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Introduction

"There are those that are concerned that if we abandon the concept of equality that is emphasised in HR policy at Japanese companies, 'salaryman' society will become stratified and income differentials will grow. In the end, we will become a criminal society such as the US."
(Yashiro, N., "Get rid of the HR Department!" 1998, p. 218)

This book is about employment systems, their relationship with national corporate governance regimes and how pressure for change to the latter causes shifts in work practices and organisational structures. Specifically, it is about the Japanese employment system, the way in which large Japanese corporations align their organisational structures and HR practices and how these might change following a takeover by a company whose own practices are embedded in an "institutionally distant" employment system and corporate governance framework. Prior to the late 1990s there were very few examples of large-scale takeovers of Japanese companies by foreign firms. Although foreign firms had operated in Japan for decades, their employment practices were seen to be quite distinct from those at traditional Japanese firms.[1] Since the late 1990s, however, foreign takeovers have been a growing phenomenon and have attracted considerable attention. There has been a great deal of speculation as to what impact these takeovers will have on economic life in Japan, in particular its employment system. As is illustrated

[1] There are some notable exceptions, such as IBM or Showa Shell, companies with a long history in Japan whose practices were seen as deeply embedded in the Japanese system.

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in the quotation from Yashiro above, there are many that consider the maintenance of the traditions and the underlying philosophy of the Japanese employment system to be fundamental to the continuity of civilised life itself. On the other hand, there are many others, including Yashiro himself, who see Japanese employment practices as a significant barrier to economic progress and who seek reform. By and large, these authors emphasise greater individual accountability, a more performance-based organisational culture where rewards are based more on individual, rather than group, effort, or age and seniority. For this reason, the study of the organisational impact of foreign takeovers on Japanese companies is of considerable interest and importance, both to academics interested in employment systems, as well as practitioners who are involved in the management of multinational firms and for whom acquisition has become an increasingly feasible alternative to establishing a presence in hitherto "institutionally distant" corporate societies such as Japan.

Some time during the summer of 1991, when I was working in the Corporate Finance Department of SG Warburg & Co in Tokyo, I was telephoned by the CFO of one of my Japanese clients, a large and successful manufacturing company. He said to me:

> "Look here, Olcott-san, I've been hearing from a lot of my friends at our competitors about this 'investor relations' thing. It sounds like something that we've got to take seriously, so I've asked my team to design a brochure in English so that we can inform overseas investors more effectively about our activities. Could you come over and have a look at it?"

The next day, I visited him at the company's headquarters and examined the document, which was already at proof stage. It was glossy, with photographs of the company's various products and factories, and a good deal of text explaining the company's history and strategy. At the top of the first page was a photograph of the President, with "A Message to Our Stakeholders" underneath. As the concept of the "stakeholder" had hardly caught on in the UK, let alone Japan, this was a promising beginning. For "employees", they promised a stable and rewarding workplace; for "clients", the best products at reasonable prices; for suppliers, a long-term relationship based on trust; and for "society", a sense of corporate responsibility towards the population at large and the environment in particular.

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"There appears to be one important stakeholder missing here," I told the CFO.

"And who would that be?" he asked.

"Shareholders?" I suggested tentatively.

"*Naruhodo* ... yes, of course!" he exclaimed. "I thought there was something missing!" His subordinate shifted uncomfortably in his seat and undertook to add a message to shareholders right away. A few days later, he duly sent me a revised version, complete with a new section promising shareholders a stable dividend policy and high standards of disclosure.

I relate this episode not to cause amusement, but to illustrate a number of points. First, it demonstrated the historical tendency for shareholders not to demand managerial attention at large Japanese companies; second, that there were forces at work as early as the early 1990s causing management to rebalance stakeholder priorities (hence the new brochure) and that, third, this re-evaluation was still in its very early stages, and changes were limited largely to symbolic gestures that were not accompanied by changes in attitude. It was interesting, for example, that the company originally intended to produce the brochure only in English, and to distribute it to institutional investors based outside Japan. There appeared to be a clear understanding that foreign institutional shareholders were an entirely different species to domestic ones and needed to be approached accordingly. Indeed this episode was only one among a host of examples which seemed to support the proposition, forcefully put by a number of commentators since the 1950s (e.g. Abegglen, 1958; Ouchi, 1981; Vogel, 1979), that there was a distinct version of Japanese capitalism, underpinned by fundamental attitudinal differences about the very purpose of the firm.

