**SPECIAL ISSUE:
BUSINESS AND INDUSTRY IN MODERN JAPAN**

**Japanese Management in Historical Perspective:
Informal, Integrative, Democratic, and Focused
on the Long Term**

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Introduction

There are no explicit designs or rules which can be used to describe "Japanese management." It is an informal system of business management containing many practices which appear to be unique to Japan and which seem to have developed because of particular characteristics inherent in Japanese society. However, "Japanese management" is essentially a rational system, modeled, for the most part, on Western methods or systems, but modifying those systems to fit Japanese circumstances. For example, the Japanese learned quality control from an American engineer, but developed it into a system of total quality control unique to Japan. In short, "Japanese management" is not a myth. Rather, it is a product of economic rationality, the reasoning and application of which is to some extent uniquely Japanese. It is important to remember in this regard that "Japanese management" differs from management in other countries only in relative terms, although such relative differences are often very difficult to understand and sometimes become the source of international disagreements.

This author once found it difficult to convince some American students that no special promises are made to Japanese employees taking up lifetime employment in particular firms and that, in fact, no real contract is involved for such long-term employment. In many ways, business practices in Japan are informal and differ greatly from those in the United States where nearly everything is based on a formal contract. Such differences in social practice cannot be explained only in economic terms. We must therefore occasionally resort to sociological terms and refer to "cultural structure," that is, the patterns of thinking and behavior peculiar to a given country or society.

It goes without saying that the unique features of "Japanese man-

agement” can be explained to a large extent by the nature of the “economic process” of Japan’s industrialization, its rapidity, and the scarcity of the resources in demand. However, an economic understanding of “Japanese management” must be supplemented by sociological interpretations that focus on the acquisitive, competitive and integrative behavior of the Japanese people, bearing in mind that these patterns of behavior can to some extent be explained by the country’s unique economic conditions.

It is also necessary to take into account the problem of “organization”, particularly when we try to understand postwar Japanese business management. Japanese business in the postwar period has been much more organized than the prewar version. In addition, in spite of the rapid disappearance of “familism” in postwar Japanese society, a strong “family-like” integration has remained, and perhaps even expanded in large-scale business enterprises. Therefore, we may argue that it is the business enterprise or business “organization” itself that has fostered “familism” in postwar Japan. It would not be an exaggeration to say that big business is now the last stronghold of Japanese “familism”.

To understand “Japanese management,” it is necessary to trace the process of interaction between cultural, economic and organizational factors which have resulted in the development of a business management system unique to Japan. This author believes that business historians stand to benefit from promoting such an interdisciplinary approach to this controversial subject.

Additionally, the “Japanese employment system” cannot be fully understood except in the context of its close relationship with the unique financial structure of Japanese business enterprises. For example, the allegiance of Japanese employees to their companies is most often discussed in terms of traditional Japanese “groupism.” However, such “groupism” must be considered as the sense of community interest which has gradually developed out of the unique financial and managerial structures of Japanese enterprises.

Japan, a latecomer to industrialization, had to adopt the joint-stock company system at the beginning of the industrialization process. Consequently, the age of the family business in the history of modern Japan was a limited one; in the prematurely born managerial enterprise, workers had some sense that their efforts aimed at increasing the company’s prosperity might enhance the level of their own material well-being as well. This sense of a community of interest was further expanded in post-World War II Japan by the overall retreat of prewar

capitalists and by the conspicuous reduction in income disparities between management and labor.

I. The “Japanese Employment System”

Until the end of the 19th century, systematic management practices had yet to appear in Japanese industrial plants. Artisans at government and private shipyards were employed by skilled boss workers and followed their bosses from one shipyard to another, seeking better pay and better working conditions. Cotton mills, which from the very beginning were established as joint-stock companies and had introduced ring frames, struggled to entice skilled female workers from competing mills.

