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Whither the Japanese Model?: Institutional Change and Emergence of "Many Japans"

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Amidst a prolonged recession and financial crisis during the past ten years, Japan's capitalism has undergone change. In what direction is it moving? Is Japan converging on the US model? Or will it maintain distinctive national characteristics? This paper argues that no single clear pattern has emerged with regard to the future of the Japanese model. Rather, Japanese firms have responded to the challenges differently over the past years. Four systems of governance have emerged. First, the traditional Japanese type of corporate governance, a relationship-based, insider-oriented form, remains in place. Second, very few are adopting a US-style, market-oriented corporate governance. Meanwhile, two emergent 'hybrid' forms mix market/outsider-oriented elements with relational/insider-oriented characteristics. This means that Japan is demonstrating an increasing diversity of mechanisms of governance that prefigure "many Japans."

Keywords: Japanese capitalism, corporate governance, diversity, path dependence, evolution, metagovernance.

1. INTRODUCTION

In the roughly three decades after the defeat of war, Japan made a distinctive capitalist economy, governed by nationally specific social and political institutions that made for high international competitiveness and at the same time low inequality of incomes and living standards. By the late 1980s when the differences in performance and governing institutions between the Japanese economy and other competitors such as USA came to be widely noted, few doubted the continued viability of the "Japanese model" as the most successful of the major economies. Shortly thereafter, "the Bubble" burst in 1991. Japan went into a prolonged economic recession (the so-called "lost ten years"). Suddenly, many experts, government officials, business executives and opinion leaders questioned the very institutions that had been credited with Japan's economic miracle.

Reform advocates concluded that government and industry would have to fundamentally change their ways. They emphasized deregulation and other structural reforms (*kōzō kaikaku*) such as corporate governance reforms. Japanese government and industry leaders responded. The government downsized and reorganized itself, injected tax payer's money into ailing banks, liberalized financial markets, eased labor standards, revised corporate laws, privatized public corporations, and revised pension systems. Likewise, firms sold off subsidiaries, merged with past rivals, switched supply sources, shifted financing methods, introduced new wage systems, and reorganized their board of directors. All in all, during the past ten years since the banking crisis of 1997, the same year when the financial crisis swept Asia, the Japanese government and industry have transformed their institutions and practices. Then, the questions are in order: Is the Japanese model really changing? In what direction is it moving? Is Japan converging on the US model? Or will it maintain distinctive national

characteristics? Can Japan be a 'thought leader' of East Asian countries that are searching for an appropriate post-crisis model of capitalism?[1]

The existing literature either emphasizes the inevitability of Japan's neoliberal convergence (Dore 2000; Hansmann and Kraakman 2004), or stresses the rigidities of its institutional structures that resist change (Lincoln 2001; Anchordoguy 2005; Vogel 2006). Beyond this customary dichotomy embedded in the literature, this paper argues that no single clear pattern has emerged with regard to the future of the Japanese model. Rather, the Japanese government and industry have responded to the challenges differently over the past years. The result has been an increasing diversity of mechanisms of governance that prefigure "many Japans." Diverse forms of mechanisms that govern industries coexist within the Japanese economy. Ultimately, this work suggests a type of meta-governance that accommodates organizational diversity.

Empirically this paper examines how various elements of corporate governance have changed. Corporate governance is often defined narrowly in terms of agency problems between owners and managers within a firm. Instead, this paper takes a broader view of it as involving relations among multiple stakeholders, such as shareholders, managers, employees, unions, banks, government bureaucracy, and political leaders. It is viewed as being embedded within various rules and norms that shape how these stakeholders interact in corporate decision-making. Here, corporate governance is about power and responsibility located within institutional contexts such as the financial system, corporate law, industrial relations, or the regime of political economy where the elements of politics are in play (Gourevitch and Shinn 2005: 1-2). Patterns in corporate governance vary substantially with the broader institutional structures of a given capitalism. In this sense, Japanese corporate governance lies at the core of the Japanese model. Much of what has happened is driven by it (Aoki 2001; Dore 1997, 2000).

