Challenges to Japanese Models of Corporate Governance: Stakeholder Attitudes towards Merger Control in Banking[1]

Koji SHIMOHATA
University of Exeter

Financial globalisation alters the strategic calculation of national firms and will require them to restructure through mergers or acquisitions. National regulations recognize the changed market environment and, in order to assist national firms, adapt national regulatory structures to permit participation in the market for corporate control. Globalisation forces the relevant authorities to promote more equity-market-led elements in its merger-control. However, Japanese financial reforms are essentially defensive, keeping globalisation at bay. The CME model which Japan currently adopts is the best in the long run for their national interests. Therefore, the regulatory changes reinforce a 'coalition of interests' and emphasise the existing institutional characteristics which coordinate M&A strategies. In this context, M&A strategies after a series of reforms are the same as before. At ownership structure level, owners and workers are protected. Managers still distribute benefits in a highly corporatist fashion. As a result, the stakeholder attitudes towards Japanese merger-control in banking highlight the existing characteristics of the Japanese coordinated market economy under the pressure of globalisation.

Introduction

Government-industrial relations within the Japanese banking industry have been affected by a number of alternative effects of financial globalisation, for example, capital flows, hostile takeovers via open stock markets, international anti-trust pressures, and 'reciprocity' when Japanese firms engage in merger and acquisitions (M&A) in the US/UK markets. The effects have one common dimension: the regulatory adaptation to globalisation reshapes the national market coordination. Globalisation alters the strategic calculation of national firms and will require them to restructure through mergers or acquisitions. National regulations recognise the changed market environment and, in order to assist national firms, adapt national regulatory structures to permit participation in the market for corporate control (MCC). This in turn will require adaptation in national models of corporate governance. Institutions offer firms a particular set of business opportunities. In this context, the stakeholder attitudes towards Japanese merger-control in banking highlight the existing characteristics of the Japanese coordinated market economy (Japanese CME) under the pressure of globalisation.

The paper examines stakeholders' support for the specific Japanese model of corporate governance in the face of tensions between financial globalisation and continuity in the national capitalist model. It focuses on characteristics of Japanese-style stakeholder-regime and its power-distribution for inner-political interests and financial benefits through financial reforms and merger-control reforms. In Japanese banks managers and workers dominate and operate to the disadvantage of minority shareholders. This relation is closed and opaque. The paper defines the regime as a 'coalition of interests'. Briefly, in Japan there is a strong concern to limit merger threats. In recent years, globalisation of financial markets further forces the Japanese banking authority to promote more equity-market-led elements in its merger-control. However, the regulatory changes reinforce a 'coalition of interests' and emphasise the existing institutional characteristics which coordinate M&A strategies. It is argued there that the CME model which Japan currently adopts is the best in the long run for the national interest. Therefore, regulators and managers intend to keep the traditional competitiveness. Japanese financial reforms are essentially defensive, keeping globalisation at bay. M&A strategies after a series of reforms are the same as before. At ownership structure level, owners and workers are protected. Managers still distribute benefits in a highly corporatist fashion.

In order to understand the Japanese style of corporate governance, the first section explains characteristics of Japanese models of corporate governance in the CME, focusing on stakeholder-regime 'coalition of interests' without consideration of the pressure of financial globalisation. The second section explores MCC in Japanese corporate governance system in order to argue simple national models on the link between the corporate control and shareholder-value. The mechanism derives from its large bank and inter-corporate holdings. Japanese firms produce low returns for shareholders. Research in the 1990s concluded that the Japanese main-bank system and cohesive corporate groups, keiretsu system (main-bank and keiretsu system) comprise of institutional 'inside' investors (non-minority shareholders), and as a result, they do not introduce a MCC into the Japanese market economy.

Recent research illustrates the Japanese style market for corporate control to have limited functions. Dore (2005) argues Japanese corporate governance system has shifted towards the Anglo-Saxon system, but the changes are so far the characteristics of the US. In this context, the section focuses on the relationship between managerial function and equity market in CME of Hall and Soskice (2001), and the inner-firm politics in Gourevitch and Shinn's work (2005). This author takes a position that the MCC exist a little influence because of the presence of 'poor' external pressure of shareholders, and poor profitability by business achievement. However it is true that aims and decision making of managers are abstracted to main-bank base. The third section describes the financial system changes package from 1996 to 2001, the 'Japanese Big Bang' and its following policies promotes more equity-market base activities of financial institutions in the domestic markets. M&A activities in Japanese market became more common under globalisation, while the changes in Japanese banking merger control have highlighted more equity market-led solutions. The fourth section shows how takeovers are enforced to use the characteristics of the market for corporate control. Japanese takeovers rely heavily on main-bank and keiretsu system. Banking M&A are under discretional control of regulators with informal industrial meetings with managers. Therefore, in Japan there is a strong concern to limit merger threats, whilst in the UK there is a strong interest in making mergers work properly. As a result, in Japanese corporate governance, managers and workers dominate and operate to the disadvantage of minority shareholders.

Stakeholder-Regime 'Coalition of Interests'

Different models of national capitalist systems exhibit different patterns of firms' activities. The Japanese model of corporate governance and the Japanese political economy make use of non-market relationships as opposed to competitive ones found in other models. Gourevitch and Sinn's (2001), *Political Power and Corporate Control* explain the incentives that shape the organisation of the firm, and shows that the incentives are greatly influenced by regulatory framework in industrial relations, price setting, competition, and the relationship among firms and finance; the framework they and the other Varieties of Capitalism (VoC) theorists referred to as CMEs and Liberal Market Economies (LMEs). They address the different capitalist models and different outcomes with this reason from institutions for market coordination (Hall and Soskice, 2001), and stakeholder models (Vitols, 2001). Their arguments show that actors (owners, managers and workers) within corporate governance make regimes for power-distribution in order to distribute benefits, which characterised national capitalist models.