In the early 1890s, the Cotton Spinners Association ruled that it was inappropriate to steal workers from competitors' mills. Major mills instead turned to recruiting young farm girls and housing them in dormitories. Nevertheless, working conditions in the mills were poor and the rate of worker mobility very high, most girls quitting within a few years. After the turn of the century, however, each major cotton mill established and acquired new plants at several sites across the country and began to produce finer yarns capable of competing with Lancashire goods. The demand for skilled workers increased and cotton mill managers had to improve working conditions by establishing workers' health funds, company stores and company schools for young female spinners and male mechanics.

The shortage of skilled workers was more serious in the rising heavy industries, such as shipbuilding, rolling-stock manufacturing and iron and steel mills. In these industries, the technological discontinuity between traditional craftsmanship and modern, western-style mechanical skills was very conspicuous. Furthermore, the frequent strikes provoked by inflation and the labor union movement during and after World War I forced Japanese industrial firms in both light and heavy industries to introduce more scientific labor management.

First of all, major firms in the heavy industries tried to wrench factory apprenticeships away from the control of traditional gang bosses, *oyakata*, by creating new company apprentice schools where educated engineers devoted themselves to training young workers, using a combination of shopfloor practices and theoretical education. Such company apprentice schools were uniquely Japanese in that, in contrast to registered apprenticeship programs in Western countries, they were managed by neither labor unions nor by chambers of commerce, but

by educated engineers at individual firms. It was to be expected that worker training of this kind at the company's expense should be directed toward the specialized tasks required by individual factories and that companies should be eager to retain the graduates of company schools for as long as possible. To keep such young skilled workers in their factories, companies offered a series of inducements, including payment and promotion based on seniority and generous company welfare programs. These inducements eventually led to the development of the Japanese "life-time employment" system.

In the case of cotton spinning mills, from the turn of the century the task of management had already shifted from recruitment of a labor force to the raising of labor productivity by long-term employment. For example, in the Kanegafuchi Cotton Mills (Kanebo for short), the general manager, Sanji Muto, replaced recruitment and training by *oyakata* with the establishment of company schools. In 1902 the *Yonen Shokko Yosei Seido* (young mechanics training system) was established, under which new male graduates from primary schools were housed in dormitories for three years and educated at the company's expense. Two years later the *jogakko*, a school of general education for young female workers was started. Muto also introduced a workers' cooperative society along the lines of the Krupp Steel Co. in Germany and the National Cash Register Co. in the U. S., emphasizing the importance of family-like, "warm-hearted" cooperation between management and labor for the long-term development of the Kanebo company.

Obviously, this kind of "Japanese management" system was not simply a continuation of the traditional employment practices of the merchant houses of the Edo period; rather, it was an achievement of gradual managerial innovation, promoted by educated managers and engineers in order to overcome the shortage of skilled workers in the growing Western-style industries. However, it would be totally wrong to believe that this system did not bear any resemblance to the traditional employment system. The three pillars of the Japanese employment system, "life-time employment," payment and promotion based on seniority, and in-firm welfare systems, were already well developed in merchant house management in the 18th century, and in the case of white collar employees, the modern large-scale enterprises had in fact been the direct heirs of such practices of managerial "familism" through the government enterprises of the Bakufu and the Meiji authorities.

The concepts of *kagyo* (family business) and *kasan* (family fortune)

found among Edo merchants were uniquely Japanese in that family kinship interests were frequently disregarded for the sake of continued prosperity of the “family business” and “family fortune.” An able candidate to lead the house was often adopted from outside the family and the name of a non-family manager who had successfully served the family business for a long time would be formally added to the family genealogy as head of a new associated family. In other words, the *kagyo* of the Edo period was considered a kind of corporate unit. In light of practices of this kind, it is not surprising that the employment system developed in these “corporate units” was readily applied to modern businesses established as public joint-stock companies.