The next section begins by briefly introducing the theoretical underpinnings of this paper. It builds on insights from institutional theories such as 'Varieties of Capitalism (VoC)' school (Hall and Soskice 2001). Section 3 sketches the main characteristics of the Japanese model, with analytical focus placed on corporate mechanisms of governance. Section 4 discusses the economic and political forces promoting reform. Section 5 interprets the emerging patterns of diversity and institutional change in post-crisis Japan. Largely four distinct patterns of corporate governance are present. The conclusion provides some suggestions for governing diverse mechanisms of governance and implications for the future of East Asian capitalism.

2. DIVERSITY AND INSTITUTIONAL CHANGE

There is no single form of capitalism. Capitalisms diverge (Albert 1991; Whitely 1992, 1999; Hollingsworth et al. 1994; Whitley and Kristensen 1996, 1999; Boyer 1996; Berger and Dore 1996; Crouch and Streeck 1997; Hollingsworth and Boyer 1997; Kitschelt et al.

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[1] This word is used by Aso Taro, the Minister of Foreign Affairs, Japan in his speech (12/06). "Thought leader is one who through fate is forced to face up against some sort of very difficult issue earlier than others. And because the issue is so challenging, it is difficult to solve. But as the person struggles to somehow resolve the issue, he/she becomes something for others to emulate." http://www.mofa.go.jp/announce/fm/aso/speech0512.html

1999; Iversen, Pontusson, and Soskice 2000; Quack et al. 2000; Dore 2000; DiMaggio 2001; Hall and Soskice 2001; Amable 2003; and Yamamura and Streeck 2003; Morgan, Whitely and Moon 2005). Institutionalist approaches such as regulation and VoC suggest that market forces are merely one factor contributing to capitalist reproduction. Adherents reject the key assumption of neoclassical economics that there is a clearly delimited, socially disembedded sphere of economic action that is driven by the economizing behavior of inherently rational individuals who have a stable order of preferences. Instead they are concerned with the socially embedded nature of capitalist institutions (Granovetter 1985). Just as societies are diverse according to a diverse mix of rules, laws and norms, so are types of capitalisms. Capitalism, as a set of institutions that pattern human relationships to persist or reproduce over time, has diverse forms of mechanisms of governance by which organizations are coordinated and institutions are maintained and reproduced. Hall and Soskice (2001), leading VoC approach, divides various capitalisms into two categories. One is a liberal market economy (LME) identified with neoliberal policies, labor markets setting wages through competition, corporate financing through capital markets, and Anglo-American countries. The other is a coordinated market economy (CME), where social and political institutions engage directly in shaping economic action. Labor markets are strongly regulated and corporate financing is made through long-term relationship with banks. This form is linked to social democracy and non-Anglo American countries.

This dichotomy may suppress the important diversity within the CME category. Hall and Soskice respond to this criticism by accounting for ‘second-order’ differences among CMEs. For example, many of the northern European cases demonstrate industry-based coordination while in Japan and Korea, group-based coordination prevail. In the former, coordination depends on business associations and labor unions that are organized primarily along sectoral lines. By contrast, coordination in the latter builds on keiretsu, or families of companies, with dense interconnections cutting across sectors. Hall and Soskice also note that France is a case that does not correspond to the ideal types of either LME or CME (Hall and Soskice: 34-6).

Hall and Soskice extend their works further by making a claim that a particular set of institutional structures provides firms with advantages for engaging in specific type of activities (2001: 37-9). In CME, firms make more extensive use of non-market modes of coordination to organize their activities, while in LME, firms rely mainly on markets to coordinate their activities. The former is better at supporting incremental innovation, while the latter is highly supportive of radical innovation. The finding is that Japan specializes in technological developments that are just the reverse of those in USA. Yamamura (2003) argues that the US model performs better during periods when technology is changing fundamentally and rapidly while the Japanese model performs better during periods when technology is evolving slowly. Likewise, Anchordoguy (2005) explains why communitarian Japan as a CME variant finds great difficulty in promoting IT industries.

This brings us to an important point on institutional change. In VoC, typologies are fixed over time; institutions persist. This is particularly so because institutional complementarities work in each form. Complementarities exist where components of a whole mutually compensate for or reinforce each other. VoC either anticipates that strong complementarities among institutions within a capitalist form generate disincentives and substantial barriers to radical change. Or, it anticipates that complementarities may entail change in one institution creating momentum for changes in other institutions, leading to radical change (63-4).