At the time, the consequences of non-engagement with foreign institutions did not seem to be serious. Although the stock market bubble had burst at the beginning of 1990, property prices were still on the rise and the economy was still growing. Most felt that Japan would soon be back on track. Foreigners had never owned more than around 5 per cent of the Japanese stock market. There were of course a large number of foreign firms operating in Japan. There were examples of large and successful firms, such as IBM, Coca-Cola and Showa Shell (the result of a merger between Shell and Showa Oil), that had long been established in Japan and had become part of the domestic scene,

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with employment practices to match. There were even examples of acquisitions by foreigners of listed Japanese firms. SG Warburg & Co had acted on two large acquisitions of Japanese firms by foreigners during the early 1980s: the acquisition of Banyu Pharmaceutical by Merck and that of Osaka Sanso by BOC. Large stakes had been taken by foreign firms, such as Ford's holding in Mazda. However, these were invariably "friendly" transactions involving the full cooperation of the Japanese company's main banks and, more often than not, the bureaucracy, usually in the form of MITI. They were also very rare. On the whole foreign firms such as the one for which I worked operated at the margins, occupying niches and sweeping up and living off the crumbs left to us by our Japanese competitors. Japanese and foreign firms had parallel, but separate, lives. The strength of the Japanese economy, the global success of many Japanese companies and the esteem which "Japanese management" was held in internationally suggested that there was no reason for a drastic change of direction.

By the late 1990s, however, the landscape had undergone a dramatic transformation and, for the first time since the post-war period, serious questions were being asked about the suitability and sustainability of the Japanese version of capitalism. By this time Japan's economy had endured a period of stagnation of unprecedented duration in the post-war era. The "bubble economy" that had inflated asset prices to extraordinary levels by the late 1980s had burst and equity prices had fallen almost continuously since the beginning of 1990. Land prices started falling somewhat later, in 1992–1993, but had fallen even more sharply. The weakness of the entire financial sector was exposed and in late 1997 there were a number of major bankruptcies, including Hokkaido Takushoku Bank, one of the smaller city banks, and Yamaichi Securities, one of the "Big Four" securities firms.

It was argued by many that the Japanese model of capitalism, which gave a broad range of stakeholders a claim on the fruits of the country's economic success, was outmoded and needed to be replaced with a more orthodox, Anglo-Saxon style of capitalism that rewarded winners and had no place for losers (e.g. Porter *et al.*, 2000). Capital was the lifeblood of companies, and shareholders, who had put up the equity capital and who held all the residual risk, had to be properly rewarded. Arguments that Japan was somehow exceptional, which were mostly culturalist in nature and which held that Japanese society was organised

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in a way that supported a different mode of capitalism (e.g. Fujiwara, 2005; Funabiki, 2002), were, it was claimed, no longer valid.

While it is possible to interpret declining Japanese asset prices and extreme weakness in the financial sector as harbingers of permanent decline for Japan, many foreign companies saw these events as presenting major opportunities for investment. Japan was, and still is, a large and sophisticated market, with many industrial sectors at the forefront of technological innovation. Moreover, it seemed possible, even likely, that the long period of economic decline might bring about the kind of environment that would make the Japanese authorities, corporations and society at large more sympathetic to a more orthodox capitalistic and shareholder-friendly mode of operation.

However, there still remained the question of how to enter and expand in the Japanese market. As we have noted above, despite Japan's position as a major global exporter and decades of gradual integration with the global economy, there had hitherto been very little inbound mergers and acquisitions (M&A) (i.e. cases of foreign companies buying Japanese companies) and most foreign companies had entered Japan either through green field investments or joint ventures. While the reasons for this will be explored in later chapters, by the mid-1990s, with banks in straightened circumstances and beginning to unwind their substantial portfolios of cross-held shares (Okabe, 2001) and with the valuations of Japanese companies at historic lows (especially relative to their international peers), it was clear that buying a Japanese company was going to be easier for a foreign firm than it had ever been. It can be seen from Figure 0.1 that, from a very low base, the volume of inbound[2] M&A took off sharply from around 1996.

The firm for which I worked was among those who saw the considerable potential of the Japanese market. I had returned to London in 1993 and, two years later, SG Warburg was bought by Swiss Bank Corporation (SBC). In the summer of 1997, SBC announced a wide-ranging alliance with a Japanese bank, the Long Term Credit Bank of Japan (LTCB), to pool their respective investment banking and institutional asset management businesses, and start jointly a new private

[2] In Figure 0.1 "out-in" refers to inbound M&A, or foreign companies taking over Japanese companies. "In-out" is the opposite – Japanese companies taking over foreign companies.