In addition, we should not overlook the fact that the corporate nature of Japanese enterprises has been maintained on the basis of entirely informal relations. For instance, when an individual is employed by a Japanese company, the formality of an employment contract is rarely engaged in, nor is there any promise of long-term employment. The Japanese employment relationship is just as informal as the kinship relationship. There is nothing more than a mutual expectation that an employee will work in the company for life and that the company will never discharge an employee except in the case of bankruptcy.

II. Japanese Business Enterprise as Community Interest Group

The high level of integration of Japanese employees in working for their companies has been supported not only by the “Japanese employment system” but also by the unique financial and managerial structure of Japanese enterprises. In fact, the employees of large-scale enterprises in Japan can find it fairly difficult to comprehend for whose interest they are working so hard every day. At the same time, employees can perceive without much difficulty that their hard work is likely to contribute to the security and improvement of their lives.

Until quite recently, the ratio of so-called “owned capital” (stock capital plus reserved fund) to total capital in large-scale industrial firms was very low in Japan. It decreased from about 40 percent in the 1950s to less than 20 percent in the early 1970s. The remaining proportion of the total capital of large scale industrial firms was mostly borrowed from banks. Moreover, the stock capital of the major banks themselves was only one or two percent of total resources; 97 percent came from individual and corporate depositors. Japan’s postwar economic development was thus achieved not with stock capital subscribed by

individual capitalists, but with borrowed capital, financed by banks collecting resources from the public, whose savings ratio has been more than 20 percent since the early 1960s. The Japanese economy might be characterized as a capitalist economy without capitalists.

Given this kind of capital structure, it is easy to understand why profit maximization is not always the ultimate objective of Japan's large-scale enterprises. The goals of enterprises have not been set by short-term monetary yardsticks, like the rate of profit or the amount of revenue, but rather, by long-term objectives, such as the growth of the firm, as represented by its increase of market share and the maintenance and expansion of employment opportunities for all the firm's employees. Japanese business firms can therefore to some extent be considered as communities of interest of management and labor.

The structure and function of the board of directors in Japanese big business clearly demonstrates this basic nature of Japanese enterprises as communities of interest. Contrary to the theory that a board of directors represents the interests of stockholders by appointing a president and other executives and supervising their activities, in Japan the directors are themselves executives of the firm who have climbed the executive ladder after entering the company as new college graduates. The social and psychological gap between board members and young white collar employees in Japanese enterprises is thus a fairly narrow one. As well, important policies are frequently promoted at the middle or lower management level and are finally formally approved by top management only after circulating through the lower levels, usually by a process known as the *ringi* system.

This unique method of "bottom up" decision-making developed at an early stage in Japan's industrialization. Japan, as a late-comer country, had to invest in modern Western-style industries on a scale large enough to be internationally competitive. However, because domestic capital accumulation was limited, modern business enterprises had to be established as joint-stock companies, collecting resources from relatively rich people such as former *daimyo* landlords and traditional merchants who knew nothing about modern industry, trade or finance. At the same time, such pioneering Western-style businesses were seen not as private profit-making enterprises but as undertakings of national significance and these modern business companies, *kaisha*, built up a prestige high enough to allow them to recruit the best university graduates. It is therefore not surprising that major business policies at Western-style business enterprises of this kind should be formulated at the lower levels of management and that young execu-

tives should tend to rise swiftly to top positions.

From the beginning of industrialization, Japanese banks have played an important role in supplying industrial firms with long-term capital, first by giving stock-mortgage loans to individual investors and then by giving long-term loans to industrial firms on the basis of resources collected from the people as time-deposits. Moreover, in the course of the development of this so-called "indirect financing," Japanese banks have become major shareholders in industrial firms. What is more noteworthy, however, is the fact that banks hold this stock not for the anticipated dividend but rather, to induce firms whose stocks they hold to continue to borrow large sums from them. Because of such close relations between banks and firms, even where the money market is relatively relaxed, industrial firms do not usually pay off all their debt to the banks, as they believe that continued borrowing will guarantee a quick and favorable loan from banks later when the money market may be tighter.