Both ways of anticipation lead us to another aspect of dichotomy in terms of change: stability vs. radical change. A Concept of this kind is consistent with the conventional path of

dependence literature. Thelen is critical on this point, however. She points out that there is a wide variety of modes of institutional change among which is an evolutionary, incremental one (Thelen 2004, 2005). Given a varied patchwork of a set of polar contrasts, there is no room for "hybrid" forms to be recognized as a viable option. Hybridization, as opposed to simple imitation of the exogenous model as well as *status quo*, is the usual outcome of attempts at borrowing institutions and practices. Mixing of institutional forms is quite common in practice (Zeitlin and Herrigel 2000).

The second point is in order. Several distinctive mechanisms accounted for by VoC, such as sunk costs, learning effects, coordination effects, and institutional complementarities, all operate at the national level. Most typologies of capitalist diversity are based on the nation-state, or the national economy. This is not because of any inherent tendency of institutional analysis to the nation-state, nor because of normative preference on the part of theorists for markets to be intervened by the state. It is the belief that twentieth-century capitalism was organized and regulated by the state (Crouch and Streeck 1997: 2). According to Aoki, diversity among skill formations occurs at an inter-national rather than inter-industry level. "There is a tendency for a single organization mode to prevail and become established as a convention within each economy (2000: 46)." In sum, the VoC literature takes the centrality of the nation-state in shaping the modes of governance for granted (Crouch 2005: 41).

The nation-state cannot always be treated as a unit of the same phenomenon, however. Some empirical findings follow. Dualism persists in the German model. Herrigel (1996) demonstrates that two distinct mechanisms of governance (decentralized versus autarkic industrial governance), located in different regions, have characterized the modern German experience. The two-Japan thesis, one made up of highly competitive export sectors and the other comprised of inefficient protected sectors, also demonstrates weakness of a national-level analysis (Katz 1998). VoC works should be clear about the distinction: arguments about the characteristics of national economy limited to specific sectors, or claims about those to apply to all.

In sum, in order to better understand capitalist diversity and particularly institutional change under systemic stress, we need to deconstruct the taken-for-granted prevalent conceptions of institutional change. Central to the account of this paper are these two conceptions. First, change can occur in diverse ways, including a hybrid way. Second, diverse institutional forms can coexist in a national economy.

3. JAPANESE SYSTEM UNDER PRESSURE

3.1. Traditional Model

During the high-speed growth period, a Japanese-style corporate governance system emerged. It is characterized as twofold: one is an external side of governance that is shaped by inter-firm relations such as bank-firm relationship. The other is an internal side of governance that is characterized by intra-firm relations among the management, owners and employees.

The traditional Japanese financial system is best characterized by its bank-centered system. Capital markets were underdeveloped. Firms relied on bank loans. Under this condition, firms tended to have a stable, tight relationship with a specific bank. In Aoki and Patrick's term, it is a "main bank" relationship, "a more or less informal set of regular

practices, institutional arrangements, and behavior that constitute a system of corporate finance and governance." (Aoki and Patrick 1994: xxi) The main bank establishes a cross-shareholding relationship with a firm, provides loans, provides the majority of its other banking needs, and acts as a leader within a group of institutions that provides funding. Further, it monitors the client firm and intervenes when the it runs into financial difficulty. It is expected to organize a work out to save (Hoshi, Kashyap, and Scharftein 1991; Sheard 1994).

Japanese firms not only held cross-shareholding with banks, but also with other industrial firms. These horizontal groupings form dense and stable networks based on long-term relationships (Gerlach 1992). The ownership ties often overlap with various other cooperative business relationships within corporate groups (*keiretsu*). The vertically structured keiretsu such as the famous subcontracting relationships in the automobile industry also belong to this category. Here, stable shareholders protect firms from hostile takeovers and short-term stock market pressures. This enables firms to pursue a long-term management perspective, a characteristic feature of Japanese firm.

In what is called stakeholder capitalism (Dore 2000), the interests of employees play an important role. The primary concern of top managers is the long-term prosperity of the firm and welfare of members. Profits are secondary. In this firm, long-term employment is the norm. It is supported by strong legal constraints on dismissals, and equally by seniority-based wages and rank-hierarchy system of promotion.