This situation confirms the roles of managers in the regimes. Managers coordinate benefits based on the regimes. For example, In Japanese banks, managers distribute benefits in a highly corporatist fashion whilst in UK banks, they protect minority shareholders by seeking profits and protecting liquidity. There are different regimes in capitalist models. Therefore, firms in different capitalist models distribute different outcomes. Japanese CME characterise specific pattern of stakeholder-regime within corporate governance of its domestic firms. This paper defines the stakeholder-regime coalition of interests. The regime is devoted to the establishment of a privileged position of owners in corporate governance. It is composed of institutional settings of the national market economy from the reason that regulatory framework coordinates business opportunities and interests. Based on this argument, this chapter outlines the characteristics of the Japanese model of corporate governance in a CME, focusing on the stakeholder-regime's 'coalition of interests'. This intermingled alliance of interests comes from the power-relations of Japanese policy-making process as described in the work of Wilks (Wilks, 1994: 1).

Based on the characteristics of Japanese CME, banks have political coalitions in their corporate governance. Japanese CME makes more use of non-market relationships as opposed to competitive ones. Competitive advantages are embedded into the room behind closed doors, which can only be accessed by inside-stakeholders of firms such as blockholders (middle or long term stockholders), managers, and representatives of labour unions. Key elements of non-market relations are the extensive relational investment, incomplete contracts and network monitoring based on the exchange of private information within networks (Hall and Soskice, 2001:8). Corporatist compromise amongst inner-firm actors (blockholders, workers and managers) becomes is best conducted behind closed-doors (Gourevitch and Shinn, 2005:207). Owners have difficulty establishing their presence in this political coalition. Blockholders in banking ownership structure are main members of main-bank and keiretsu system. They are subordinates of banks. and not owners in this system practically. Minority shareholders (aimed short-term financial profits) are out of the regimes for power-distribution in order to distribute benefits on which its capitalist system is based. Minority shareholders have financial information to public at large. However, it does not mean that the minorities can attend informal roundtable with the other stakeholders in the room behind doors. Such financial statements do not offer the minorities to monitor banks. Standardised accounting practices are less important (Gourevitch and Shinn, 2005: 207). To the contrary, blockholders conduct corporate governance through informal negotiations with the others.

> *Blockholders have direct access to the firms' internal financial statements and are motivated to dig as deeply as necessary to monitor the firm, both ex ante and ex post.*
>
> (Gourevitch and Shinn, 2005: 207)

In this context, Japanese model of corporate governance shows a 'concentration without owners', sustained by consensual political institutions. Therefore, the model establishes political coalition between managers and workers, 'coalition of interests'. Stakeholders include owners, managers and employees each of whom have preferences which they pursue through the coalition. Managers have fiduciaries for protecting the coalition, and for financial profits of each stakeholder. Therefore, they have decision-making based on a set of institutions for Japanese market coordination. Indeed, firms' business opportunities and corporate strategies are offered by the institutions, including inner-firm relations (Hall and Soskice, 2001: 15). Managers' decisions and their activities reflect the characteristics of coalitions. This paper focuses on banking managers' role in order to understand the regime.

Managers of banks seek their policy preferences in respect of the maximisation of business achievements on balance sheets. The main reason comes from business performance regardless of corporatist relationships with other stakeholders in order to achieve their own benefits, for instance, income, job securities and managerial autonomy (Gourevitch and Shinn, 2005: 59). However, managers of Japanese banks and those of British ones have different benefits, which derive from different motivations. Vitols describes that German owner-companies one or more shareholders with strategic (rather than purely share value maximisation) motivation for ownership (Vitols, 2001: 342). Japanese ones are much more likely to be characterized by this motivation. Fiduciaries of Japanese firms' managers contain to maximise their-own objectives (position / income promotion); not only stock price, but also benefits of customers, employees, suppliers, subcontractors, creditors, and local communities (Dore, 1999: 10). Banking managers act to maximise more the interest of its stakeholders (e.g. keiretsu enterprises) than that of individuals. The coordination of their reciprocity makes informal negotiations, for example, a main-bank and keiretsu-enterprises share financial source and human resources. In order to coordinate their common benefits, they have 1) managers' meetings in their main-bank and keiretsu groups, and 2) personal changes between keiretsu-enterprises at board member level.

However, these 'corporatist alliances' are regimes for the allocation of political and financial benefits. All stakeholders in one-bank-centred corporatist regime within Japanese CME share 'one big pie' (pieces of financial and political benefits which makes into banking business performance). The political benefits mean that each stakeholder tries to obtain a privileged position to maximise their financial profits with social success (e.g. promotion of managers and representatives of employees) at inner-firm or political economy levels. It is the fact that financial performance of a Japanese bank such as its capital accumulation, business profitability, and its market share makes a 'pie of political and financial benefits' which are shared by all stakeholders. Managers have the responsibility to handle corporate managements in order to make a 'bigger pie'. It means that managers can re-shape the size of the 'pie': smaller or bigger via managing decisions and their outcomes. Moreover, they can decide stakeholder-members who obtain pieces of the pie.

The business decisions of managers restrict the membership of keiretsu and enhance / restrict the scale of business networks. For example, if bank managers decide to diminish a certain part of their business, their decision may cut off a part of the group members and its customers. Changing strategies (e.g. from deposit banking to premier private banking specializing with wealthy customers) will change and select its customers' social layers, while the strategies re-structure banking group companies which offer total financial services and its relevant services towards targeted customers. These activities confirm that managers make their decision for maximising through the pyramidal system of ownership and control. Therefore managers can re-shape the political and financial benefits. Gourevitch and Shinn explore the general meaning of 'the pie' within CMEs:

> (Managers) *want high payments of various kinds from salary to options, and the greatest autonomy in directing resource of firms-which also gives them the greatest leeway to shirk.*
>
> (Gourevitch and Shinn, 2005: 59)

Indeed, managers need to enhance their own benefits and also the other stakeholders' benefits, while they avoid the cost and expense of firms and those of the others. Gourevitch and Shinn (2005) describe that managers dislike expropriation costs at the expense of the firm for reasons similar to those of works. Although managers have common interests with workers against some kinds of action by owners and common interests with owners against workers' claims, managers of banks within a political economy seek their policy preferences in respect of maximisation of business achievements on balance sheets. Therefore, national characteristics of the stakeholder-regime are created from managers' activities and their responsibilities in consideration with common interests of the other stakeholders.