On the other hand, Japanese banks usually continue to support their weaker customers, even loaning firms additional funds to bring them back from the brink of bankruptcy. Especially where there is a bank which plays the role of main bank or *kanji ginko* for a particular industrial firm, the bank is expected and forced to support a declining industrial firm to the end, because of its responsibility not only to other banks but also to other industrial firms in the same business group or *keiretsu*.

III. Business Group and *Keiretsu* in the Postwar Japanese Economy

The *kigyo shudan* (business group) and *keiretsu* (line of affiliation) are additional integrative aspects of the industrial organization of Japan since World War II. The prewar Japanese economy was dominated by several huge business groups called *zaibatsu* which were dissolved in the late 1940s. Since that time, the largest of the former *zaibatsu* banks and giant trading companies, *sogoshosha*, which acted as the two cores of prewar *zaibatsu* organization, have replaced the holding companies of the prewar *zaibatsu* as leaders in the development of the postwar Japanese economy. The development of the industrial organization of postwar Japan has therefore been characterized by the formation of six large-scale business groups, each organized around one major bank and one or two *sogoshosha*. These are the Mitsui, Mitsubishi, Sumitomo, Fuji, Ichikan and Sanwa groups; in 1983, together they controlled 546 of the 859 largest industrial and financial

firms listed in Section 1 of the Tokyo Stock Exchange.

Control by the group's bank and *sogoshosha* has not been so tight and exclusive as the control exercised by the prewar *zaibatsu* organizations. For example, if one looks at the ratio of resources borrowed from within each group (i.e. from the group's bank and trust and insurance companies) to the total amount of borrowed capital in each group, the highest figure was about 25 percent for the Mitsubishi group. However, in addition to such "*keiretsu* finance," the ratio of mutual stock-holding between firms within each group was found to be as high as 26.14 percent in the case of the Sumitomo group. In other words, the largest shareholders of individual firms in each group were firms in the same group, and firms within a group could thus enjoy a high degree of independence of the interests of individual stockholders in the public capital market. That large-scale industrial firms in Japan, most of which are members of the six largest business groups, have not been particularly enthusiastic in seeking profit maximization to pay high dividends or raise the market value of their stocks, is not, in these circumstances, surprising.

The *sogoshosha* of each business group granted extensive credit to both manufacturers and wholesalers within the group, utilizing substantial resources, most of which were borrowed from the group bank on the strength of credit established by the *sogoshosha*'s prosperous trading activities over many years. Especially in the 1950s and 60s, when the heavy and chemical industries in Japan were rapidly expanding, the *kigyokan shinyo* (inter-firm credit) created by *sogoshosha*, a type of trade credit mostly in the form of promissory notes, proved to be vitally important in financing the development of rising manufacturers in those industries and accelerating the distribution of their products to new markets where existing merchants were as yet unprepared for dealing in new products of this kind.

Although trade credit itself is one of the most basic forms of commercial credit, the scale and manner of its utilization in Japan has been unique. In the United States, for example, the ratio of trade credit to total capital has normally been less than 10 percent and the duration of trade credit has generally been restricted to about three weeks. In Japan, by contrast, the amount of "inter-firm credit" tended, in the 1960s, to be more than 30 percent of total capital, temporarily exceeding the total amount of bank loans, and the duration of this type of credit was also frequently extended to nine or ten months.

As already stated, the interests of individual stockholders have not been a decisive factor in the management of large-scale enterprises and

the major part of monetary resources remained in business enterprises without flowing into the pockets of individual stockholders. The scale of resources controlled by the corporate sector of the Japanese economy is also revealed by the fact that in 1956 and 1966 the corporate sector accounted for 27.4 percent and 33.6 percent respectively of total time deposits held by the private sector, in contrast to ratios of 0.9 and 3.7 percent in the United States. It is apparent that in Japan resources did not flow out from business firms, but rather remained concentrated around large-scale enterprises, and thus effectively supported the growth of the corporate sector of the Japanese economy.