The board of directors is an extension of internal promotion. Board members consist almost entirely of internally promoted employees. As such, the president and top managers are seen as the elders of enterprise community (Dore 2000). The statutory auditor has become an honorary position bestowed to former high-ranked managers.

In summary, Japanese corporate governance includes a number of interrelated institutions. Japanese firms are governed by insiders. The market for corporate control does not work. An Insider-oriented board is sustained by a particular labor relations system such as long-term employment and seniority-base wages which, in turn, enables firms to invest in firm-specific skills, being the source of distinct comparative advantages for incremental innovation in the manufacturing sector. Insider governance is supplemented by 'contingent governance' by the main bank as well as stable ownership ensured by cross-shareholding with keiretsu firms. Ultimately, the state monitors the main bank, promotes industry, and ultimately provides the contexts by which all the institutions subsist and reproduce.

Japan has achieved astonishing economic growth, at an average annual rate of 9.3 percent in 1956-1973 and 4.1 percent in 1975-1991. Between 1956 and 1973 Japan quadrupled its gross domestic product per worker. It became the second largest economy in the world. By the time the Cold War ended, Japan was heralded as the real winner. The bursting of the bubble, however, was a big turnaround. The subsequent, prolonged economic recession has driven change in corporate mechanisms of governance.

3.2. Globalization and liberalization of Money and Finance

Financial deregulation in Japan was a gradual process beginning in the late 1970s and culminating in the so-called "Big Bang" of 1997. The state deregulated the secondary markets for government bonds, followed by the 1980 revision of the Foreign Exchange Law, which opened the door for cross-border finance. Just as profitable Japanese firms, mostly

Table 1. Corporate Finance: All listed firms in Tokyo Stock Exchange (billion yen)

	Bank Debt	Bond	Domestic Market	Foreign Market	Straight Bond	Convertible Bond and Warrant Bond
1975-79	117,840	19,730	74.30%	25.70%	72.00%	28.00%
1980-84	195,332	32,881	50.70%	49.30%	43.50%	56.50%
1985-89	328,426	123,159	50.10%	49.90%	16.50%	83.50%
1990-1992	288,445	104,947	37.90%	62.10%	59.10%	40.90%
1993-1995	51,775	84,939	71.00%	29.00%	60.90%	39.10%
1996	NA	118,184	79.80%	20.20%	61.80%	38.20%

(Data calculated from Bank of Japan, *Shuyo kigyo no keiei bunseki* and Nomura shoken, *Shokentokei yoran*)

export sector firms, could finance their projects from overseas, so did the state allow firms to issue bonds and equity domestically at market prices in order to compete (Table 1).[2]

With new opportunities, large firms, in particular, reduced their reliance on bank loans and diversified their financial resources. The ratio of equity finance (i.e., equity, convertible bond, warrant bond) to total corporate finance increased dramatically. The average of the total amount of bonds issued from 1985 to 1989 increased by more than 140 percent from ones issued between 1980 and 1984. By contrast, during the same period, bank borrowing declined dramatically. The share of bank loans declined by about 10 percent points from the late 1970s to 1990. Although the amount of debt capital raised had declined in the 1990s because of the prolonged recession, bond issuance did not decline as drastically as bank borrowing (Table 2).

As mentioned earlier, main banks had played a disciplinary role in the Japanese financial system. With the decline in bank financing, main banks faced challenges. Those who left banks were good clients, equipped with a wide range of debt choices. This led banks to find new clients in order to fill the gap. Adverse selection was caused. Banks found risky firms, such as firms in construction, real estate, and non-banks (Hoshi 2001).[3] The bubble economy

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[2] Japanese firms could finance in the Euromarket and Japanese financial institutions opened branches overseas. They became a major player in the Euromarket, which allowed them to circumvent domestic restrictions. Since this market did not require collateral, firms could lower the cost of bond issues. One study shows that eurobond issuance costs were less than one-tenth those of a domestic bond in the early 1980s.Matsuo Junsuke, *Nihon no shasai shijo* (Toyokeizai shimbunsha 1999), p. 81.

