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ACTA ASIATICA VARSOVIENSIA

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tel./fax: (+48) 22 635 99 37
www.askon.waw.pl
askon@askon.waw.pl

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TERUJI SUZUKI

Some Characteristics of Corporate Culture and Governance in Japan

Abstract

Corporate governance in Japan may be characterized as a harmonious model of management based on lifetime employment, a seniority wage system and a harmonious relationship between management and trade unions. However it is facing difficulties with more and more serious influences of “global standards”, namely an Anglo-American model of corporate governance.

Historically observed, the reasons of why corporate scandals often reported since the 1990s should be analyzed. Due to a strong position of management shareholders are relatively weak. Although a reform of corporate governance is requested by introducing the US model of corporate governance, the situation is complicated and it is not easy to reach a single conclusion because the ethical principles of management and the other stakeholders towards work and company involved in Japanese society are different from that of the West. Corporate culture has long been shaped by traditional Confucian ethics.

1. Debate on corporate governance in Japan

The notion of corporate governance became attractive as a way to gain control over the management of a corporation by stockholders in the 1990s. This was because most of individual stockholders demanded some reforms of the stock exchange system, which was vital to affect the recession of the market. The reform oriented criticism against the established system claimed to introduce the American type of corporate governance in Japan,¹ which were also debated between the governments as a problem of structural adjustment of socio-economic reforms in Japan since 1989.

Despite such a political climate, however, it was not easy to reach a common goal on a system of corporate governance.

2. Background of moral hazard

A Japanese corporation mainly in the form of joint stock company (the only form of a limited liability corporation due to the amendment of the Commercial Law in 2005) is formally established based on ideas on corporations historically shaped in Europe, and has long

¹ James C. Abegglen, *21st Century Japanese Management: New Systems, Lasting Values*, Tokyo: Palgrave Macmillan, 2004; Dennis C. Mueller, “The Anglo-Saxon Approach to Corporate Governance and its Applicability to Emerging Markets”, *Corporate Governance*, Vol. 14, No. 4, July 2006, p. 207.

sustained in its principle without any changes. However, it is true to say that although the formal institution was not changed, it has cultivated a unique corporate culture since its transplantation at the end of the 19th century. According to the law, despite the fact that legal institutions like general meetings of stockholders were established as the superior organ among other institutions within a corporation, management, namely the board of directors being subjected to the general meeting, has actually secured its stable and monopolistic position in making policy decisions and the execution of them in corporations.

Corporate activities were monitored by various institutions *de jure* (inside) such as the general meeting of stockholders, auditors, the board of directors but at the same time *de facto* (outside) organs such as collective “Mochiai” – a group of companies associated with cross holding of stocks and banks (the main banks) or groupings of corporations called as “Keiretsu” which are associated within production and technology development, and additionally, the authorities of the Stock Exchange, if they were listed there. Those all functioned till the end of the 1990’s. Therefore, corporate culture, which focused on stable management for a long time, could be characterized as a significant element of corporate culture in Japan until the 1980’s.

Why was the notion of the American form of corporate governance was forcibly introduced into Japan in the 1990’s? It is true to say that since corporate culture had thus traditionally been fairly well developed, the management was considering its moral responsibility relating to its business activities, at least to some extent. During the 1980s, it was then, called “corporation society”, which all stakeholders including managers, trade unions and other associated units were involved with it for this purpose.

Therefore, it was a opinion that there was no need to apply corporate governance of the US type to control the management.

However, as it has been told that since business people with tremendous success during the economic boom in the 1980’s were full of conceit in their behavior at that point, they inclined to lose foresight of their fair management, namely because of moral hazard. Coincidentally business scandals have often been reported since then. There have been several types of illegal performances reported since the 1980s. Many of them are related with accounting based on false reports, in particular on its bad debts due to business failures. Management tended to abuse their capacities and they could not maintain fair principles by concealing documents.

Then, a question of who could control such a false performance of the management?

3. The difference between Japanese corporations and the US model of corporate culture

American corporate culture was cultivated since its independence of the 18th century, followed by high economic growth. In particular, it was characterized by the “frontier spirit”, which is well known as ambitious and aggressive behavior in business, spiritually based on Protestantism. Contrary to that of Japan, which was cultivated after the long lasting feudal socio-economic environment, it was very much self-restrictive. In addition there were obvious differences between the two. In Japan it was shaped under the pressure of commands of feudal lords influenced by their religious culture of Confucianism inherited from patrimonial traditions. For example, modern corporate institutions such as “Zaibatsu”, which existed as a form of big family capital corporations before the war, were regulated by

not only official state law but also internal house laws. Based on them Zaibatsu's were shaped as modern form of holding corporations of a similar type to "komanditgesellschaft" or "ohne Handelsgesellschaft" in German law. While it is difficult to say to what extent traditional elements are included in them, it is a matter deeply depending on the socio-economic conditions of Japanese society. The problem indeed coincides with what a German sociologist Max Weber had once conceived and which was, then called "patrimonial piety" in the relationship of family and society in general.

