

Chapter 4. Economic Growth and Japanese Management

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Prologue: The Japanese Miracle of Post-war High Economic Growth

Today I am speaking from a very symbolic site of the post-war Japanese miracle, blast furnace of the Chiba steel mill of the JFE steel corporation. This is one of the places where Japan began its drive for recovery from the war and its quest for high economic growth.

From the ruins of that war, however, Japan rose like a phoenix against all the odds. From 1955, only ten years after the war, Japan entered a long period of high economic growth, which the world called the “Japanese Miracle.” In the subsequent 18 years before the first oil crisis in 1973, the Japanese economy kept growing at an average rate of 8.7 percent, and sometimes more than 12% a year. The annual economic growth rate for the 36 years from 1955 till 1991 averaged 6.4%, an amazing performance for an originally war devastated economy like Japan’s. Japan became the No.2 economy in the world after that of the United States as a result.

Looking behind this Japanese miracle, we find many Japanese entrepreneurs who built their firms from very humble beginnings after the war and succeeded in supplying the many good products people wanted at very low cost and high quality. These firms are one of the major factors in the Japan’s economic growth.

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I would like to name a few of them: Matsushita Kohnosuke who founded Matsushita Electric Industries (, renamed Panasonic many years later), and he later brought the era of consumer electronics to Japan; Honda Soichiro who founded Honda Motors and was the genius engineer in motorcycles and cars that made Honda world famous; and finally, less well-known than the first two entrepreneurs but equally as important, I want to mention Nishiyama Yataro who was the steel engineer-turned-president of the company Kawasaki Steel, who is considered a pioneer in the post-war Japanese steel industry.

He decided to build the steel mill that I am now standing in front of. Nishiyama built the first fully integrated large steel mill within a coastal area in the world in 1954 on the coast of Tokyo Bay. Because of its location this steel mill could import both coal and iron ore from all over the world at low transportation costs by ship and began to produce very low-cost steel using the newest technology at that time.

He was a lone pioneer, however, among the Japanese steel makers when he built this steel mill. While all the other steel producers in Japan followed Nishiyama some four or more years later, this was only after they saw his success. Those investments made the huge supply of low-cost steel possible that Japan needed for the reconstruction of its cities and transportation networks after their destruction during the war and also for the development of many heavy industries including automobiles, shipbuilding and machinery.

The reconstruction of the land of Japan as well as Japanese industry was the first step in achieving high economic growth. As a pioneer in the steel industry, Nishiyama was one of the main engines behind the Japanese miracle. In a sense, he almost single-handedly ushered in the era of high economic growth.

Common to all these entrepreneurs was their earnest implementation of Japanese-style management principles. Their management style, which I will explain in detail later in this lecture, motivated their employees to work hard for both the prosperity of the firms and their own better future.

Of course, they were not the exceptions but the rule. Japanese-style management as practiced in so many firms in post-war Japan, is thus one of the important factors which made the Japanese miracle of high economic growth a reality. That is the topic we cover

in this lecture on Japanese modernization.

Section 1: The Basic Factors of Economic Growth

Before discussing Japanese management itself, let us develop a broader framework to advance our understanding of economic growth, including why an economy can grow. As a conceptual framework to explain economic growth, we can group the basic factors into three categories.

The first group is “accumulation from the past,” including the industrial infrastructure of the country, the level of education, and earlier technology accumulation in many industries. These are the factors that a country inherits from the past. Thus, the modernization efforts by Japan from the Meiji Revolution actually paved the way for the post-war period of high economic growth.

The second group of basic factors for economic growth is the source of energy for that growth. One type of energy source is the physical and monetary energy for growth and another kind is human energy. In simple terms, we need energy to carry on the activities contributing to growth.

Natural resource endowments like oil reserves are a very clear example of a physical source of energy, although Japan is not endowed richly in this sense. The supply of capital to make many investment activities possible is another kind of physical resource.

And the high rate of saving by domestic households after the war was very instrumental in making this source of energy a very important factor in Japan’s growth.

Among human energy sources, we should consider population and its increase, in other words the sheer number of people in the nation. They are essentially important for growth both as the source of labor and as a source of buying power that creates demand. Japan had a growing population about the half the size of the US after the war. It was a big advantage to have that big a labor supply and its level of domestic demand.

Another kind of human energy is also essential, namely the psychological energy of the people. The Japanese people after the war were full of this psychological energy, wanting

very eagerly to rebuild the country after the war and to seek a better life for themselves.