[3] It is misleading that financial liberalization led to banks' lending to risky projects. Hoshi and Kashyap (2001) point out that 1980's financial liberalization unevenly affected firms, households and banks. While it broadened the range of choice for firms to finance, the options for households (savers) and the range of services that banks could provide did not expand simultaneously. Due to a slow pace of deregulation in the compartmentalized financial system, banks could not successfully pursue a universal banking strategy by broadening the range of services while household assets were held in bank deposits. This uneven development induced banks to risky projects which caused the bubble, leading to financial crisis in the 1990s. See also Takeo Hoshi and Anil Kashyap, "The Japanese

Table 2. Sources of External Funds, Flow Data: 1971-95 (percentage distribution)

	Securities Market				Domestic Borrowing				
years	Total	Equity	Domestic Bond	Foreign Bond	CP	Total	Private Lender	Public Lender	Foreign borrowing
1971-75	10.9	4.3	0.3	6.2	0	86.3	78.4	7.9	2.8
1976-80	14.2	4.7	1.6	7.9	0	83.0	71.6	11.3	2.8
1981-85	16.2	2.9	5.1	8.2	0	84.5	77.3	7.2	-0.6
1986-90	28.1	3.8	8.9	9.7	5.8	66.2	58.9	7.3	5.7
1991-95	20	20.4	0.8	4.2	-5.4	75.7	43.0	32.6	4.3

Source: Hoshi and Kashap (2001), 244.

firms with good valuation.

3.3. Capital market pressure

By the mid 1990s, Japan had began to face strong pressure from global capital markets. This came with the troubles in the banking sector which suffered from huge NPLs piled up after the bubble burst. In 1995, two credit unions and a regional bank failed. The difficulties that faced housing loan companies (*jusen*) became a hot political issue. A heated discussion of how to bail out *Jusen* and other ailing financial institutions made it clear that even healthy banks would suffer if they bore the costs of bailing out ailing institutions under the convoy system.

Domestic problems were immediately transmitted into the global markets in the form of the so-called "Japan Premium." Stock prices of banks declined while rating agencies such as Moody's and Standard and Poor's downgraded the rates of the banks. The main banks that were rated AA or higher during the early 1990s dropped to A and BBB by 1996. The banking crisis of 1997 — the fall of the Hokkaido Takushoku Bank, the collapse of Yamaichi Securities and the spread of the Asian Financial Crisis — all led to a furthering drop in bank stock prices, downgraded credit ratings, and increased Japan Premium.

Meanwhile, the steady decline of stock prices attracted foreign investors who now valued Japanese stocks as cheap relative to others in the global market. Foreign portfolio investment increased dramatically. In 2005, foreigners owned 23.7% of the stocks listed on the Tokyo Stock Exchange (TSE). Table 3 illustrates that the share of institutional investors in firms representing Japan is over 50 percent, and that of foreign investors in those firms is over 30 percent. Likewise, stock market turnover increased dramatically from 27% in 1992 to a

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Banking Crisis." In Ben Bernanke and Julio Rotenberg eds., *NBER Macroeconomic Annual* 1999.

[4] Hoshi and Kashyap conclude that the combination of lower borrowing and less board representation reduced bank's bargaining power with firms and the ability of banks to play an important role in corporate governance. Hoshi and Kashyap, *Corporate Financing and Governance in Japan* (Oxford 2001), p. 257.

Table 3. Foreign Share in Key Japanese Firms

Rank	Company	Institutional Investor			Foreign Investor		
		1974	1990	1999	1974	1990	1999
1	Canon	29.4	41.6	60.4	3.7	15.5	40.7
2	Hoya	16.5	28.7	58.1	7.8	5.0	29.9
3	Yamanouchi Seiyaku	27.7	41.1	57.5	2.0	18.8	38.3
4	Rom	-	11.1	56.2	-	6.0	42.9
5	Murata	16.4	30.8	55.5	0.1	14.9	36.0
6	Furukawa Denki	13.6	24.7	54.0	0.1	5.0	37.0
7	Sony	41.3	29.5	53.3	38.0	18.8	44.6
8	Takeda Yakuhin	25.3	32.9	53.3	3.4	6.0	27.7
9	Fuji Film	33.9	29.7	53.1	14.8	9.7	35.6
10	TDK	15.1	35.7	51.9	1.1	12.1	36.8
11	Yokyokawa Denki	44.2	52.9	51.3	1.3	9.7	18.6
12	Mitsumi Denki	7.2	18.6	50.8	7.2	3.7	28.3
13	Sumitomo Denki	31.5	44.2	50.8	6.2	14.9	25.1
14	Pioneer	17.1	34.7	50.3	5.7	12.7	36.5
15	KOA	19.5	30.0	50.2	0.3	0.9	30.4
16	Sanko	18.9	37.4	50.1	1.3	15.2	30.1
17	Shionogi	30.8	30.1	50.1	2.1	2.6	31.2
18	Kurata	5.6	34.2	50.0	3.6	8.6	36.3
19	Crare	16.4	41.7	50.0	0.0	11.0	24.3
20	Shinkoshi	15.9	35.4	49.7	0.1	11.0	25.8