According to his explanation the notion, "patrimonial piety" is a permanent loyalty to family relationships and so, a negative element for modern corporate culture, which is in principle based on contractual relationship of freedom and equality. However, in the case of Japan it has played a significant role as a specific form of a corporation.²

4. The process of transplantation of "Societe" or "Company" in Japan

When the capitalistic economic system was first introduced in Japan at the end of the 19th century (between 1870 and 1900's) capitalist business people emerged as leaders of the newly modernized Japan. Since no modernized merchant class of people (adequate term for "bourgeois" in the strict sense of the term) existed before, new leaders were created from the enlightened and ambitious samurai class of people (before the lower middle class but at least among educated people), so they could be called "merchant-samurai class". One of the pioneering leaders of business, Eiichi Shibusawa who belonged to this type of a leader, was first sent to Europe and shocked by the Western economic system of growth during his first stay as a member of the Shogun mission to France in 1867–1869. He was particularly impressed by "societe" as a legal entity of business in France. Soon after returning home he did indeed introduce it into Japan as a key institution of economic reform of the Meiji Restoration. According to his understanding a "societe" or "company" would play, (instead of the feudalistic private entity under the command system based on feudal lords) a dominant role in capitalist Japan. In addition, he noticed the fact that a new private entity should function as a social stabilizer and the core element of social development. He often stressed that the societe (company) should be introduced not only for profits gain by investors, but it should be treated as a social institution for a new era of Japan.³ Since then, when corporate issues were discussed in Japan, the notion of a corporation or company has always been understood as an entity associated with various functions in the society. Shibusawa had first started his carrier as deputy minister of finance, despite his background as a farmer business activist (quasi-samurai) related with the Shougun (politically opposite side of the Meiji Restoration Reform regime).

He, then, succeeded in establishing the first central bank of Japan. Soon after that success, however, he resigned from the official post in the government because he considered that capitalist Japan should first develop a private sector of economy which was more important than the public sector. He had willingly accepted proposals of private business circles for new business. Since then, he became an initiator and a

² Max Weber, Max Rheinstein (eds.), *Law in Economy and Society*, Harvard University Press, 1954.

³ Teruko Craig, *The Autobiography of Shibusawa Eiichi: from Peasant to Entrepreneur*, Tokyo: University of Tokyo Press, 1994.

founder of private corporations by establishing nearly 500 corporations in various fields of industry and finance, including the first private bank, “Daiichi Bank” (the first private Bank = “Mizuho” at the present). He was also interested in the social function of business professionals (not investors) who should be the main players in shaping of corporate culture in capitalist Japan. Then he took an initiative to establish the first Chamber, “the Japan Chamber of Commerce and Industries”, which he was elected for the first president and then, the presidency was kept for more than 30 years until 1931. Shibusawa’s propagation of business culture was known as moral management based on Confucius thoughts. One of the debated known as the Shibusawa vs. Iwasaki (the founder of the Mitsubishi Zaibatsu) debate at the end of 19th century, the two leaders discussed as follows; While Iwasaki emphasized on the dominant role of individual leadership in business decision making, particularly the relationship with government, on the other hand, Shibusawa insisted on the importance of collective decision making as the members of board of directors in a corporation, who have to be professionally trained in business as the agency theory explains.⁴ Since for him corporation had a social responsibility in the broadest sense, it was also important to promote the educational system, in particular by establishing a business school. Shibusawa took the initiative to open a business school supported by the government, the first business school in Japan (today, it is called Hitotsubashi University). His philosophy which was based on Confucianism often relied on some fragments of Confucius sayings, which were to some extent, similar to those of egalitarianism or stoicism in European philosophy, and claimed that business leaders should behave morally.

(It is very interesting question whether Shibusawa knew at that time about Adam Smith’s books, both “The Theory of Moral Sentiments”, published in 1759 and “An Inquiry into the Nature and Causes of the Wealth of Nations”, published in 1776, or not? His son-in-law, prof. Hozumi was one of the first law scholars who studied in the UK during the 1870’s and became the first dean of the faculty of law at the Imperial University of Tokyo in 1882. From him Shibusawa had fairly good information on the British literature.)⁵

However, Shibusawa emphasized moral sentiments based on Confucianism. For instance, it was often quoted by him as the Confucian wisdom that “the richer people should be acknowledged that they could dispose of their wealth as a result of the business success at the latest turn after the associated people all did enjoy”.⁶

Although the influence of Shibusawa was a decisive element in corporate culture before the war, in the 1930’s, after his death, many organizations and non-governmental associations influenced by his idea were gradually taken over by governmental agencies and consequently, their leaders became officials of the government because of the war time administration.

⁴ Taichi Sakaiya, *The Twelve Men Who Made Japan*, Tokyo: Kodansha, 2003, p. 174; There are many writings of Shibusawa on Confucian sayings (see: Shinnichi Sano, *Shibusawake sanndai*, Tokyo: Bungeishinnjuu, 2000).

⁵ Hozumi, Nobushige (1856–1926). Among his publications economic issues were also included. (Housouyawa and other works published between 1885–1892).

⁶ Masato Kimura, *Shibusawa Eiichi*, Tokyo: Chuo Koronsha, 1991; *The Collection of Works* written by Seien Shibusawa.

On the other hand, the strong Zaibatsu like Mitsubishi, Mitsui or the like became predominant in economy and collaborated with the government. Their characters were different from what Shibusawa emphasized on before.

5. Legal foundation

As far as institutional aspects are concerned, corporations in various forms were legally defined by civil and commercial codes at the end of the 19th century, which were greatly influenced by European laws. Principally similar to the notions of European model of corporations, for instance French and German corporations, the legal form of corporations was defined and the terms were included as a part of the modern commercial code of Japan, which was enacted at the end of the 19th century (1899). According to the laws it was possible to create business entities with various forms that could do business as natural persons. In addition, from the practical points of view, the notion of “limited liability” is significant since individual investors could take part in business activities of a corporation on their own risks. The legal principles of the created institutions have not been changed until recently, although some marginal amendments were introduced after the Second World War.