The third group of basic factors for economic growth are the mechanisms or systems that allow a community to effectively utilize the accumulation from the past and the sources of energy for growth. Even if a country has a rich past and is endowed by abundant supply of energy for growth, it will not be able to grow if it misuses this potential.

Among the mechanisms or systems for effective utilization of growth potential we can mention two types, one public and the other private. Public policies to promote growth and industrial development included, in the case of Japan, the income doubling policies of the Ikeda Cabinet after 1960, which accelerated the already high growth rates. We can also mention the various kinds of industrial policies by the Ministry of International Trade and Industry that were implemented from around 1950 as being important initiatives by the government.

However, the mechanisms or systems for effective utilization of the nation's potential were found mainly in the private sphere, and we should mention the relatively unique Japanese corporate system and the management style practiced by many Japanese firms after the war.

I say "relatively unique" to imply that the Japanese corporate systems and management principles are appropriate universally outside Japan, even though they have a unique historical and cultural background within Japan.

This is the major topic for this lecture as a basic factor in economic growth.

Section 2: What is the Japanese Corporate System and Japanese Management?

In any national economy, there are many firms producing the many products supplied to consumers and other firms. In each firm there are many people inside its organization, some as workers and others as managers, and each firm has trading relations in the market place with outside parties, buying raw materials and parts from suppliers and selling what they produce to customers or distributors.

If we imagine each firm as a single island, then the economy as a whole is like an archipelago of islands, where each island has its internal structure as a workplace relationship and each island has market trading relations with many of the other.

If we conceptualize the entire archipelago as a nation's corporate system and try to characterize how this system functions, it seems appropriate to focus on three basic construct: the concept of the firm, the concept of sharing within corporate organizations, and the concept of trading relationship between sellers and buyers.

The concept of the firm defines the ownership and management of the firm. For a firm to exist and operate, it needs capital, often supplied by shareholders, and it also needs employee who carry out the actual operations. Who 'owns' the firm is the central question of the concept of the firm.

While company laws usually give the final legal authority to the shareholders, in terms of real management, is it not better to think that the employees have at least a partial de facto ownership of the firm, not in the legal sense but in the organizational or social sense of ownership?

The second construct useful for understanding the characteristics of any corporate system is the concept of sharing within the organization. Top management determines strategy, local managers make decisions regarding daily operations and activities, and down-the-line employees determine the actual manner in which a particular job is executed. The quality of each of these decisions and the degree of overall integration and coordination between them is the decisive factor in determining the final economic performance of the firm.

At this point I want to introduce the concept of sharing, which determines the distribution patterns of three important things within the organizations: information as an essential input to all decisions; the decision-making power held by the people concerned; and the remuneration to the people who contribute to its activities. Thus, the concept of sharing defines who gets what information, who decides what, and who gets how much money for

what result.

The third basic construct of a corporate system is the concept of trading relations among businesses in and outside the firm's logistics chain. This concept is important as it determines the final efficiency of the corporate system as a whole, because a firm's ability to produce goods and services is almost always contingent on the cooperative relationships that it maintains with other trading partners. These interrelationships facilitate the division of labor between the firms through the medium of market transactions, as in the case of an automobile manufacturers and its parts suppliers.

Continuing the analogy of islands and an archipelago, the concept of the firm defines the island itself, the concept of sharing defines the internal structure of the island, and the concept of trading relationships defines the inter-island relations among many islands.

Compared with a classical capitalistic corporate system, the US system being the typical example, the Japanese corporate system has the following characteristics in terms of the three concepts explained earlier.

First, regarding the concept of the firm, many Japanese firms tend to treat core employees as the de facto owners of the firm and the major stakeholders of the firm, often over and above the actual stockholders. This does not mean that Japanese firm violates the legal rights of its stockholders, but suggests that they tend to protect the interests of the employees as much as possible within the legal limit.

For example, when a recession comes and the size of economic pie to be distributed to the employees and the stockholders becomes smaller, the portion given to employees as personnel expenses increases and the portion to the stockholders as dividends often decreases. Thus, Japanese firms try to keep employment levels by reducing dividend payments in recessions.

Of course, if economic conditions become so bad even Japanese firms may have to reduce employment to save the firm itself, but they try not to do so more than American firms who lay off their employees more easily and hire them back when things get better.

I call this behavior of many Japanese firms the "employee sovereign" concept of the firm. In this terminology, the American concept of the firm can be called "stockholder sovereignty."