(Data calculated from Tokyo keizai shinbunsha, *Kigyo keiretsu soran*, Nikkei NEEDS)

historically high level of 108.8% in 2005 (Jackson and Miyajima 2007). The sharp increase in foreign share and market turnover disrupted stable shareholding patterns among firms and banks.

3.4. External Governance Change

Liberalization and globalization of finance, the rise of capital market pressure and, most of all, the long economic recession culminating in the banking crisis caused substantial changes in corporate mechanisms of governance in Japan. Yet changes are uneven across different institutions of corporate governance. Financial globalization and liberalization dramatically changed the bank-centered financial system in Japan. As corporate financing has diverged into two (bank-financing firms and bond-financing firms), bank-financing firms have maintained the main bank system whereas bond-financing firms have been left out. In particular, large-scale firms lessened ties with banks while small-scale firms continued borrowing from banks (Miyajima and Arikawa 2004). It is followed by the diminishing role

of banks with regard to corporate governance in large-scale firms. Likewise, the corporate governance role of banks vis-à-vis small or financially distressed client firms diminished. Banks facing financial distress engaged in soft-budgeting and followed and "evergreen" policy of rolling over loans to distressed firms (Jackson and Miyajima 2007, 19). In this case, banks serve as the main provider of loans, but not as disciplinarian (= traditional main banker) to firms.

Given the power of foreign institutional investors dramatically increased in TSE, investment targets are invariably the firms with a high reputation in the capital markets (high ranks by international credit rating agencies) and high ROE. This means that foreigners invest in firms that are mostly large-scale, low leveraged, highly profitable (or high expected return) and given full access to the bond markets. The foreign investors put pressure on those firms in the way that firms pursue transparent and ROE-centered business management. In doing so, foreigners affect corporate governance by participating on boards of directors.

The weakening of the main bank relationship coupled with increased foreign portfolio investment is an important element of the declining ownership stabilized by cross-shareholding. In the *2006 Economic and Financial White Paper*, the percentage of cross-shareholding declined from 20% in early 1990s to 7.6% in 2003. The percentage of stable ownership also decreased from 40% to 24% in the same period (Cabinet 2006, 174). Again, dualism emerges. Profitable firm with easy access to capital markets and high foreign ownership reduced their relationship with banks and sought to improve their market valuation by dissolving cross-shareholdings with less profitable firms. Together, distressed banks had to sell high-priced stock shares in order to improve their balance sheets. By contrast, less profitable firms with difficulty in accessing capital markets and less foreign investment maintained bank relationships and cross-shareholding (Miyajima and Kuroki 2007).

3.5. Internal Governance Change

Despite substantial changes in many elements of Japanese corporate governance, long-term employment practices persist. The 2003 METI survey shows that over 80% of firms continue their commitment to long-term employment. In the *2006 Economic and Financial White Paper*, the same commitment increased to 90% (Cabinet 2006, 180). But firms no longer maintain seniority-based pay. They have introduced either a merit-based payment system or more complex types of payment systems that combines seniority and merit. And yet, insider governance faced reform. Board reform is the case in point. While introducing independent outside directors is the core of reform, Japanese firms are given options. Some introduced the American-style board of director, others stick with the traditional Japanese-style, and still others introduced the executive officer system (*shikko-yakuin sei*), a hybrid form.