In a corporation (company) in particular in the case of a joint stock company similar to the German “aktiengesellschaft”, notions and functions of institutions such as stockholders, board of directors are precisely defined. Although stockholders as the owners of a corporation are legally superior to others and their function through general meetings. It is generally accepted that stockholders and management are in principle separated from each other (although it is needed to indicate that a new trend such as stock option practices in the USA, may change the relationship). However, stock option practice, which was introduced in Japan through US corporations operating in Japan is yet premature.

(The tax office authorities of Japan treat it as a part of personalized income like ordinary wages, but not a dividend.)

6. Fragmentation of ownership and decreased role of shareholders

The relationship between ownership and management was explained by the so called agency theory which considered the management was to function as an agent for the shareholders.⁷ According to the theory management acting as an agency for stockholders has to function within the capacities assigned to it by general meetings, namely for corporate interests as a whole. Put into a modern context it does not necessarily mean its exclusively for stockholders. When corporations were dominantly owned by private founders in the beginning the agency theory seemed adequate, but its ownership structure and social character has changed since then. (An average stockholders in practice tends to maintain his ownership in Japan for several months only). Besides, it is particularly important to see that the structure of ownership has changed in Japan since the 1950's in line with the rapid economic expansion. The capital structure of a corporation has changed not only through free transactions of stock (democratized and liberalized activities of the stock exchange), but also through mergers and large scaled

⁷ Magdalena Jerzemowska, Kevin Campbell, “The Limits of Agency Theory as a Framework for Analysis of Corporate Governance, Współczesne Problemy Analizy Ekonomicznej”, *Prace i Materiały Wydziału Zarządzania Uniwersytetu Gdańskiego*, Wydział Zarządzania Uniwersytetu Gdańskiego, Vol. 1, 2006, p. 153.

acquisitions. The structure of stockholders in most cases is then fragmented by large or small portions of shares. For instance, even in the case of the once family dominant corporation of “Panasonic” (Matsushita), the company, which was established as a small business with a small capital of Kounosuke Matsushita, with his personal shares (nearly 100%) in the beginning before, his share decreased dramatically by a successive increase of additional investment by issuing new stocks at the stock exchange and increase of number of the other investors with its fast capital demands path. After 70 years operations of the business Matsushita’s personal stock value tremendously increased, but his share decreased by nearly one percent of the total shares of the corporation.⁸ Consequently, it can be said that the character of a corporation has changed in its property structure from a personally owned corporation based on family property to that of the various and scattered individual owners or otherwise owned legal entities. From this point of view it may be correct to say that capitalism can be called as “people’s capitalism” because the fragmentation of shares was indeed seemed to say so. Taking the developing process into consideration, it can be said that corporate structure and its feature has been modified from what was called “corporation shared by ownership” to “that of management or the other stakeholder governed”. Therefore, if a stakeholder such as a management is once succeeded to be *de jure* nominated as a member of the board of directors by the general meeting of stockholders, authorized by the highest organ of a corporation, it could play a definite role in decision making and its execution of policies. Then, the strong management could *de facto* govern the corporation instead of stockholders. It was indeed a general trend in Japanese corporations until the 1990’s.

7. Social responsibility and gap between company law and practice

However, there was no adequate provision of commercial code adjusting such a situation, namely, a gap between formal law and the practical reality which needs to be regulated. The problem is in other words that some discrepancies between laws officially enacted and rules in function obviously had existed in business practice. Some criticized company law arguing that it became fictitious due to the fact that instead of the general meeting and management, that the board of directors will play the strongest role. In theory, management should be responsible only for the implementation of policies based on decisions and recommendations from the general meeting, but it is practically unrealistic to believe this because management is subjected to only the time of the general meeting, which is not a standing organ, but it summoned once or twice a year.

Besides, stockholders, who in the case of an exceptionally influential investor, usually large scale stockholders like some pension funds, tended to demand value up at the stock exchange, disregarding the other issues of the corporation. Indeed, there are other stakeholders, whose interests and demands are also inevitably important for the corporation.

Future plans such as Research and Development (R&D) projects, to sustain good human relationships between management and skilled workers are decisively important for long run policies.

Collective group investors have tended to claim higher dividends in short periods of time, in particular to ask for a dividend based on financial reports each quarter of the year.

⁸ Ajit Singh, Ann Zammit, *Corporate Governance, Crony Capitalism and Economic Crisis: Should the US Business Model replace the Asian way of “doing business”?*, ESRC Centre for Business Research, University of Cambridge, 2006.

It is an inevitable trend that management who is nominated by the general meeting of stockholders has, to a large extent been forced to accept such short sighted claims of stockholders.

In such circumstances a kind common ground between the management and stockholders has been shaped to sustain stock value at the stock market and balance of accounting and then, so called “crony capitalism” started.⁹

However, a corporation should not only be evaluated by its stock value on the stock market, in particular we need to take the social role into consideration, but also the other stakeholders stances. Some argue that a corporation has some social duties such as a social mission to sustain a good relationship with workers employed, associated corporations (Keiretsu and sub-contracted entities) and to have adequate investments for R&D based on long term policies of the corporation, which also influences the local economic development in the area, where the corporations factories are located.

There are two approaches to the problem; in the case of the American corporate governance, which is predominantly influenced by stockholders, the most important element for the management is stock-value. The other stakeholders views such as relationships with trade unions, future investment strategies are taken as a complimentary choice. Therefore, management is forced to provide a short sighted policy in order to increase the stock value. It is indeed the case of GM, for example. At a time of financial difficulties management tended to take a short sighted policy without alternatives in order to improve the stock value by saving of expenditure, for example, by laying off a large number of workers and by disregarding an investment budget of R&D for future technology.

Although there may be some criticism inside of a corporation, for instance between the R&D department and the general manager, the management in such a situation is reluctant to take another choice, namely a policy for future. Then it should concentrate on improving first of all financial conditions of the corporation in the short term and then, the plan for R&D investment is prolonged or treated as a secondary issue.