Based on the managers' activities and their responsibilities, the incentives of Japanese banking managers are embedded into corporatist profitability and stockholder value (middle and long-term stockholding) through business performance. In economic literature (Kaplan, 1994: 512; Kubo, 2001: 230), managers have little financial incentive to pursue 'profitability and shareholder value on market-principle'. There is no positive link between executive pay and shareholders' return (Kubo, 2001: 230). Little reward to their firm's performance will be paid. Recent political economy research, like the VoC approach, seeks to answer the point of institutional settings of national political economy. In CMEs, like Japan, the intricate system of cross-shareholding and inter-corporate linkage reduces the access of firms to capital that is not tied to current profitability. Moreover, based on Gourevitch and Shinn (2005), Japanese banking managers face to drive common interests with inner-employee representatives against stockowners, while they confront to take common interests with stockowners against the representatives. Therefore, the managers coordinate 'the greatest common divisor of all stakeholders' common benefits'. The managers' annual rewards are paid by outcomes of this coordination. Managers are seeking 1) financial performance and 2) common benefits of all stakeholders. In this context, the research argues the incentives are profitability, shareholders value and 'other corporatist elements'. Corporate strategies and structures have reflected incentives of stakeholders. The incentive of managing directors in Japanese banks is set up to increase the privileged position of each stakeholder (and employee representative). Managers have decided corporatist policy preferences towards Financial Services Agency (Japanese-FSA: J-FSA), and encourage the recognition of the Chief of J-FSA about such profitable relationship based on Japanese CME characteristics. In this context, the incentive of Japanese banking managers is set up to increase the privileged position of all stakeholders. The research argues the incentives are profitability, shareholders value and 'other elements'.

To sum up, 'coalitions of interests' are composed of institutional settings of national market economy from the reason that regulatory framework coordinates both business opportunities and interests. Japanese banks have been central to the management of this compromise. However, they have been threatened by the stagnation of the economy and pressures of financial globalisation in the last decade. The next section describes how financial globalisation requires the regulatory changes in banking M&A in order to re-structure the strategic calculation of Japanese banks through M&A.

Japanese CME and Market for Corporate Control

The processes and influences by which financial globalisation prompts substantial changes in the characteristics of institutions for market coordination. This paper focuses on one of institutions, such as MCC. The essence of MCC relates to corporate structuring and shows, among other things, how managers are hired and fired, how ownership is re-allocated, and what the link is between corporate control and shareholder-value. It establishes the situation suggested by Kang and Shivdasani:

> *In the United States, several internal and external governance mechanisms provide incentives for corporate managers to maximize shareholder wealth. These include equity ownership by top executives, monitoring by institutional and large shareholders, outside directors on the board, and the threat of takeovers.*
>
> (Kang and Shivdasani, 1995: 29-30)

MCC refers to the market for acquisitions and mergers where there is competition for control rights in the national models of corporate governance. MCC creates strong incentives for managers to further develop and pursue shareholder interests in the national political economy. There are many ownership structures that facilitate the operation of the market for corporate control. Profitability and shareholder value are heavily dependent on the differences in national market economies. This paper examines MCC in two types of corporate governance: the British model and the Japanese model. In this context, this chapter studies the impact of the ownership structure of a bank on the characteristics and efficiency of MCC in two types of national economies (CME and LME) under influence of globalisation. It suggests simple national models on the link between the corporate control and shareholder-value. This section focuses on the relationship between managerial function and equity market in CME of Hall and Soskice (2001), and the inner-firm politics in Gourevitch and Shinn's work (2005).

The Japanese main-bank and keiretsu system has a played a significant role in Japanese-style corporate governance. Characteristics of the system are outlined as the follow:

> *…the structure Japanese economy encourages sharp competitions between firms in the same industry. Cooperation on sensitive matters is more likely to take place within the keiretsu, i.e. among firms operating in different sectors but within one family of companies.*
>
> (Hall and Soskice, 2001: 34).

Moreover, the Japanese system shows its large shareholder blocks that generate substantial cross-shareholding amongst firm (Gourevitch and Shinn, 2005: 4). The block is held by financial institutions, banks, and in family firms. The system is negatively correlated with performance in equity market and cash flow, which is in its turn affected by financial globalisation. The pattern of keiretsu-led coordination (Hall and Soskice 2001) encourages sharp competition between companies and in the same industry. This paper follows these definitions, but also contains regulatory guidance on corporate strategies without ownership. In this paper, the main-bank and keiretsu system means bank-centred share-block under discretional state control. Therefore, there is a difficulty in the market for corporate control in the Japanese market economy.

MCC does not work in the corporatist compromise of non-minority shareholders concluded competition in the domestic market: bi-level combination of competition and regulation so called compartmentalised competition (Murakami 1982). Porter also suggests Japan to have a market economy which develops domestic competition (Porter, 1990: 117-118). This means that a ‘coalition of interest’ generates intricate links between competition and regulation (Wilks, 1994). From the view of competition policy analysis, Wilks concludes that Japanese competition policies must comprises limited leverage of competition enforcement, because of the reaction of Japanese firms in the specific social system. Recent research defines the concept as ‘concentration without owners’ (Gourevitch and Shinn, 2005).

Drastic changes such as improved accesses to global capital markets and the de-regulation of domestic capital markets would have influences to the mechanism of the Japanese main-bank and keiretsu system. it is shown here how managers have become concerned with the market for corporate control through the following internal and external dimensions: 1) accessibility to capital market through managerial functions characterized ownership structure, 2) managerial monitoring, and 3) efficiency in business performance and shareholder value based on equity market, 4) accessibility to capital market from social context.

First, the market for corporate control in Japanese CME has not had strong connection with portfolio investing elements. The Japanese political economy still remains the fundamental framework, in which the main-bank and keiretsu systems work. The system controls the limited accessibility to external markets. In this context, this paper suggests that the management of Japanese banks is not changed in respect of MCC. The main reason why MCC has no functions comes from the managerial functions characterized by the Japanese style of ownership. The political coalition between managers and workers in the ownership structure operates to the disadvantage of numerous minority shareholders and institutional investors as non-family enterprises.