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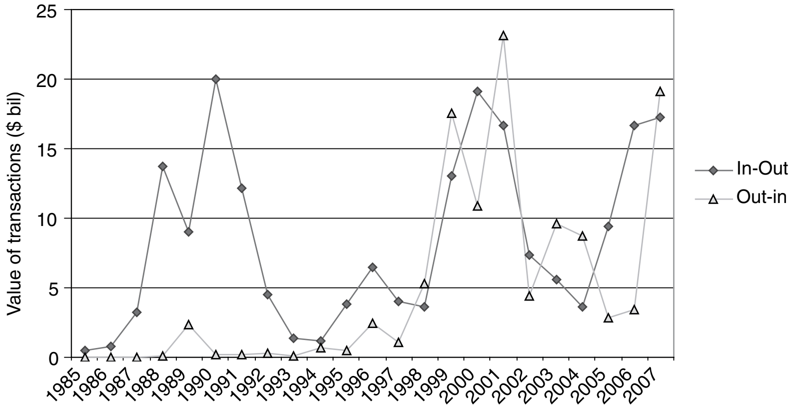

Figure 0.1 Trend of M&A transactions: Japan 1985–2007
Source: Thompson One Banker (2005)

banking business in Japan. Thus, although SBC did not take control of LTCB, it saw its alliance as a means of establishing a presence in Japan which would give the company direct access to a large pool of corporate and institutional clients, as well as private savings – an effort that would have taken years, perhaps decades, to build up organically. I was told that I would shortly move over to the asset management side of SBC to become the SBC representative in the asset management joint venture with LTCB.

I started work at the asset management joint venture in Tokyo in September. The joint venture was in fact an existing LTCB subsidiary, LTCB Investment Management, which had been set up fifteen years earlier, which managed ¥1 trillion ($10 billion) of Japanese pension fund assets and which had 80 employees. SBC bought 50% of the company. It was a classic joint venture of the old style: the local company providing human resources and the client base, the foreigner providing technological know-how.

I had lived and worked in Japan for many years and, even though I had never worked for a Japanese company, I felt that I knew my way around. Yes, Japanese firms looked and felt different from the foreign firms I had worked for, but I felt the gap would not be so great and that I could act as an effective "bridge". It would be easy.

The fact that it was not was brought home soon enough. In a particularly bizarre episode, I found myself writing a series of memos …

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to myself. There was one particularly contentious issue which arose from various commitments that LTCB had made to distribute mutual fund products of our competitors through their branch network, something that deregulation of the financial markets was going to permit from 1 December 1997. These arrangements had been made prior to the announcement of the LTCB–SBC alliance and, in any event, SBC would not have any products ready for distribution by 1 December. My superiors (who were located in Chicago) were not at all happy about this arrangement and saw it as a betrayal. I was asked by my boss in Chicago to draft a letter to LTCB emphasising our displeasure and telling them to desist. "You know the Japanese", he said; "couch it in the right way". I duly drafted a letter which was faxed from Chicago to LTCB's Tokyo headquarters. The next day, I received a call from my counterpart at LTCB, who told me he had received the fax. He explained the situation and stressed that it was not their intention to "betray" us. He was not going to change his mind. I told him that while I had understood and perhaps even sympathised with his point of view, our position was as my boss had explained it. I suggested he write back outlining their position, putting some apologetic language at the end of the letter and hopefully that would be the end of the matter. To my surprise, he asked me to draft the letter. "You know the Americans", he said. "You will know how to put it." I duly drafted a letter for him. I ended up drafting two more letters, one from each side, before the issue faded away.

There were many such incidents and, while some were just differences of opinion based on simple considerations of economic interest, many others were due to different interpretations, based on cultural factors, as to what and how things should be done. Whilst the role of the "bridge" – interpreting and explaining cultural differences and how they impact on business decisions to culturally distant partners – was important, it would only get me so far. We needed to establish a cultural frame of reference which would serve as a basis for organisational design and routines. Would our organisational structure and practices be based on Japanese principles? Or should we transform the company into a "foreign" firm? If we did the latter, what would be the impact on the employees and on the business?

Even at the outset, SBC were given considerable leeway to reorganise the company. The company was now 50% foreign owned, but when I started work it looked and felt just like my perception of a Japanese

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company. There were eight directors for a company of 80 employees. They had all been sent by the parent company and were therefore commercial bankers by background. Some, such as the President, Yuji Kage, had remained with the subsidiary for a considerable period and had in the process become highly professionalised, but others had little experience of asset management and I was under the distinct impression that they had been "parked" there to await retirement. There was also a group of very bright young employees who had also been sent by the parent company to acquire skills in a strategically important area for the firm (i.e. asset management). There was also a group of female clerical staff who had been recruited directly by the subsidiary. The layout of the office clearly reflected the office hierarchy: directors' and general managers' desks lined up by the window facing inwards. In front of them the managers' desks, also facing inwards, and in front of the managers, ranks of desks facing each other, with employees getting more junior the further they got from the window, with the (uniformed) office ladies at the very end.