There is an additional tool for governance of management by introducing an “outside member of directors”, who have to check the decision making process of the executives in order to maintain objective and comprehensive views on management decision making, which originated from American business practice. However, “outside-directors” are usually persons chosen from good “friends or intimate people of the executives” and consequently, they are not always so strict and objective in monitoring corporate governance, which you can see in the case of the ENRON in the USA(2006), for example.

Such a short sighted decision of management is indeed a response to demands of speculative stockholders, who tend to appreciate the effectiveness of management that could quickly adjust stock market quotations indicated day by day such as Dow-Jones or NIKKEI, for example.

Although such a short term policy of the management may improve the stock value for a while, it is criticized by experts like Peter Drucker, who was once a consultant for GM.

⁹ When the ENRON case was disclosed and the ex. executives were sentenced as guilty, many people considered that without ethics in society, capitalism would fail. Even President Bush who has been intimate with the ENRON people, said that there is no capitalism without conscience. There is no wealth without character. (President George Bush).

According to his statement, the GM type of management, for example, would be continuously faced with a critical situation in the long run because of lack of future feasible strategy of management including technology development and so on.¹⁰

When we discuss the second alternative, we should consider the question of whether a corporation as a legal entity is only functioning for profits gained by stockholders or not? Furthermore, why are the other stakeholders, labor, R&D issues disregarded? When do we consider the modern role of a corporation at the age of civil society, what the other elements of a corporation are also vitally important for big corporations, in particular production corporations with employment of a huge number of workers, and many group firms associated as capital related or sub-contracted partners (Keiretsu)?¹¹

8. Corporate culture from “Zaibatsu” to “Mochiai” or “Keiretsu”

Corporate governance in Japan has been differently cultivated at different stages.

As mentioned above, some alternative ways were discussed in the pre-mature period of Japanese capitalism. However, then, the historical trends were interrupted by the state centralization policies during the war (1938–1945).

Most of the unique ways of management in Japan were fundamentally shaped in the post war period, partly encouraged by the liberalization and democratization policies of the Occupation Authorities. Then, under the 1955 socio-political system, which political scientists prefer to call a stable socio-political system, in particular between 1960–1980, not only in business circles but also labor unions integrated as centralized unions in the form of federation which have been shaped a balanced socio-political powers to the management associations.

With a strong recommendation for “democratization” by the Occupation Authorities “Zaibatsu” (a kind of holding company¹² was totally liquidated and no family controlling economic entities existed any more after the war). Besides, a large scale state procurement business after the liquidation of the state military industries was not possible.

It was also significant from the point of view of the domestic policy during the occupation period that a tight economic policy was applied to preserve a balanced economic development. No foreign capital investment was admitted by the government between 1950–1980’s.

Consequently because of shortage of capital almost naked corporations tended to integrate as groups of corporations called “Mochiai” by cross holdings of stock.

In the beginning it was based on the framework of ex-Zaibatsu group corporations. Cross holdings of stock had to be a marginal portion of stock of the other corporation because there were legal restrictions of the anti-monopoly law of 1947, which prevented one corporation from having influence on another, in particular financial institutions from hegemonic capital control over another company such as a holding company (Zaibatsu) before the war.¹³

¹⁰ Peter Drucker, *Concept of the Corporation*, New York, 1946 and 1993 Transaction Publishers; Reprint edition; R. J. Gilson, “Globalizing Corporate Governance: Convergence of Form or Function”, *American Journal of Comparative Law*, Vol. 49, No. 2, 2001, p. 329.

¹¹ Teruji Suzuki, “The Case of Japan’s Limited Pluralism. Some Premises for Understanding the Socio Economic Problems of Japan”, *International Review of Sociology*, No. 1, 1988, p. 143; Teruji Suzuki, “Przedsiębiorstwa w Japonii”, *Studia Prawnicze*, Vol. 1, 1990, p. 111.

¹² Shigeaki Yasuoka, *Zaibatsu no keieishi* (History of Zaibatsu), Tokyo: Nikkeishinsho, 1978.

¹³ *Ibidem*.

The first merit of Mochiai is to be granted financial privileges from the main bank, a member of the Mochiai,¹⁴ and the second, to protect management from surprise takeover from outsiders. Naturally after the establishment of Mochiai the managers should be directly or indirectly committed to take joint actions as a single group of corporations. A Mochiai member, in particular manufacturing corporation is, at the same time formulated as a group of Keiretsu. Strictly speaking there are two types of Keiretsu.¹⁵ For the purpose of financial cooperation Keiretsu based on friendly corporations of the former Zaibatsu is formed as a group of corporations of different branches like a bank, heavy industries, trade and services in parallel form.

Second, in the case of division of labor and specialization in a production system, “Keiretsu” which is one of the characteristics of the industrial production system in Japan, is usually shaped as a gigantic group of corporations, composed of technically specialized corporations. A Member of Keiretsu has to specialize in a definite part of production and then, the whole complete production in e.g. automobile industries has to be assembled by Keiretsu group corporations based on a precisely organized division of labor system (The main auto manufactures in Japan like Toyota have about 20–30% share in the total production. The other parts are manufactured by their Keiretsu). Therefore, Keiretsu is associated with various corporations different in scale and forms of capital relations.