The corporatist compromises in Japanese corporate governance, such as the ‘coalitions of interests', do not change the incentives of managers under financial globalisation. Several researchers (Prowse, 1992; Kaplan, 1994; Kang and Shivdasani, 1995; Dore, 1999) illustrate this point. Prowse (1992) explains the ownership concentrations in keiretsu and independent (non-keiretsu) firms in the mining and manufacturing sector. His research suggests that the Japanese style of ownership has negative relations to independent firms. The independent firms have strong connections with returns from external markets beyond the Japanese style of corporate control. Conversely, his research suggests that Japanese ownership is positively related to keiretsu firms. His research examined the concentration by several variables(Prowse, 1992:1131), for example, percentage of institutional owners related to the firm size, ratio of capital expenditure to total sales, ratio of advertising expenditure, ratio of research and development (R&D) expenditure, value of total assets, and concentration of debt ownership (top 5 shareholders) and so on.

The result shows two facts: 1) keiretsu members have negative reaction to returns, 2) independent companies in Japanese CME follow more returns from market than the keiretsu-firms, like US and UK firms. Banking industry is at the heart of the Japanese style model. Therefore, this traditional research outcome in Japanese business studies indicates that banks do not rely heavily on business performance with competitive arrangements. Kaplan (1994) explains that incentives of managers in Japanese firms are similar to that in US firms;

however the turnover of Japanese executives was more sensitive to low income and less sensitive to stock returns than was that of U.S. executives. He compared the executive rewards and firms' performance between Japanese and US firms. He focuses on large Japanese firms in the 1980s in order to examine the relations of top-executive turnover and cash compensation (salary and bonus) to earning levels, changes in earnings, stock returns, and sales growth（Kaplan, 1994 :511).

In this context, the research finds that business performance and its short-term outcomes such as stock prices have positive co-relations with managing performance of managers. It is partially true that their activities and its motivation come form similar reasons of the US firms' managers in order to improve business achievements in short, middle and long-term. The sales amount is not only heavily dependent on the characteristics of the Japanese system. Therefore, Kaplan suggests that the turnover of Japanese executives was more sensitive to poor earnings performance and less sensitive to stock returns than was that of U.S. executives (Kaplan, 1994).

Kang and Shivdasani (1995) explore the hypothesis that management turnover amongst Japanese firms with the main bank increases when managers make poor earning performance. This is because they suggest the following situation in the respect of MCC dimension in Japan:

> *…in Japan, equity ownership by management is considerably less, large shareholders are sometimes viewed as passive the frequency of outside directors is lower, and takeovers are extremely rare*
>
> (Kang and Shivdasani, 1995: 30)

Their research data sample, 270 non-financial firms based on 1984 Moody's International Report suggests managers of Japanese firms ignore the effects of corporate actions on firm performance and shareholder wealth(Kang and Shivdasani, 1995: 55). There are the positive relations between poor stock performance and top management turnover with large shareholders. Dore (1999) also follows these views of these precedent researches in 1990s. His research suggests differences between shareholder-favouring firms and employee-favouring firms in terms of corporate governance patterns. Japanese companies take employee favouring firms. The most important stakeholders to managers are 'the member of enterprise community' such as employees, suppliers, customers and so on（Dore, 1999:10）. In this context, Dore describes managerial functions in Japanese firms comes from inside, for example appointment of a CEO is as the follows:

> *There is 'no domestic external market for executive talent'. ……..When a Japanese CEO is appointed -unless the firms is in dire trouble, with almost 100 per cent probability from inside- there is no more negotiation than there used to be in Thatcher days when a British civil servant was appointed a permanent secretary.*
>
> (Dore, 1999: 24)

'Insiders' coordinate not only appointments, but also promotions from employees to directors (Dore, 1999:24). Primary personal objectives of managers in British firms are financial rewards as a result of delivering profits to shareholders. Those of managers in Japanese ones are the extension for conditions negotiated by the labour unions as opposite to those of British managers. They expect increases in basic salary and/or summer salary, and promotions (Dore, 1999; 25): Therefore, MCC has no function in Japanese firm. In conclusion, precedent research in 1990s without effects on drastic global market changes shows the traditional characteristics of the Japanese model. Japanese main bank and keiretsu system has a played a significant role in order to constraints managerial functions in MCC.

Hall and Soskice (2001) and Gourevitch and Shinn (2005) reach similar conclusions. Japanese firms are not always sensitive to the terms on which external finance is supplied (Hall and Soskice, 2001: 22). Hall and Soskice suggest that managerial incentives tend to reinforce the operation of business network. Managers and stakeholders are a corporatist compromise of a manager-worker alliance of 'concentration without owners' (Gourevitch and Shinn, 2005) or 'a coalition of interests.' Therefore, managers are supervised by insiders (Gourevitch and Shinn, 2005). Managers concentrate to their reputation while they do not rely heavily on stock-option schemes in managerial compensation in CMEs relative to LMEs (Hall and Soskice, 2001: 24). On the other hand, Dore (2005) considers the changes in management priorities and strategies as a result of legal reforms focusing on power of managers in financial matters. 'Employee sovereignty' has shifted to shareholder sovereignty':

> *Managers have come to focus more on share price or be more proud of how tough they have been on their employees than on how large an increase they gave them in wages and bonuses. Standard business doctrine has come to include focus on core competence, corporate restructuring, deconglomeration, ending cross-subsidisation of unprofitable divisions, and the sell-off or closure of unprofitable branches*
>
> (Dore, 2005: 43)

However, he stresses that effects in the changes are far below those of the US. The basic structure of managerial functions is still embedded into characteristics of Japanese CME, as suggested Hall and Soskice (2001) and Gourevitch and Shinn (2005). Therefore, in this paper Japanese CME has managerial function in MCC under globalisation, but the functions are very limited in this moment.

