. The most pressing tasks at hand are to regenerate the ties between business and society addressing wealth disparities, and to provide comprehensive, viable solutions to both environmental as well as social challenges ranging from carbon emission reductions to demographic shifts affecting the labor market and pension schemes.

Therefore, current developments require a close and consistent liaison between government and business, which is indispensable for bringing the global economy back on track. Essentially, companies must work in tandem with official authorities, recognizing them as partners, rather than foes. Anglo-Saxon management must learn how to respond appropriately to government initiatives, identify its underlying motivations, acknowledge future implications, and finally participate in the progress of the global community towards a society, which measures its welfare using more pluralistic criteria than stock price.

Hence, institutional contexts must be reshaped in the Anglo-Saxon world, making an ideological shift to a stakeholder focused consensus economy imminent. What role-model serves better for this formidable task, than the Japanese amalgam of capitalism and social values?

Managing post-subprime

Plenty of lessons are to be drawn from the way Japanese businesses operate in a regulatory environment that promotes, rather than imposes desired behaviors, meeting public needs without constraining economic growth, innovation, and cooperation in the enterprise sector. Moreover, the success of corporate Japan on international scale will make its underlying capitalist model extremely seductive to other countries, and I argue that chances are high.

First, past downturns have brought about fundamental changes to industry structures, affecting the pecking order of entire sectors, and the current one is no exception from this rule, calling for less financial and more real engineering. Accordingly, technological innovation will substitute capital accumulation, as an engine of economic development. Therefore, the next economic expansion will be shaped by new energy technologies, nano-/biotechnology, and robotics, for instance.

Second, investors in the Anglo-Saxon world sought enhanced returns over the last two decades, turning to private equity, and hedge funds. Today, they are confronted with economic reality, vying for financially strong firms with a clear plan of using the downturn as a springboard to improve their competitive position. Hence, companies must recognize the forces behind industry change, gain and retain market share, and finally help governments in identifying where to direct its stimulus policies.

Many of Japan's (nonfinancial) corporations did manage to prosper during the last protracted downturn and may be relatively well positioned to cope with the current crisis.
A combination of asset restructuring, better revenue generation, and lower leverage led to considerably improved financial performance. Product/market portfolio reviews encouraged moves into Asian RDEs[8], where Japanese MNCs have integrated their local affiliates on a regional scale, investing in complementary production/assembly operations and using such networks as a platform for exports to developed US, European markets (not merely as a source of "reverse imports" to Japan).
A new division of labor between Japan and East Asia emerged, based on each nation's technological level, rather than its resource endowments.

Moreover, having mastered incremental rather than disruptive innovations[9] (e.g. hybrid and solar technology), Japanese manufacturing powerhouses will clearly benefit from the aforementioned change in industry structures, and are predestined to capitalize on their expertise in designing goods and services that enrich society. By serving as the region's leading businesses, Japan's corporations should strive - as powerful R&D machines - to develop new technologies that differ from existing commodities pushing the frontiers of global demand, and - as good corporate citizens - to promote constructive collaboration, creating employment, and social wealth both home and abroad.

Consequently, Japanese high-tech MNCs must progress in overseas production by replicating their domestic *keiretsu* networks, and harnessing affiliated Asian companies around the same principles of long-term mutual benefit, loyalty, obligation, as well as information, fund and risk sharing.
Embracing stakeholders in such a way will not only yield exceptional performance, but at the same time guard the competitive advantage grounded in technology against potential imitators

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[8] Rapidly Developing Economies.

[9] Reflecting a long-term management perspective.

(i.e. by placing discrete operations at different clusters throughout the region, so as to avoid full exposure of the entire production process). Those MNCs involved in service related industries, such as construction (e.g. airports, roads), need to develop a business model based on hiring and fully training local talent, to offer high value-added Japanese-style services at lower cost to Asia's ascending middle income group. Acquiring new global challengers from Asia's RDEs can serve as another means of market access, and an attractive opportunity, considering the pressures for consolidation, which many industries with overcapacity are now facing.

The Asian link

In line with this, the overarching strategic imperative for Japan rests in the creation of an East Asian community under *sanmi-ittai* and *keizai kyoryoku.*

Such comprehensive regional policy approach - extending beyond merely trade liberalization to assistance in institution building, development of legal systems, human resources, and supporting industries - will further desired institutional contexts in the respective nations, producing a fertile ground for the dissemination of selected virtues of Japanese corporate capitalism.

By accommodating local economic practices, fostered through Asian's shared Confucian legacy in this framework, Japan may be well positioned to assume a leading role in establishing a new structure for stable cooperation and security across the region, advancing a concerted effort of Asian countries towards a community, converging on macroeconomic policy, governance, business philosophy, trade, investment, and ultimately single currency.

A final advice…

As a nation whose intentions of being a good neighbor are clear, Japan must recognize an increasingly vital East Asia as its basic sphere of being, and spur political integration by coaxing local economies out of their actual, presumably comfortable inward-looking perspective. Here, refocusing regional attention on a joint effort to regenerate institutional ties around those non-economic values, which have been neglected by the unrestrained progress of Anglo-Saxon market fundamentalism, is a priority.

Japan's government should therefore work in conjunction with businesses, assigning to its major corporations (i.e. *shosha*) an ambassador role of promoting codes of conduct, best reflected in the traditional spirits of Sumitomo Corporation: "Respect for human resources", "Farsighted planning" and "Conformity of self-interest and altruism, of public and private affairs" (as cited in http://www.sumitomocorp.co.jp).

And a caveat…

As world's second-largest economy, Japan cannot afford to become isolated from geopolitical trends, marked by dominant free trade zones (e.g. EU, NAFTA, ASEAN), and an increasingly powerful China.

Without embarking on a foreign policy, centered on the aforementioned objective, Japan incurs the risk of turning into an economic backwater, with major economies instead focusing on China, as the region's advocate.

For many Asian nations (including Japan) such scenario would be pessimistic, at best.

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