In some cases only sub-contractually related firms are included. The number of corporations in a Keiretsu is usually a few hundred or more, which are a pyramid type of the organic shape headed by the main corporation, closely associated with the main bank.¹⁶

Since the laws on Fair Trade Commission of 1947 (theoretically independent from the government) strictly monitor all activities concerning mergers or capital transactions like acquisitions, the principal character of Mochiai or Keiretsu is to hold a small portion of stocks (permissible limits of stock share around 7% until the amendment of the law in 1997) of the other member corporations (cross holding) in order to avoid such a restriction of the Commission. Consequently stockholder structure is, in general, composed of not so many private investors but a large part of it is shared by corporations, most of them friendly corporations. The positive side of it is that the member could be financed on friendly terms and the management is protected from the fear of a takeover bids.

After all the corporate governance of stockholders over management may be weak because the representatives of stockholders from other Mochiai or Keiretsu corporations are not necessarily interested in monitoring the management in their friendly corporations.

However, it is also emphasized that the bank within Mochiai or Keiretsu, which is usually called the main bank and is operating as a traditional universal bank functions as an indicator of corporate governance through its consulting. The main bank is not only vitally important for any member of Mochiai or Keiretsu because of its friendly terms of financing but also consulting based on its general survey and analysis on a given corporation. From the corporate governance point of view it has been observed that

¹⁴ Masahiko Aoki, Hugh Patck (eds.), *The Japanese Main Bank System: its Relevance for Emerging and Transforming Economies*, Oxford University Press, USA, 1994.

¹⁵ Ronald J. Gilson, Mark J. Roe, “Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization”, *Yale Law Journal*, Vol. 102, No. 4, 1993, p. 271.

¹⁶ Hiroshi Okumura, *Houjinshihonshugi* (Corporate Capitalism), Tokyo, 1984.

instead of the general meeting recommendations through consulting are the key point in corporate governance.¹⁷ In addition, the main bank has to take an initial role at a time of financial difficulty such as in the case of an issue such as bad debts in a corporation (not legally responsible but full commitment required) to reconstruct the whole management. For that purpose the bank has always to monitor and consult operations of the Keiretsu group corporations. Besides the members of Keiretsu, if it is faced with difficulties, which cannot be solved, have to accept the recruitment of personals from main bank to act as urgent relief managers.

That may be the reason why individual investors involved in the stock exchange in Japan are not so active in comparison with the other leading stock markets oriented countries. (For instance in 2000 private investors' share was 25% in Japan, and 50% in the USA)¹⁸. Consequently a large portion of stockholders are corporations, and so, stock exchange transactions are mainly operated by friendly corporations, who are not necessarily interested in dividend and stock price at the stock exchange.

It was reported that the 64% of the total transactions registered were conducted by banks and other friendly corporations during the 1980s. That is the reason, as some criticize, why the Japanese stock market system is not so friendly and not open to individual investors but it is for corporation. This corporate stockholders domination phenomenon is often called "corporate capitalism".¹⁹

In addition, as Okumura analyzed it, the management and the employed workers, including trade union, which is a single company based union (not like union shop in the USA), are integrated in a single unit called "corporation union" and they are psychologically to commit themselves in conformity with corporate interests as a common goal, which may be the strongest spiritual genesis for the competitiveness of Japanese corporations. In such a situation the relationships between "you", managers and "us", trade union, which are common in the trade union movement in the West based on the class conflict ideology, are indispensably disgraced. They all concentrate their efforts on corporate goals. Okumura called it "corporate society based on corporate capitalism".

Besides, the management of a corporation is mutually monitored among Keiretsu group corporations and consequently it is asked to behave in harmony with the other members of Keiretsu, who always take common strategy into account.

Good harmonious relationships with the other members of Keiretsu and trade unions are important in cases of joint strategic actions for future R&D as a long term plan. As a result the stock value is not the highest issue for management in Japan. We can also see good harmonious relations in the market policy, namely those with consumers.

As far as market strategy is concerned, the maximum profit policy, which is common among the Anglo-American type of corporation, is not applied in Japanese corporations. When the setting the market strategy Japanese corporations prefer to get a stable share by considering the fact that low profit policy is usually accepted by consumers. Until the

¹⁷ Aoki, Patck, *The Japanese Main Bank System...*

¹⁸ The situation has recently been changed because of the Heisei Reform. See: "Japanese Individual Shareholders Flex New Muscle to Thwart Deals", *The Wall Street Journal*, Feb. 23–25, 2007; According to the information the individual stock investors' share has raised from 25% to about 50% just recently.

1990's this type of corporate culture prevailed and was appreciated by business circles in Japan.

However, since the 1990's there has been criticisms against Japan's model of corporate governance which is actually controlled by the management, "too strong management" influenced by Mochiai or Keiretsu culture, and consequently a weak function of governance over management by stockholders. In particular when the government of Japan declared a liberalization of capital investment many foreign investors asked about global standardized regulations on stock exchange rules.

In addition some corporate scandals relating to false accounting statements submitted to the general meetings were reported, which were formally due to lack of precise legal provisions based on obscurity of accounting, e.g. lack of legal assignment of auditors, but mainly were due to collapsed moral standards of business people concerned because it is impossible to regulate such problems by laws.

However, it is indeed a permanent question to what extent, it is possible to restrict corporate governance by laws. It is true that business activities should be conditioned by several fundamental rules such as unified commercial conduct between partners, unified rules on unified commercial laws, common understandings of social rules, mutual trust and so on, but it is not necessarily regulated by laws or statutes enacted by state. Rules and conducts including commercial customs have been cultivated by historical traders as "lex mercatorium", and, later some of them have been established by state authorities as commercial laws. Therefore, it is quite natural that there is a discrepancy between law and *de facto* commercial practices, even though modern rules which are predominant in the age of globalization are regulated by state organs as an unified code in harmony with the international standards.