Second, the Japanese model also shows the limited market for corporate control by inside board member monitoring. Kaplan and Minton (1994), Kang and Shivdasani (1997), Mcmillan and Schaede (1997) conclude the reason is that managerial monitoring is handled by main banks. Kaplan and Minton (1994) argue that the external monitoring by main bank makes poor business performance with stock price, and brings earning losses. Main banks improve corporate performance of family firms. Kang and Shivdasani (1997) explore mainbank-employee relations in the case of restructuring of Japanese manufacturing firms such as downsizing and layoffs. Main banks have constraints effects of corporate restructuring in respect of financial performance of firms. Main banks exercise corporate governance of Japanese firms without consideration with external monitoring.

This research argues that market competition of firms and banking monitoring are complementarities. It means that banks define the competitiveness of firms within bank-centred societies as the same as the concept of Hall and Soskice: institutions offer business opportunities and limit a range of corporate strategies to take advantages of the market coordination. Dore also explores the insider system that boards of directors are exclusively stuffed by life-time employees and not subject to any effective monitoring (Dore, 1999:77). He finds the reasons that Japanese societies are too immature to have an efficient stock market. Indeed, Japanese firms find the substitute of efficient monitoring in main-bank system. Main-banks monitor the financial situation of firms, and arrange finance when firms are in distress. Therefore, previous studies explain how the monitoring of inside board members restricts the market for corporate control.

Recent research such as Hall and Soskice (2001), and Gourevitch and Shinn (2005) explore the banking monitoring. Gourevitch and Shinn describe this point through transparency in the corporatist compromise:

> *In Japan instead of external auditors, listed firms rely on kansatyaku, statutory auditors, to certify the quality of the financial figures. The kansayaku are retired members of the company's financial bureau or former main bankers*
>
> (Gourevitch and Shinn, 2005: 208)

Main banks also send their members to leading positions in their family companies. Hall and Soskice (2001) describe how main banks handle the family companies through the basic concept of coordinated market economies: (bank-centred) network-monitoring based on the exchanges of private information inside networks and more reliance on collaborative, as opposed to competitive relations to build the competencies of the firm. In this network, banks and family enterprises exchange human and financial capital, information, and the other resources.

Next, the Japanese corporate governance model is not effective in maximising business and shareholder value based on the equity market. The precedent researches show the model does not lead to higher profitability or corporate growth on market principle and at an individual level. Their research outcomes show that Japanese corporate governance is exercised by mainbank-keiretsu system and not through external pressure from shareholders in equity market.

Weinstein and Yafeh (1998) argue that capital accessibility of borrowing firms is increased by closer relationships with the main bank. Their argument is that this mechanism does not ensure profitability or growth. It concludes that banking monitoring has no aim to follow high returns for outside shareholders. Japanese firms prefer indirect financing and a high shareholding of main-banking and its family companies as banking regime supporters within corporate governance of firms.

The recent studies, Hall and Soskice (2001) and Gourevitch and Shinn (2005) also support Japanese firms still remains Japanese-style corporatist characteristics in corporate governance. They argue banks have corporate control of a main-bank is one of the main characteristics of Japanese CME. On the other hand, Dore (2005) shows the managers consider both shareholders and the employees' benefits. However he stresses Japan still remains the national model of a capitalist system.

Fourth, it is legally possible for Japanese CME to have function in MCC, while Japanese CME rejects the function politically and economically. The Japanese model of the market for corporate control has functions from the view of managerial function and business performance to returns from markets, after a series of the regulatory changes since the late of 1990s. Prowse, 1992; Kaplan, 1994; Kaplan and Minton; 1994; Kang and Shivdasani, 1995; Kang and Shivdasani, 1997; Mcmillan and Schaede, 1997; Weinstein and Yafeh, 1998; Dore, 1999 explain that the Japanese political economy has corporatist compromises. Firms are embedded into the mainbank-keiretsu system. Japanese firms follow the political and economic benefits from enterprise communities (Dore, 1999), or 'coalition of interests' based on collaborative bank-centred societies. The reason shows Japanese firms to have broad and numerous stakeholders: employees, customers, suppliers, and subcontractors, creditors, local communities and so on (Dore, 1999: 24). One of the main reasons is that the policy reforms do not change the characteristics of the Japanese coordinated market economy: business practices, inner-firm relations, and managerial monitoring and so on. Actually, the financial reforms promote re-organisation and M&A strategies in respect of corporate competitiveness. However the reforms do not change non-market coordination required as the follows:

> *…extensive relational or in complete contracting, network monitoring based on the exchange of private information inside networks, and more reliance on collaborative, as opposed to competitive , relationships to build the competencies of the firm.* (Hall and Soskice, 2001: 8)

Such non-market mode of market coordination restricts functions of MCC in Japanese CME. The other reason is that the corporatist mainbank and keiretsu system is at the heart of Japanese market economy. A series of financial reform-changes provide incentives for corporate managers to maximise shareholder value. Corporate compromises of the system make managers to depend heavily on competitive market arrangements. The main-bank and keiretsu system is an extension of the ownership structure. Moreover Japanese banking regulators, Ministry of Finance Banking Bureau (MoF Banking Bureau) and its successor, J-FSA have discretional control for banking activities. A series of regulatory reforms (Japanese financial Big Bang) for market competitiveness promotes more short-term profit stance in firm-stockholder relations than before the enforcement of the reform. However, in the Japanese CME model, the long-term stance is still stronger than short-term one, and the bank and regulator choose longer-term profitable stance in firm-stockholder relations through M&A. The reason comes from the competitiveness of banks comes from coordinated market economy. Regulators can partially handle the banking M&A activities through the institutional characteristics of the local capitalist model with banking M&A strategy. Therefore, Japanese CME rejects the functions of MCC politically and economically.

Based on these dimensions, this section concludes with a point on the relationship between globalisation and the market for corporate control in Japanese CME. Many researchers show Japan has no market for corporate control. Dore's work in 2005 suggests that Japanese corporate governance system has shifted towards the Anglo-Saxon system, but the changes are so far the characteristics of the US. Japanese CME has a little effects of MCC. This author takes a position that the MCC exist a little influence because of the presence of 'poor' external pressure of shareholders, and poor profitability by business achievement. However it is a fact that the decision making and activities of managers in Japanese firms abstract those of stakeholder-regime. Adaptation to globalisation in the decision making of managers is mixed with corporatist arrangements and simplifies the research outcomes. This research recognizes that main-bank and keiretsu system hide such poor effects of equity-market by expanding globalisation of finance. However it is sure that globalisation has enhanced the equity-market led components and the presence of MCC is shown slowly. Therefore, this paper considers this weakened and poor Japanese style MCC.