The behaviour of the employees was quite different from the Japanese with whom I had worked at foreign firms in Japan, who had always been regarded as "mavericks" and "outsiders" (see Kang, 1991). There was, at least on the surface, a respect for authority that was almost military. As SBC's representative, I was the Deputy CEO of the firm. Employees bowed before entering my office, and bowed again before leaving.

The HR practices were also in line with what I had imagined to be typical for white-collar workers at a large Japanese company (see Beck and Beck, 1994). Recruitment of the executives had taken place exclusively at the elite universities. Training had been of a general kind, aimed at creating solidarity among cohort members. Careers had followed a generalist path, with employees moving from head office to a branch, back to head office to a lending department or a currency or bond dealing desk, then into the planning or personnel department, back to a branch, and so on. A few had been sent overseas, either to work in a branch or to do an MBA at a US or UK university. These employees spoke good English but seemed reluctant to use it, for fear of embarrassing their non-English-speaking colleagues, who represented the great majority, or so I was told. This was very different behaviour from the Japanese who worked at foreign firms. Two employees who might have joined the company

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at exactly the same time fifteen or twenty years ago would often be paid, to the nearest yen, exactly the same salary, despite manifest differences in ability. Bonuses were a fixed proportion of salary and hardly changed from one year to the next. Company or individual performance had almost no bearing on the bonus the employees received – a practice totally alien to someone who had worked at a foreign financial institution.

Authority appeared to be delegated to the lower reaches of the organisation and the traditional consensus-building mechanisms were in place, with the *ringi* process being vigorously followed. The *ringi* process dispersed responsibility through the organisation, and it was not clear who was accountable for any one decision.

Although these observations, particularly from an Anglo-Saxon perspective, might leave an unfavourable impression, this would be misleading. There was, for one thing, a remarkable sense of cohesiveness in the organisation that was entirely missing in the foreign firms operating in Japan, especially in the financial sector. Yes, it was hierarchical and bureaucratic, but it also had a sense of order and discipline. Employees identified strongly with the firm and with its parent, LTCB, despite its manifest financial problems, and this sense of identity seemed to function as a source of pride and long-term commitment to the organisation. This was not only true of the front office elite, but also the clerical staff, who were highly dedicated and professional and who, in most cases, were generally earning half of what they might have been paid at a foreign firm. It was also true to say that the nature of the relationships that existed between the firm and its clients was different. The company had over 100 clients, many of whom had never dealt with a foreign firm and with whom it would have taken SBC years, perhaps decades, to develop a relationship on their own. However, many of the clients were very small, and would have been considered too marginal for coverage by a foreign asset manager. Relationships were highly structured and ran much deeper than would have been the case at a foreign firm.

Notwithstanding these positive attributes, our instinct was to bring practices into line with what might be considered best practice at a western firm. We therefore set about making drastic organisational changes and radically altered the HR system to bring it into line with that of other foreign financial institutions. There would be no more rotation, employees would have to specialise, rewards would be

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strictly on merit and bonuses would vary considerably according to individual and company performance. Clear job descriptions would be issued outlining the scope of individual responsibilities. The hierarchical arrangements were simplified and the organisation flattened. The size of the board was cut drastically.

Within six months of the inauguration of the joint venture, LTCB collapsed and SBC took full control of the company.[3] Within this short period, the employees of the old LTCB Investment Management had seen their employer change from a 100% Japanese company to a 100% foreign firm, via the intermediate step of a 50/50 joint venture. As if this was not enough drama for the employees, SBC was at this time merging with UBS, the largest of Switzerland's "Big Three" banks. UBS had an established asset management business in Japan. Their employees were typical of those Japanese working in foreign firms and they provided a remarkable contrast with the employees of the former LTCB Investment Management.

LTCB Investment Management was now called UBS Asset Management Japan (its third name in six months) and, despite the fact that the employees were the same, it was beginning to feel like a very different operation. I wondered what the links were between employee behaviour and HR practices and what the impact the changes in HR practices we had begun to implement would be on the behaviour of the old LTCB employees. There were media reports of radical organisational change occurring at other Japanese firms taken over by foreign companies and I reflected on the impact that changes in underlying corporate governance attitudes would have on deeply embedded Japanese organisational practices, especially when the changes were brought about by the "shock" of a takeover by a foreign firm. For, despite the debate alluded to above about the fundamental nature of Japanese capitalism and calls for a far greater emphasis on "shareholder value", there was little sign of change in Japanese companies (e.g. Morgan and Takahashi, 2002), many of whom argued that the Japanese system was still a source of competitive advantage. Many of the institutions regarded as typical features in Japanese companies, such as the reward and decision-making systems, and which I had found in abundance at

[3] For an excellent account of the story of LTCB and especially its demise, see Tett (2004).

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