Given these institutional changes, Japanese firms demonstrate a continued commitment to the so-called "Japanese-style management (*Nihon-kata keiei*)" characterized as emphasizing employee-oriented and market share-oriented (as opposed to shareholder-oriented, ROE-oriented) management (Ibid., 182). Further, the survey by the Cabinet found a positive relationship between long-term employment and corporate performance (186).

3.6. Diversity in Governance

Japanese corporate mechanisms of governance are not moving in a uniform way. Theories of convergence point to growing international capital mobility and competitive pressure to generate shareholder-oriented governance. The US model plays a hegemonic role in this sense (Dore 2000). The findings of recent research suggest otherwise. During the past decade, Japan has transformed itself substantially. It has clearly moved toward a more market-oriented, American model of governance. Nonetheless, very large differences remain firm. Not all industries and firms are equally exposed to pressures for change. Nor are their responses to those pressures. There emerges an important diversity of corporate governance in contemporary Japan.

The emergent diverse forms of corporate governance can be categorized into four types by using two indicators: external governance structures (financial and ownership characteristics) and internal governance structures (board and employment characteristics). In terms of the former, there are market-oriented (e.g., bond finance and institutional investors) and relational (e.g., bank financing and cross-shareholding) patterns. In terms of the latter, there are outsider/market-oriented (e.g., outsider boards, high disclosure, no long-term employment, merit pay, and use of stock option) and insider/relational (e.g., insider board and private information, long-term employment, seniority pay, and no stock option) patterns.

Looking at Figure 1, four types of corporate governance are established. The upper left-hand corner(A) represents the traditional Japanese type of corporate governance with relational patterns of external governance such as bank finance and cross-shareholding (stable ownership), coupled with relational patterns of internal governance such as insider

Figure 1. Emergent patterns of corporate governance in Japan

	Insider board Relational employment	Outsider board Market employment
Relational finance Low shareholder influence	《A》 **Japanese model**	《C》 **Hybrid model (II)**
Market finance High shareholder influence	《B》 **Hybrid model (I)**	《D》 **American model**

boards and long-term employment. The lower right-hand corner (D) approximates US-style corporate governance (Anglo-American type) with market finance, high shareholder influence, outsider boards, and market employment patterns. Meanwhile, the two 'hybrid' forms mix market/outsider-oriented elements with relational/insider-oriented characteristics. The lower left-hand corner (B) has market finance and strong foreign and institutional ownership, but retains relational elements of employment and to a lesser degree some characteristics of insider boards (higher transparency but fewer independent outsiders, establishing 'executive officer'). Finally, the upper right-hand corner (C) is another hybrid form that shows relational finance and cross-shareholding combined with market-oriented board and employment pattern.

The recent work by Jackson and Miyajima (2007) suggests that while A-type of corporate governance remains most common among Japanese firms, B-type is becoming the predominant pattern among large Japanese firms (33). Blue chips such as Toyota, Canon, Kao, and Yamaha represent this pattern. The best example is Toyota. While external governance clearly shifted to market orientation (market financing along with high level of foreign shareholding and low cross-shareholding), Toyota's internal governance stayed relational. It has resisted outside directors and strongly maintains long-term employment practices coupled with a moderate level of merit-based pay. Some of groups that retain more traditional Japanese characteristics, such as the modest use of bank financing and predominant practice of seniority-based pay, have made a modest but significant degree of governance reforms toward B-type. Examples are Hitachi, NTT DoCoMo, Tokyo Electric Power and many large Mitsubishi keiretsu firms (38).

C-type includes IT or high-tech service firms, retail firms, general trading firms, and family owned firms. In general, Japanese service industry prefers more market-oriented governance in terms of employment patterns with low levels of long-term employment as well as using merit-based pay and stock options (38). But these firms rely on bank financing and a modest level of inter-firm relational practices. One deviation from C-type is board structure. These groups retain insider board structure (38). Finally, few firms are close to convergence. The example of Sony and Orix is closer to D-type.