Financial Globalisation and Reshaped Japanese Bank-merger Control

Financial globalisation which is reshaping the national market coordination requires re-structuring the strategic calculation of domestic banks through M&A. The reason is that a mix of intrinsic and national characteristics throws each national banking industry into complex national and global banking competition, and so the industry is under pressure to choose a strategy of M&A. Therefore, since 1990s, a large bank-merger wave has restructured the global financial market since 1995. From 1995 to 2004, there have been forty-nine cases of M&A and four withdrawals after the merger–agreement, between top 150 banks on capital (each year-base)[2]. In Japan the stagnation of the economy in 1990s and pressures of financial globalisation have in fact provoked structural shifts in the architecture of Japanese banking market and its governance systems through banking M&A.

Financial system changes in Japan re-structure the models of ownership in the dimension of regulation, in organisational form and in corporate strategy to follow profitability and shareholder value. The system-change package from

1996 to 2001, 'the Japanese Big Bang' and its following policies have aimed to deregulate and restructure the ownership structure of the financial institutions in Japanese financial markets, with an eye to making them free, fair, and global. It expedites the removal of financial barriers and to have resilience and stability in the more competitive international financial markets（Kitamura, 1998: 2）. As a result, M&A activities in the Japanese market have become more common under globalisation, while the changes in Japanese banking merger control have highlighted more equity market-led solutions.

Japanese banks ruled the international banking market in 1990s. The government established a top 21 bank-regime (11 city-banks[3], 3 long-term credit banks[4], and 7 trust banks[5]), and some of them, 9 city-banks and 2 long-term banks ranked World Top 25 on Tier 1 Capital in 1995[6]. From 1995 to 2002, they were transformed to a 4-bank international bank-centred financial group (Mitsubishi Tokyo Financial Group, Mizuho Financial Group, and Sumitomo Mitsui Financial Group and UFJ Group*)*, 1 super-regional bank group (Resona Group), and 2 trust-bank centred financial groups (Sumitomo-Trust bank, and Mitsui Trust Holdings). Moreover, in the context of mega-competition, banking mergers in Japan have accelerated, and in October

2005, MTFG finished to incorporate *UFJ Holdings*, and January 2006, and their subsidies, Bank of Tokyo Mitsubishi (BTM) finished merging UFJ Bank.

The Japanese banking-merger authorities, such as J-FSA (before 2000, MoF Banking Bureau) and *Kose Torihiki iinkai* (Fair Trade Committee: FTC) have further adapted to the ever increasing financial globalisation in the respect of their merger control. J-FSA (and MoF Banking Bureau) carries out its domestic banking-merger policy discretionally in terms of banking competition. To the contrary, the Japanese Fair trade Commission, handles the legal procedures and market influence of merger practices via their own statutory standards of antimonopoly (6 rules and 33 guidances in antimonopoly act). The institution accepts Amakudari from MoF traditionally.

On the one hand, J-FSA (and MoF Banking Bureau) operates equity market-led acts for banking institution concentration. Like the US, the Japanese market authority has restricted the organisational structure of financial institutions so as to prevent capital concentration via business integration. For example, bank holding companies and horizontal mergers with companies in other financial sections (insurance, mortgage and so on) had been prohibited until the late 1990s. Japan had adopted a single-business scheme in which banks are exclusively engaged in banking business, insurance companies in insurance business, and securities firms in securities business until financial reform in 1993. J-FSA legislated for financial institutions' merger regulations under mega-competition across the financial sectors through the following framework:

> 1) *lifting of the ban on the mutual business entries through subsidiaries in respective business fields as a result of the financial reform in 1993*
> 2) *lifting of the ban on financial holding companies and the development of regulations concerning subsidiaries by the Financial System Reform Law in 1998*
>
> (FSA, 2006: 7)

This banking supervision introduced the view that the institution for a banking business had developed a business complex consisting of financial institutions engaged in different types of businesses as a result of regulatory changes under financial globalisation. A series of regulatory changes on Japanese financial market from middle of 1990s gave the practical initiative of banking merger control into J-FSA. Pure financial holding company law was enforced in 1999. The Financial Reform Programme in December 2004 further specified the national finance industry policy for international competition, such as establishing financial conglomerates. J-FSA outlines the following issues of the conglomerates in:

(1) More globalizing of the domestic financial market
(2) Reinforcing the competitiveness of each financial-business category (e.g. banking, insurance etc) and cross-bordering 'vertical business categories of the financial industry' (e.g. banks with securities).

(Program for Further Financial Reform 2004)

The meaning of competitiveness for J-FSA lies in both the earning capacity and credibility of domestic financial institutions in the international capital market. J-FSA contains the adaptation to globalisation in its national regulations. As a result of banking activities engaged in the other type of business, J-FSA supervises banking activities across a broad range of business segments. The banking regulations open up the possibility for multiple financial business schemes 'with the lifting of the ban on the mutual business entries through subsidiaries in respective business fields as a result of the financial reform in 1993' (FSA, 2006: 7).

On the other hand, J-FTC looks at 1) processes, 2) patterns (e.g. business combinations across financial segments) and 3) effects (economic power of concentration) of the expected mergers through more equity market-led solutions in term of Antimonopoly Act. The chapter 4 of the Act Concerning the Prohibition of Private Monopolisation and maintenance of Fair Trade 1947 (revised in 2005) authorize the part of role of J-FTC embedded into provisions for the control of M&As. Moreover, the institution attitude to recent banking mergers could be seen in the four guidance of the Act:

- Notification System Concerning M&A by Companies outside Japan 1999
- Guidelines Concerning Companies which Constitute an Excessive Concentration of Economic Power 2002
- Guidelines Concerning Authorization of Acquisition and Holding of Voting Rights by Banking and Insurance Companies under the Provisions of Section 11 of the Antimonopoly Act 2002
- Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination 2004

As a result, financial globalisation forces the relevant authorities to promote more equity-market-led elements in its merger-control. Globalisation seems to change some characteristics in the CME models of corporate control. However, the next section explores that the changes reinforce ‘coalitions of interest’ and emphasises the existing institutional characteristics which coordinate M&A strategies.