Limited diversification of large-scale enterprises is another characteristic of Japan's industrial organization, at least by comparison to recent developments in the United States. This limited business diversification has, to some extent, also been a product of the existence of the dominant business groups identified above. Each business group has already diversified into almost every area of industry and finance. To avoid competition within the group, individual firms have deliberately restrained themselves from diversifying further, probably in line with a restrictive influence exerted by the group's main bank or trading company.

In addition, the limited diversification of industrial enterprises has also been due to the informal management organization of Japanese firms. A system of business management which is so vitally dependent on informal human relations cannot be effective for administering large-scale diversified enterprises. Since the early stage of the country's industrialization, Japanese industries have therefore developed by detaching a new product or a new business from the developed parent firm, establishing it within the framework of an independent enterprise. Even after being separated, however, the new firm maintains close financial and managerial relations with the parent company and with the other firms in the group. The postwar development of business groups in Japan seems to have been similar to the prewar formation of the *zaibatsu* organizations, in as far as both the postwar groups and the prewar *zaibatsu* were more or less products of the informal business organization of Japanese enterprises.

The extensive development of subcontracting in Japanese industries can also be considered the result of such an informal business organization. To take an example from automobile manufacturing in 1978, the ratio of "in-firm production" of parts and accessories to the total was 25 percent in Japan, whereas the same ratio in the United States was as high as 48 percent. The number of employees of Ford, for

example, is consequently almost four times greater than that of Toyota. As is well known, industrial production in Japan has been highly dependent on subcontracting, and levels of technology and productivity have been conspicuously high in these subcontracting manufacturers. It seems that the greater the size of the subcontracting firm, particularly if there are more than 200 employees, the more independent is the firm which contracts out to as many as seven or eight parent companies to produce already partially assembled components. Consequently, for large-scale industrial firms in Japan, the maintenance of good and efficient informal relations with independent subcontractors of this kind has become far more important than the elaborate structuring of a formal administrative organization within the firm.

Generally speaking, the informal organization of Japanese business enterprises requires a relatively small management hierarchy. It is not unusual for a factory manager to also be present at meetings of the board of directors and the top executive committee. In many cases, a divisional manager or department head keeps his desk in the middle or at the end of a large room, in which all the employees in the division or department work together. Factory management and young workers on the assembly line are also frequently dressed in the same uniforms.

The sense of community of interest which exists seems to have been additionally supported by limited income disparities between management and labor. According to a 1979 study for large-scale enterprises in Japan, the average annual income of top executives, including salaries, executive bonuses and stock dividends, was 22.6 million yen; this sum was only three to five times greater than the average income of white collar employees and four to six times greater than that of blue collar workers.

IV. Postscript

It has been shown above that Japan's industrialization has been largely promoted on the basis of informal systems, and for the most part rigidly formal and contractual organizations have not been established. The long-term employment of laborers, extensive loans by banks to industrial firms, as well as generous allowances of trade credit by *sogoshosha* to manufacturers and wholesalers, have all been developed and sustained mainly on the basis of a mutual expectation of continuing favorable relations between the partners, and a sense of community of interest fostered by the repeated experience of business activities based on mutual expectation in this way.

Despite its informal character, Japanese business and industrial organizations have managed to remain integrated. This author has tried to explain informal integration of this kind mostly in light of the economic reasoning which can be assumed to have operated at various stages in Japan's industrialization. The rationality of the "Japanese employment system" could be explained by economic conditions, such as the shortage of skilled workers and the relatively adequate supply of educated engineers in modern Western-style industries. The close relationship between the "Japanese employment system" and the unique financial structure of Japanese industrial enterprises was also emphasized, in an attempt to look at "Japanese management" in the broader context of the economic and social history of modern Japan.