9. Relationship with employees (Trade Unions)

Then, another question of who owns corporations today, is a fundamental one.²⁰ As we have recently seen in France (the amendment of labor law in 2006), an amendment of labor law which, from the employers' point of views, means that a corporation manager is able to make a decision to layoff workers easier than before as in the cases in the USA. For French corporations it is necessary to have such capabilities in order to be competitive in global markets, but from the workers point of view, losing jobs by managers decisions based on easy (or one sided) reasons have raised serious social problems. Controversies and criticism not only by the trade unions but also many people who are associated with workers indicate a keen reaction over the issues of corporate governance. The relationships between management and workers or union are a vital issue today because most people are inevitably involved in business with a corporation as a partner or its worker for some time of their lives. To find a harmonious rule to settle it is only a way to create a precondition of civil society, which we are going to build.

¹⁹ Hiroshi Okumura, *Kaisha honnishugi wa Kuzureruka* (Could Corporate culture of Japan be converted from the Corporate centralism to liberal one or not?), Iwanami, 1992.

²⁰ Ronald Dore, *Stock Market Capitalism: Welfare Capitalism; Japan and Germany versus the Anglo-Saxons*, New York: Oxford University Press, 2000.

Legal reforms during the occupation encouraged trade union movements, particularly the 1949 law on trade union, the 1947 law on labor standard and related laws which protected the rights of workers and encouraged them to strengthen their positions. They are a legal basis for relationships between management and workers in a corporation today. However, it is worth to mention that some preparatory conditions were created during the war time command system in the 1940's. For the purpose of an economic concentration policy for the war the government of Japan in 1938 made a declaration which ordered one integrated national system in the fields of socio-economic and political activities, called "Yokusanntaisei". Under this order most private corporations including management and workers together were organized as a patriotic organs cooperating with the government on a national scale, with the membership more than 5 million in 1942. Although the leaders and the people who were deeply involved in it, were all purged by the democratization policy of the Occupation Authorities after the war, it was easy for workers to follow the practices and the experiences of pseudo labor movement of the war time.

Thus, after the war as the result of democratization policies in the field of socio-economic activity, ownership of capital was scattered by the liquidation of Zaibatsu and the reformed stock exchange system, on one hand and on the other hand, because of liberalization of the trade union movement, trade unions and workers became stronger. Soon after the 1949 law on trade union had been passed, more than 17,000 unions were organized before the end of the 1940's.

One of the characteristics of corporate culture in Japan is that management-worker relationships are harmonious.

Corporate governance, which has been raised as a question by American business circles, is a one-sided aspect of the problem which is based on the interests of stockholders. A corporation as an economic entity is naturally functioning in order to make profits but at same time existing as a social entity with a large number of committed people and associated economic entities.

According to the OECD report of 1999 (OECD Principles of Corporate Governance)²¹ the notion of corporate governance is understood comprehensively and it includes not only stockholder's view but also that of the other stakeholders, i.e., "the full set of relationships among a company's management, its board, its shareholders and other stakeholders". Besides, the report has emphasized on the role of a monitoring system in given environments. Since then, interesting reports on corporate governance have been published and debated on by various academic and business circles. It seems that most of the European studies are willing to accept the stance of the OECD.²² Therefore, it is necessary to survey further the issue of existence of a corporation which has to achieve dual goals, namely competitiveness for profits and social function under their own circumstances.

In response to this, the Keidanren, Japans Federation of Economic Associations, which is composed of big corporations in Japan and which has been said to reflect the opinion of Japanese business circles, has conducted research on corporate governance by asking

²¹ *OECD Principles of Corporate Governance, Ad-hoc Taskforce on Corporate Governance, SI G/CG 5, Paris: OECD, April 1999.*

²² G. Lenssen, W. Gasparski, B. Rok and P. Lacy, "Corporate Responsibility and Competitiveness", *Corporate Governance*, Vol. 6, No. 4, 2006, p. 324.

member corporations about their opinions and actual status of it in their corporations since 2005 and as a result the *ad hoc* report was published on June 20th, 2006.²³

In the report most of the replies show that Japanese firms are conscious of the importance of corporate governance, which is to protect the needs of various stakeholders, including not only stockholders but also consumer, interests of the local community, workers employed, trade partners (Keiretsu firms) and so on. However, there is no definite conclusion about the tool to conduct it because stakeholders of each corporation depending on its field of business activity are differently shaped.

From legal point of view the problem has been partly regulated by the amendments of the commercial code (1974, 2001, 2002, and 2006). Then, it is also emphasized that disclosure principle, prohibition of hidden information by management, namely all information should be revealed to stockholders and other stakeholders.

Otherwise, the controversial issue of relatively poor participation of individual investors in the stock exchange (the stock exchange of Japan is dominated by trade of corporations) could not be improved. The report has concluded that despite the difficulties due to different corporate culture depending on corporate activities in the given fields, management should accept a liberal stance toward investors from outside, and the stock exchange should also be operated flexibly in the era of globalization.

There should be some common ground for corporate governance to protect interests of stakeholders, not only for stockholders but also other stakeholders. Also the fact that there has been a harmonious relationship between competitiveness and good corporate governance for the long run, should be approved of.²⁴

10. How to improve moral standard of business practice?

There have been several amendments of the commercial code successively introduced since 2000. However most of them have been marginal and there have been discrepancies between business practices of a corporation, in particular a large scale joint stock corporation and its legal regulations.²⁵

The corporate culture has been influenced by expansionism, ambitious and simultaneously arrogant behavior of management, which was especially obvious during the bubbled economy of the 1970–1980's. It is naturally observed that the moral standards of conduct of managers have been damaged sweepingly by those practices. Alongside this management used to be involved in inadequate practices, and the corporate culture was indeed eroded by the moral hazard phenomenon at the same time. There were several alleged cases reported concerning false accounting and financial reports. There were scandals of the arranged general meetings by executives with professional arrangers for

²³ Keidanren (Japan Federation of Economic Associations) is the most influential economic organizations whose membership are mainly composed of large scaled corporations.