Regulatory Changes, National Characteristics, and Stakeholder Attitudes

A series of regulatory changes stimulate stakeholders in banks seeking ways to be more profitable, whilst Japanese financial reforms are essentially defensive, keeping globalisation at bay. The CME model which Japan currently adopts is the best in the long run for their national interests. Therefore, the regulatory changes reinforce a ‘coalition of interests’ and emphasise the existing institutional characteristics which coordinate M&A strategies. In this context, M&A strategies after a series of reforms are the same as before. The regulatory changes in banking M&A seem to re-structure the models of ownership structure in dimension of regulation, in organisational form and in corporate strategy to follow profitability and shareholder value. By seeking maximisation of profitability and shareholder value, banking stakeholders would require banks to take short-term benefits in this market environment. However, M&A cases after the reforms show that changes reinforce ‘a coalition of interests’ and emphasise the existing institutional characteristics of Japanese CME which coordinate M&A strategies. Hall and Soskice ensure that these institutions offer firms a particular set of opportunities and companies can be expected to gravitate toward strategies that and take advantage of these opportunities (Hall and Soskice, 2001:15). The regulators adapt to globalisation, but they support banks to maximise profitability and shareholders’ benefits based on the characteristics of Japanese CME. The former regulator, MoF Banking Bureau addressed domestic financial institutions are defined its profitability and shareholders' value based on 'main-bank and its keiretsu system'.

In order to achieve the best in the long run for national benefits amongst financial firms, the financial industry, and national economy, J-FSA still defines those factors based on 'main-bank and its keiretsu system'. A series of financial system reforms including merger-control reform on financial institutions become defensive, keeping globalisation at bay. Therefore, it is argued that the strategic calculation of Japanese banks remains the national characteristics in the changed market environment. This section explains that Japanese banks maintains its 'corporatist-taste' model of corporate governance, focusing on banking organisational form and M&A activities after the regulatory changes in bank-merger.

Renewed organisational form and M&A activities of Japanese banks tend to change towards an easier access to equity market triggered by the regulatory changes. The traditional discretional banking control of Japanese regulators have promoted more M&A methods and re-structured banking organizational form from single-banking firm to financial holding companies. However, this process is slow. The reason is that national characteristics of stockholder-regime 'coalition of interests' handle the market accessibility. Japanese large banks became subsidies of financial groups, but at the heart of bank-centred financial group. Banks re-organised their group companies in financial markets through the establishment of holding companies, and enhanced their business performance in banking businesses and different segments of the market such as long-term credit, trust, insurance. Banks also enhance their banking business performance and market share through M&A activities. These re-organisational activities increase the members of banking stakeholders within banks, their group companies, business affiliates, and customers, and emphasise characteristics of 'coalition of interests'. Financial holding companies become representative of stakeholders. Managers in a corporate group also act for enhancing the value of the group. In fact, the main-bank system remains a collective system of information, money, and human resources in group companies and business affiliations after establishments of pure financial holdings. The gigantic holding companies concentrate further information, money, and human resources in more broad business networks than before. In this context, holding companies emphasize corporatist characteristics of Japanese CME.

Patterns of Japanese banking M&A activities motivated regulatory changes concludes the defensive way for protecting the corporatist regime's privileged position via 'regime' characterised by home-country advantages, which can effectively enforce their ownership. Industrial organisation literatures explore M&A as a means of enhancing corporate competitiveness and increasing market power. Financial-related literature argues that M&A has an effective means to remove inefficient management, to diversify risk, to reduce financial costs through the creation of internal capital markets where the information is shared, and to satisfy management. Moreover, M&A may also be a defensive reaction against the threat of takeovers. The Japanese banking authority ensures the recent Japanese banking-merger is defensive M&A. The discussion paper of MoF makes clear that Japanese large banks, so-called 10 city banks[7] and 3 long term credit banks[8] and 6 trust banks[9] have 'defensive merger strategies' from international and domestic competitors for international competition since 1997(Kawai 2003: 16).

Since 1990s, banking-mergers between large Japanese banks were merger-method. This is because merger-method protects the institutional arrangements of Japanese political economy. The arrangements are non-market components such as 'extensive relational or incomplete contracts and network monitoring based on the exchange of private information within networks' (Hall and Soskice 2001: 8). Long-termed and stable business dealings accumulate internal information of firms through capital and human relationship. Such inner-firm/social networks share financial capital and human capital. Therefore, banking M&A activities respect blockholder-grouping and control corporate strategies to maximise their objectives. Managers need to choose the M&A method which 'swallows' the whole core of institutional structures of the market, and which guarantees the continuity of the institutions. 'Acquisition' is the economic rational method only for choosing advantages on market principle. To the contrary, merger method respects core institutional structures of market coordination, which bring up opportunities and advantages for corporate outcomes. Therefore, Japanese banking managers intend to enforce the merger-method, especially 'merger of absorption'. As a result, the regulatory changes reinforce a 'coalition of interests' and emphasise the existing institutional characteristics which coordinate M&A strategies. Japanese banks remain their 'corporatist-taste' model of corporate governance.

Stakeholder attitudes are driven by national market coordination.

Conclusion

This research reaches the conclusion that globalisation highlights the national model of corporate governance in the Japanese banking system. Globalisation forces stakeholders to make structural adjustments in the capitalist system or reforms which change the conditions or constraints under which domestic competition policies are implemented, while it preserves some characteristics of the Japanese political economy. Shareholders become more important roles in the Japanese style corporate governance under a set of financial and merger control reforms. However, power-distribution of 'coalition of interests' has not changed after a set of financial and merger-control reforms. In Japanese corporate governance, MCC does not change the political coalition between managers and workers. The essence of MCC relates to corporate structuring and shows, how managers are hired and fired, how ownership is re-allocated, and what the link is between corporate control and shareholder-value.