Second, regarding the concept of sharing within the organization, I would characterize Japanese management as “diffused sharing,” for two reasons. One is that sharing in Japanese firms is more equal than in a typical capitalistic firm, thus it is diffused in the sense of non-concentration to particular individuals. The second sense of ‘diffused’ is non-similarity, i.e. different patterns of sharing for different variables to be shared, information, decision making power and economic remuneration.

In many Japanese firms, information thus tends to be more widely shared among many people in different ranks in the organization than in a typical American firm. Decision making is also more often delegated to lower ranks in Japanese firms, much more so than in a typical American firm. In terms of the distribution of financial remuneration, Japanese firms also tend to be more equal, (but on a lower base) than American firms. Thus, the sharing pattern in Japanese firms tends to be more equal across the organizational hierarchy.

The non-similarity of the sharing patterns of these three important variables can be observed when people in the lower ranks of the organizational hierarchy are often regarded by many people as having much more influential power over actual decision making or when many decisions are actually delegated to the lower level. So, by non-similarity of sharing patterns I mean Japanese firms’ efforts not to make the three curves ‘too’ similar, leaving some room to give different people different access to the three variables.

In comparison with the Japanese pattern of diffused sharing, I would call a typical capitalistic firm’s sharing pattern, like in the US, as concentrated sharing, meaning it is much more unequal and similar across the three variables. Distribution is more concentrated towards those in higher ranks in the organization and they get all three things in a similar fashion: more information, more decision power and more money.

Now let us go to the third construct of a corporate system, the concept of trading relations between the sellers and the buyers in a market transaction. In principle, they have opposing interests. The buyers want to buy at a low price and the sellers want to sell at a high price. The buyers, if they do not like the performance of a particular seller, want to terminate the trading relation and try to find some other sellers even in the short term.

Thus, a typical concept of trading relations among classical capitalistic firms is the free market concept. Among Japanese firms however, the trading relations in many industries tend to be long-term, continuing among non-changing partners, and very cooperative.

Trading partners therefore tend to become fixed: their numbers do not usually increase by much, rather the emphasis is on developing a high degree of cooperation. They often have joint development projects for the product they trade with the buyer, without a clear prior agreement about who gets what and for how long, before they go into the joint cooperation.

Japanese firms, in a sense, thus often bring into market transactions the principle of organization where people with some common objectives cooperate with each other to maximize long term common interests. Another element of this organizational principle that creeps into Japanese trading relations is that it is implicitly understood who has the final arbitration power when some disputes arise among the trading partners. The final arbitration power often implies a hierarchical relation in some sense, a part of the organizational principle.

Thus, Japanese concept of trading relations is a mix of free market transactions with some organizational principles. I call this the “organized market” relations between buyers and sellers.

Section 3: The Economic Rationality of *Peoplism*

We can argue that the Japanese corporate system and its management style has a sound base of economic rationality. That is a very basic reason why it has contributed so much to the high economic growth of Japan and why this persisted for such a long time.

Because of employee sovereignty, people who do the actual work for the firm want to contribute to its long-term future. The firm is their own, not the stockholders' tool to maximize their wealth. Naturally, employees are willing to work for their own long-term interests, by learning the technology they have to use and by teaching their skills to their fellow employees. And, through their efforts for their own future, the firm is able to grow, which will ultimately benefit stockholders through the larger economic value of the firm or capital gains from their stocks.

Because of the diffused sharing, everyone in the organization is given a piece of the action and is encouraged to participate in corporate activities cooperatively. This has a decisive impact on the way people relate to each other on the job, making internal communication much easier and thus making the quality of decisions higher.

In organized markets, conflicts arising from the potentially opposing interests of buyers and

the sellers are minimized. Neither buyers nor sellers have to balance and close the book on every transaction. They share common long-term interests and cooperation springs from these common interests. Short-term losses or gains that occur when some unforeseen contingency arises are perceived more as “loans” and “debts” that can be sorted out in the long term.

The essence of an organized market in Japan is therefore a long-term view and cooperation, which then leads to the possibility of effective accumulation of information about the technology they need to share and also information about the type of behaviors transaction partners tend to take.

You may have noticed that in my explanation of the economic rationality of the Japanese corporate system and its management style, I repeatedly use the same key words: participation, cooperation, long-term vision and informational efficiency. For a corporate system and its management style to be able to achieve these, an essential prerequisite is to create stable human networks of interpersonal relationships, and to give careful attention to the structuring of such relationships and the flow of information within them.

In a sense, this is a very people-centered way of organizing economic activities both inside the firm and between firms. That is the reason why I coined the term peoplism or a peoplistic corporate system as the basic principle of the Japanese corporate system, in contrast to the money-centered principle of a typical capitalistic system.