²⁴ J. Emmic Ricart, M. Angel Rodriguez, P. Sanchez, "Governance: Sustainability in the Boardroom", *Corporate Governance*, Vol. 5, No. 3, 2005, p. 24.

²⁵ Nobuo Nakamura, "The Revision of Japanese Company Law and its Modernization", *Waseda Bulletin of Comparative Law*, Vol. 24, 2004, p. 1; Makoto Ishida, "The Changes in Enterprise Organization and Labor Law in Japan: An Historical Exploration", *Waseda Bulletin of Comparative Law*, Vol. 23, 2003, p. 1.

general meetings. These arrangements were paid by the company money; it was known as unfair “sokaiya” scandals. Those could be the reasons why the reform of commercial law was urgently demanded by both legal professionals and business circles. The commercial code was finally revised in 2005.

The amendment of 2005 is aimed to change the fundamental legal system of a corporation. The law on corporations as a part of a commercial code has not changed in principle since its promulgation at the end of the 19th century. However, corporation is a main organization of business of Japan and has continuously developed since then. In 2004 among all registered corporations the number of “Kabushiki Kaisha”, corporations limited by shares are dominant with 1,837,900 registered (99.7% of the total corporations in Japan). Why are corporations limited by shares dominant in Japan? First, it is a form well elaborated legally, rationally arranged by accounting and so the operation is to be opened for investors. Frankly speaking, from the view point of the tax authorities it is also highly recommended because of its clear accounting requirements. According to the laws, corporations limited by shares are requested to appoint at least three directors at the general meeting, without any regard to size. Then, the directors have to form the board of directors, which should appoint one or more representative directors who have the authority to make transactions on behalf of the corporation. The daily management is delegated to the representative director or directors, but some important business such as an issue of new shares or selling material assets of the corporation need the decision of the board. Although some issues are regulated by the board itself, the board has to play the role of a supervisor over the representative director and the other executive directors through the exercise of the powers to decide and approve significant business and to remove executives. The purpose of the amendment is to strengthen the role of the board of directors, particularly its monitoring function over daily activities of the representatives, CEO.

Besides, all corporations limited by shares have to appoint at least one statutory corporate auditor to monitor and ensure that the corporation is managed in accordance with both relevant laws and regulations and the provisions of its memorandum of association. The amendment of 2005 added that a corporation with a large capital is obliged not only to appoint three or more directors to form the board of directors but also to have an external auditor. On the other hand in the case of a small corporation, the appointment of an auditor is voluntary.

In addition, the law of 2005 amended the ground for directors’ disqualification by repealing the ground for director’s bankruptcy and the conviction against the director for breach of the security exchange law or insolvency laws as a new ground for director’s disqualification.²⁶

It is indeed a step further to regulate corporate governance in Japan. However, the fields which are regulated by the new law are yet a small portion of the corporate governance issues. Most of the commercial conducts are yet largely dependent on the people who are involved in management and stakeholders as a part of the neo “Lex Mercatorium”. In practice the relationship between business realities and legal regulations looks like a see-saw and left uncompleted.

²⁶ On what is called as “Heisei Reform”, see: Rokumoto Kahei, “Law and Culture in Transition”, *The American Journal of Comparative Law*, Vol. 49, No. 4, 2001, p. 545.

Today an open market system prevails everywhere as through a world fashion of apparently unified rules. However, each society or nation state as a result of historical evolutions exists formally independently. (Mentioning on the cultural aspects, its plurality is obvious). The relationship between law (in particular national law) and *de facto* functioning social rules is complicated as a problem of official law of state organs and unofficial rules. As legal sociologists emphasize, we should continuously discuss the relationship between official law and social realities, in particular in commercial practices. However, it is true that with legal regulations developed in parallels, the mode of commercial activities including that of corporate capabilities based on rules could indeed be harmonious, and it is obvious that orderly and fair trade would possibly prevail. Then, we have to remember another fact; commercial people are, at the same time known as human beings too clever to be regulated by the limitations of enacted laws. The relationship between law and commercial activities like that of a see-saw will be modified continuously.

Then, at last it might be found as a hybrid type of balanced rules on the relations.

11. Specific issues of small business in Japan

A small business is another chapter of the corporate culture in Japan. More than 10 centuries ago some business entities operated and some of them have survived even today. Most of them were shaped or permitted by the authorities to be organized for doing business in a limited way. According to the recent Funabashi's empirical research on long life corporations,²⁷ there are more than 4,000 corporations of that type actively operating for over 100 years since their foundations in Japan. Although their capital ownership composition and legal form as a entity are different from the initial ones, one of the characteristics of these corporations that survived is to sustain their management philosophies related with family traditions from the beginning. Today nearly one million corporations may be classified as small and medium corporations, which are much or less founded by their family property and managed by their own traditional philosophies or ideals.

According to the basic law on small enterprises of 1963, they can be classified as juridical persons or individuals falling under the following categories:

- a) A company capitalized at 100 million yen or less, and having no more than 300 employees, engaged in industry, mining, transportation, etc..
- b) A company capitalized at 30 million yen or less, and having no more than 100 employees, engaged in whole sale trade.
- c) A company capitalized at 10 million yen or less, and having no more than 50 employees and engaged in retail sales or service business²⁸.