Despite powerful forces for change during the past decade, the emergent phenomena are far from convergent. While many firms still retain the traditional Japanese model, few are large firms that matter most in defining Japan's future. A significant proportion of large firms have significantly shifted from the original model. But shifts are not uniform. Among many of Japan's profitable, mostly manufacturing sectors, external elements of governance such as financing and inter-firm relationship patterns have shifted clearly toward more market-oriented ones while changes to the internal elements of governance have been partial and selective. Mostly in service sectors, internal elements have shifted toward more market-based sector while changes to the external elements have been slow. In some, both internal and external elements are converging to the American model. To put it simply, Japanese firms are moving in three ways: from Type-A to Type-B, Type-C and Type-D.

4. CONCLUSION

Japan is broadly characterized as 'coordinated market economies' where corporate ownership, finance, inter-firm relationship, government-business relationship, and labor relations all display higher degrees of coordination based on relationship-specific assets and

long-term ties. Faced globalization, capital market pressure, and prolonged economic slump, Japan has been hard pressed to reform. Given the ascendancy of the American model, there were powerful voices advocating reforms for convergence. Despite Americanized policy discourses prevalent in Koizumi's structural reform, we have found that government officials and corporate leaders engaged in 'mixing' (or 'hybridizing') institutions. Institutional change occurs in diverse ways: four distinct forms of emergent corporate mechanisms of governance; three remain in the CME camp and one closing in LME's. Second, all of these forms coexist within the Japanese political economy.

Now in 2007, Japan has clearly entered a period of sustained macroeconomic recovery. Corporate restructuring has become routine. Firms are less concerned with cash flow problems. Banks are more or less free of NPL problems. The conservative rule has been reinstated by Koizumi's remarkable political success. Thus, it is expected that the changes in corporate governance are likely to be consolidated. Diversity rules. At this point, several implications for Korean capitalism are in order.

First, in both countries, the dynamic of emulating the American model has driven the reform process. Policymakers are always vulnerable to the charge that local practices are out of line with global standards (= American standards). Liberal reforms will not be achieved by deregulation only. The state must not only dismantle the preexisting regulatory framework, but also create and foster the institutions that sustain market competition (Vogel 1996). In this sense, for Korea and Japan to move toward the American model, they must dismantle the existing institutions and create new ones. Given the institutional complementarities operating in a specific capitalist system, this task requires a full conversion at all levels in the system. Here, attempts to switching systems are costly (Freeman quoted in Vogel 2006, 211).

Second, the Japanese experience suggests that policymakers should calculate relative benefits and costs of existing institutions when designing reforms. After careful judgment, Japanese policymakers crafted a corporate governance reform in the form of corporate law by giving freedom to adopt different governance structures, rather than forcing them to do so. This approach is plausible because firms are given greater choice and flexibility to experiment with what best serves their prosperity. The emergent diversity of institutions is the outcome of flexible policy response.

Finally, in the age of globalization characterized as an open-ended process of rapid, unexpected transformation with regards to technology, market and organization, a political economy more open to diverse practices and institutions as well as of technologies is desirable. Cumulative, sustained, and motivated institutional framework that copes with diversity is necessary. Given four diverse and distinct governance forms, this framework involves what Jessop calls 'metagovernance' or 'the governance of governance' (Jessop 2003, 240). Metagovernance organizes the conditions for diverse governances. Thus it is an umbrella concept for redesigning, rearticulating, and steering the coexistence and relationship among different modes of governance. It is not the one that imposes a single, all-purpose mode of governance, nor privileges one over the others. Rather it involves sponsoring new organizations, designing institutions to facilitate self-organization in different modes, creating linkage/interdependence devices among different governance modes, encouraging a relative coherence among diverse objectives, and helps shape the context within which these arrangements can be forged (Ibid., 242).

It is the Japanese state that should play a major role in metagovernance. It should not privilege one form over the others. Rather, it should provide ground rules for governance through which each mechanism of governance can pursue its respective aim; ensure the

compatibility or coherence of each governance mechanisms; and act as the primary organizer of the dialogue among diverse participants. This is the area where Japan can play the 'thought leader' role in East Asia. Japan has faced governance problems earlier than others, and struggled to somehow resolve the problems in within ten years. Japan will gain a soft power, something to emulate if it finds a form of metagovernance that is more open to a diversity of practices and experiments, better able to combine two contrasting standards of efficiency – competition and cooperation – together, able to shape a polity more oriented to the repeated practices of reform, more capable of generating diverse conceptions of its future.

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