In peoplism, people or human beings are the most important resource for better economic activities and the formation and maintenance of a stable human network is the most important key to energizing economic activities. In contrast, in classical capitalism money or capital is considered to be the most important resource for economic activity and the formation and maintenance of a network of money (or network of those who provide money) becomes the driving principle for organizing economic activities, in the formation of the firm, in the maintenance of internal organization, and in the maintenance of trading relation.

Section 4: The Peoplistic Corporate System as Industrial Democracy

Under the peoplistic system, the duration of employment relations and trading relations becomes longer. Of course, not everyone who is employed is guaranteed long-term employment, but for many people in Japan the employment duration will be much longer on average compared, for example, with that in US firms.

Interpersonal relationships within the organization are more stable due to the diffused sharing that leads to the more equal treatment of many people. In trading relations, many people will interact with those they have known for a long time. Thus, human networks both within the firms and across the firms become stable and be maintained that way for a relatively long period of time.

As a consequence of the stability of human networks, two beneficial effects can be realized. First, communication efficiency among people will increase because people know each other for a long time and are more willing to learn from (and teach) each other, because to do so does not harm their individual interests too much and increases the potential benefit from each of them becoming more knowledgeable than otherwise.

Secondly, since many people can feel they have a piece of action of the total organizational activities, they will have an incentive to work for the benefit of the total organization, rather than demanding the satisfaction of their own narrow and short-term interests too much.

This is the basic economic rationality logic of the peoplistic corporate system. I did not use any Japan-specific language to explain this logic. I used universally understandable language as well as economic logic. This is one piece of evidence that shows that the peoplistic system can have a high degree of economic rationality and universality.

Of course, this logic brings real benefits to firms and the people who work in them as long as this kind of system is feasible in reality. And here, there may be some historical background in Japan that made the birth of this kind of system possible. I will later come back to this topic.

The peoplistic system can be considered to be one example of the success of industrial democracy, i.e. democracy in action in the industrial workplace. Most people are equal at the time of participation in the economic activity of the firms. Many grass-roots people are willing to contribute to the economic activity of the firm. This system can create an economic society

in which a mass of people can be mobilized effectively to carry out corporate activities.

In other words, this is a case of success of the industrial democracy concept in the sense that grass-roots people can participate and contribute on an equal basis *en masse* for industrial activities, with consequent society wide impacts. That is one of the very basic reasons why Japanese industries could develop rapidly and the Japanese economy could grow so much after the WWII.

Section 5: The Historical Background of Japanese Peoplism

Although we can find some seeds of the peoplistic corporate system in pre-war Japan, it was after WWII that this system began to permeate through many Japanese firms. Two features of the historical background explain why this system was born in post-war Japan. One is a rather special historic circumstances that Japan experienced after the war. Another is the historical affinity of the principles of peoplism with traditional business thinking in Japan.

Concerning the special circumstances of post-war Japan, I should point out that there was an explosion of democratic energy under the charged atmosphere of confusion and crisis. Post-war Japan, an economy in ruins, underwent a radical process of democratization-by-fiat under the occupation authorities. This included not only political reforms, but also a large number of measures designed to effect economic democratization.

The occupation forces also gave positive encouragement to the formation of labor unions, many of which soon took their policies and practices to their logical extreme. As a result, there were for a time quite frequent and large-scale outbreaks of labor strife under the banner of capital vs. labor.

Many firms experienced debilitating strikes. It was this experience of the destructive potential of discord in unforgiving times that drove home the message to both labor and management that blind pursuit of the interests of one party to the exclusion of others could lead to the collapse of the firm itself.

The disbanding of the zaibatsu led to the rapid disappearance of the traditional capitalist family from the Japanese economic landscape; management and labor were left, in effect, to run the business together. Also, as much of the pre-war top management were purged from their official positions for their involvement in the war effort, their places had to be taken by people who until then had been middle management and thus closer to, and more familiar

with, the problems and sufferings of those at the actual site of production.

They themselves had, after all, just emerged from the same front lines. Nishiyama Yataro himself, for example, was one of these those new top management replacements.

It is only natural that under such circumstances people should come to feel that the firm belongs to those who work there. Nor is it difficult to understand that the ways of sharing that were adopted should be democratic. The relations between buyers and sellers in the market were also deeply influenced by this sense of shared destiny and the feeling that cooperation was essential to their survival.

On top of these severe circumstances after the war, there remained traditions of business thinking derived from the Edo period of more than three hundred years ago. This was the thinking that deems it very important to have active participation by employees in the management of major merchant houses and the thinking that encourages cooperation in trading relationship.