However, before the law was introduced, there were several historical steps, which we should know. The concept of a skilled manual trade had no longer existed in Japan since the Provisional Commercial Code of 1868, which abolished the guild system in the skilled manual trades of the Tokugawa period (16–19th century).

However, individualistic enterprises (in terms of the modern business entity) were not specially encouraged to be created by the governmental policies during the Meiji

²⁷ Haruo Funabashi, *Timeless Ventures*, New Delhi, 2009, in prologue.

²⁸ Suzuki, "Przedsiębiorstwa w Japonii...", p. 201.

period. Since then, the situation had not changed until the war period. Just after the war the government took the issue as one of the urgent reform policies, but it took a time to be realized.

The government's white paper on the national economy published in 1957 recognized frankly the fact that there is a "dual structure" as a characteristic of the Japanese economy, referring to the simultaneous existence of advanced and less developed economic entities within the country. Since then, a vigorous debate has taken place on the problems of this dual structure in order to solve it. Although Japan has been quickly industrialized since Meiji, traditional land ownership, petty farmers or peasants and small entrepreneurs were preserved. Major corporations emerging as a big corporation were financially much or less supported by the government or their main banks. So that, they could take advantage of using cheap labor or subsidies. In this economic structure small businesses were given their characteristic place in the Japanese economy before the war. In addition, the narrowness of the domestic market imparted a militaristic and expansionist character of Japanese capitalism, small business were forced into the role of producing export goods to pay for the import of raw materials for industries. As industrial capital was immature (no foreign capital was permitted to invest directly in Japan) the hegemonic position was taken by commercial capitals like *Zaibatsu*. Small businesses were exploited under the wholesaler – dominated domestic manufacturing system.

The dual structure of Japanese capitalism was a prime candidate for modernization under the occupation policy. Agricultural land reform, the changes in family law and basic laws of labor relations of the 1940's have all improved cheap labor structure because the traditional family and social relationships in rural communities were linked with those feudalistic elements.

It is said that after all these reform measures, modern relationships were established in rural areas, in particular relationships between big business and labor which were enable to create labor market. Since the 1960's industries with technological innovations were looking for new labor force due to a shortage of young labor, the differentials between wages in enterprises between big and small almost became marginal. A certain extent some people were inclined to think that the dual structure has been dissolved.

The legislation of 1963 on small and medium enterprises is not simply the implementation of protective policies for small business like that which prevailed immediately after the war. It is a complex legal system corresponding to the structural changes in the economic environment, reflecting not only the reclassification of small business, but also the advancement of systematization and the reorganization of subcontractors under leadership of the government.

Corporate governance in these small entities is different from what big corporations are doing in practice because small and medium enterprises are usually based on family property, in which ownership of shares are exclusively hold by some members of the family or their associates and at the same the management is carried out by the similar staffs. Therefore, the principle of clear distinction between ownership and management is not strictly applied, which is different than in the case of a big corporation. The important element for good management is an intimate human relationship among members of management on the basis of mutual trust. Contrary to the notion of a joint stock company in a big corporation, for management it is easy to make decisions and to be responsible for all duties relating to

risk, even though the company is legally registered as a limited liability corporation. Some argue that such human relations may be defined psychologically as a status of “Amae” (dependence), which from the point of view of the modernization theory is not always acceptable.²⁹ German sociologist, Max Weber analyzed it as a “patrimonial piety” in which one should be subjected to another. So, it can simply be called a feudalistic relation. However, according to the empirical research of Funabashi on the long life of enterprises, business success is largely dependent on these elements.³⁰

After the new law on small enterprises was passed in 1963, small business has faced a problem of choice how to survive in the competitive market as a subcontractor or an independent entrepreneur. Since most of the small businesses have already experienced difficulties with banks in further investment, they prefer to establish a cooperative relation with large industries.

According to the law special state bank was established for the exclusively small business in order to encourage innovative investments. However, these chances were limited, in particular cases of smaller enterprises. On the other hand, large corporations have, through their favorable cooperation with the main banks, decided to introduce ambitious expansion plans in production and marketing and to organize a large scale cooperation network in the 1960's. That is the main reason why these large industries could successfully establish a group of “Keiretsu” by utilizing many subcontractors as their members.

²⁹ Takeo Doi, *Amaenokouzo* (Structural Meaning of “Amae”), Tokyo, 1969.

³⁰ Haruo Funabashi, *Timeless Ventures...*

Notes on Contributors

HAIFA A L A N G A R I, Independent Researcher from Saudi Arabia

AGNIESZKA A Y Ş E N K A I M, Department of South Slavic Philology,
University of Lodz

MAGDALENA C Z E C H O Ń S K A, Section of the Chinese Literature and
Culture, Adam Mickiewicz University, Poznan

BILAL G Ö K K I R, Faculty of Theology, Istanbul University

BEATA K O W A L C Z Y K, Institute of Sociology, University of Warsaw

IZABELLA Ł A B Ę D Z K A, Section of the Chinese Literature and Culture,
Adam Mickiewicz University, Poznan

MICHAŁ M O C H, Laboratory of Arabic Language and Culture, Kazimierz
Wielki University, Bydgoszcz

DOROTA R U D N I C K A - K A S S E M, Institute of Regional Studies,
Jagiellonian University, Cracow

MARIA ROMAN S Ł A W I Ń S K I, Institute of Mediterranean and Oriental
Cultures of the Polish Academy of Sciences, Warsaw

TERUJI S U Z U K I, Department of Constitutional Law, Kozminski University,
Warsaw

KARIN T O M A L A, Institute of Mediterranean and Oriental Cultures of the
Polish Academy of Sciences, Warsaw

BOGDAN Z E M A N E K, Institute of Middle and Far Eastern Studies,
Jagiellonian University, Cracow