The Japanese non-market mode of market coordination restricts functions of MCC in Japanese CME. The second part of the paper explores how non-functional MCC has less possibility to take hostile takeovers in the point of relationship between globalisation and market for corporate control in Japanese CME. Therefore, Japanese banks preserve the political coalition in the ownership structure. Parts three and four explore how a series of financial reform-changes provide incentives for corporate managers to maximise stakeholders' value. Globalisation forces the relevant authorities to promote more equity-market-led elements in its merger-control, whilst Japanese financial reforms are essentially defensive, keeping globalisation at bay. The CME model which Japan currently adopts is the best in the long run for their national interests. In this context, corporate compromises of the system disturb managers to depend heavily on competitive market arrangements before and after a series of the reforms. As a result, the regulatory changes reinforce a 'coalition of interests' and emphasise the existing institutional characteristics which coordinate M&A strategies. Banking managers often take the same method of M&A strategies, merger of absorption' in the recent decade. For stakeholders the sense of belonging to the specific Japanese-style corporate governance model has been intensified. Japanese banks maintain a specific Japanese model of corporate governance in the face of tensions between financial globalisation and continuity in the national capitalist model.

---

1 An earlier version of this article was presented at the University of Manchester Centre for International Politics Postgraduate Conference, Manchester, 19 January 2007. I would like to extend my thanks to participants in the Session, Trade and Finance.

2 The Bankers, July 1995-2005.

3 Sanwa Bank, Dai-ichi Kangyo Bank, Fuji Bank, Sumitomo Bank, Sakura Bank, Mitsubishi Bank, Bank of Tokyo, Tokai Bank, Asahi Bank, Daiwa Bank, Hokkaido Takushoku Bank

4 Industrial Bank of Japan, Nippon Credit Bank, and Long Term Credit Bank of Japan

5 Sumitomo Trust Bank, Mitsubishi Bank, Mitsui Bank, Yasuda Trust Bank, Nippon Trust Bank, Chuo Trust Bank, and Toyo Trust bank.

6 The Bankers, July 1995, p125.

7 BTM, Sumitomo Bank, Dai-ichi kangyo , Fuji BankBank, Sanwa Bank, Sakura Bank, Asahi Bank, Tokai Bank, Daiwa Bank, Hokkaido Takushoku Bank

8 IBJ, Nippon Credit Bank, and LTCB

9 Mitsui Bank , Sumitomo, Mitsubishi, Chuo, Yasuda and Tokyo Trust

References

Articles

Dore, Ronald. 1999. *Stock Market Capitalism: Welfare Capitalism*. Oxford: Oxford University Press.

Dore, Ronald. 2005. 'Deviant or Different? Corporate Governance in Japan and Germany,' *Corporate Governance*, 13 (3): 437-446.

Financial Services Agency. 2004. 'Program for Further Financial Reform- Japan's challenge: Moving toward a Financial Services Nation', http://www.fsa.go.jp/news/newse/e20041224-2.pdf, pp.1-12 Accessed October 21, 2006.

Financial Services Agency. 2006. *Guideline for Financial Conglomerates Supervision*.

Gourevitch, Peter A. and James J. Shinn. 2005. *Political Power and Corporate Control*. Princeton and Oxford: Princeton University Press.

Hall, Paul A. and David Soskice. 2001. *Varieties of Capitalism: The institutional Foundations of Comparative Advantage*. Oxford: Oxford University Press.

Porter, Michael, 1990. *The Competitive Advantage of Nations*, London: Macmillan: 117-118.

Kang, Jun-Koo and Anil Shivdasani. 1995. 'Firm Performance, Corporate Governance and Top Executive Turnover in Japan,' *Journal of Financial Economics* 38 (1): 29-58.

Kang, Jun-Koo and Anil Shivdasani. 1997. 'Corporate restructuring during performance declines in Japan,' *Journal of Financial Economics* 46(1): 29-65.

Kaplan, Steven N. 1994. 'Top executive rewards and firm performance: a comparison of Japan and the U.S., ' *Journal of Political Economy* 102 (3): 510-546.

Kaplan, Steven N. and Bernadette A. Minton. 1994. 'Appointments of outsiders to Japanese boards: Determinants and implications for managers,' *Journal of Financial Economics* 36 (2): 225-258.

Kawai, Masahiro. 2003. 'Japan's Banking System: From the Bubble and Crisis to Reconstruction,' PRI Discussion paper Series No03A-28, http://www.iss.u-tokyo.ac.jp/~kawai/pdffiles/respa/dipa200312.pdf, p1-35 Accessed November 2, 2006.

Kitamura, Toshiharu. 1998. 'Background to the Big Bang and Subsequent Developments in Japan−Financial Reform and Its International Implications', ASEAN Seminar held by Japan, November.11 1998, http://www.mof.go.jp/jouhou/soken/kenkyu/ron0008.pdf, pp1-13 Accessed November 2, 2006.

Kubo, Katsuyuki. 2001. 'Directors' Incentive in Japan and the UK, Vierteljahrshefte zur Wirtschaftsforschung,' 70 (2) DIW Berlin: 228-232.

Murakami, Yasusuke. 1982. Towards a Socioinstitutional Explanation of Japan's Economic Performance, in Kozo Yamamura ed., *Policy and Trade Issue of the Japanese Economy*. Tokyo: University of Tokyo Press.

Prowse, Stephen D. 1992. 'The structure of corporate ownership in Japan,' *Journal of Finance* 47 (3): 1121-1140.

Vitols, Sigurt. 2001. 'Varieties of Corporate Governance: Comparing Germany and the UK'. in Peter A. Hall and David Soskice, eds., *Varieties of Capitalism*. Oxford University Press: pp.337-360.

Weinstein, David E. and Yishay Yafeh. 'On the Costs of a Bank-Centered Financial System: Evidence from the Changing Main Bank Relations in Japan,' *Journal of Finance* 53 (2): 635-672.

Wilks, Stephen R. M. 1994. 'The Revival of Japanese Competition Policy and Its Importance for EU-Japan Relations', Chatham House Special Paper, London: Royal Institute for International Affairs.

Magazines

The Bankers, July 1995-2005