For example, many major merchant houses in Edo period Japan treated their employees not as labor to be used in exchange for wages, but as core members of the merchant house community. For example, the second earliest joint stock company in Japanese history, Mitsui Corporation, was created at the time of the Meiji Revolution, when Japan began to have joint stock companies for the first time, as the central headquarter company of Japan's powerful Mitsui zaibatsu (now a huge conglomerate). It was legally established with its employees holding a 25 percent equity share; thus, there was a legal expression of employee sovereignty at the very first moment in the history of Japanese joint stock companies.

There was also a famous philosophy of 'triple win' that had been long been advocated during the Edo period by the merchants from the Ohmi district in western Japan. Triple win means, sellers win, buyers win, society wins.

Ohmi merchants thought that all trading that they did should aspire to triple win so that everybody could feel happy and the long-term sustainability of business relationship could be secured. This thinking has a clear affinity with the idea of organized markets and long-term cooperative trading relations for joint benefit.

Thus, the principles of peoplism seem to have a great degree of historical affinity with Japanese business thinking. In that sense, peoplism was easy for the Japanese people to

accept.

Section 6: Unchanging Foundations and Changing Surfaces

Now, to end this lecture, I would like to discuss the peoplistic corporate system in recent Japanese business history. My conclusion, though I do not have enough time to discuss the evidence, is the following: while there have been many surface changes in the management practices of Japanese firms after the bursting of the bubble economy in 1991, the fundamental principles of peoplism are still practiced in the majority, perhaps unconsciously for many. We can therefore say that Japanese businesses can be characterized as having an “unchanging foundation with changing surfaces.”

The Japanese economy, however, has been in trouble since the bubble burst. Its average growth rate was a mere 1 percent. The collapse of the bubble economy was an enormous burden for the Japanese economy, not only as a financial problem but also as a psychological wound for many Japanese business managers who began to ask what they did wrong that created the bubble economy situation.

Unfortunately for Japan the bursting of the bubble coincided with the collapse of the Soviet Union. Both happened in the same year, 1991. The fall of communism became synonymous with the victory of American capitalism and criticism also began to be leveled against Japan as being heterogeneous from the mainstream economic world by Japan revisionists.

Therefore, many Japanese managers began to have double self-doubts about their management systems and abilities. First, do we have to say good-bye to our past management practices because we did such a foolish thing like creating the bubble; and second, do we rejoin the mainstream of the world economy only by revising our management system to American standards? With these self-doubts, the Japan's psychological energy for growth was very much muted.

Also, Japan's physical energy for growth has been at low level since the 1990's due to the population decrease that was anticipated in the near future. On top of this, the huge negative inheritance from the past in the form of gigantic debts to be repaid because of the bubble was a major loss of the monetary energy needed for growth.

Concerning the mechanism for effective utilization of growth potential, there is a possibility that peoplistic corporate systems malfunction in times of sudden and drastic change in environmental conditions such as the bursting of the bubble. Because the peoplistic corporate system values stable human networks, their adjustments to environmental changes tend to be slow and mild unless management pays special attention to being quick and decisive. It seems that peoplism may sometimes downgrade into lukewarm reaction patterns.

Nevertheless, after the world-wide financial crisis in 2008 which was triggered by the bankruptcy of Lehman Brothers, the performance of Japanese firms has been improving. For almost ten consecutive years up to 2018 this has been the case, and it now far surpasses the best records seen right before the bursting of the bubble, even though the entire economy has not grown that much between 2009 and 2018. It seems that Japanese firms were awakened by the two consecutive crises of the Lehman Brothers collapse in 2008 and the East Japan Earthquake in 2011.

Even so, it is apparent that Japanese firms will need many more reforms in their management practices. They do not, however, have to change the management principle of peoplism, I believe.

This is because when one designs management practices, the following formula seems appropriate:

$$\text{Management Practice} = \text{Principle} \times \text{Environment}$$

Japanese firms need not abandon the peoplistic principle but do need to design new management practices to adapt it to changing environments, like our aging society and a more globalized world. The principle is the foundation and the actual practices are the surfaces we can observe.

However, it is not so clear yet how the surfaces will change. Keeping peoplistic principles, Japanese firms will continue to develop best practice. The best example would be Toyota Motors, long heralded as the champion of Japanese management. Along with Toyota, many Japanese firms will continue to pour more effort into improving their economic and social performance.

That story will be another continuing chapter in the modernization of Japan.