The Transformation of the Ownership Structure of Japanese Financial and Commercial Institutions and Its Impact on the Level of Cooperation Between the State and the Private Sector in Japan

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Abstract

The level of ownership dispersion has a great impact on the level of cooperation between the state and corporations and also on the establishment of the developmental state structure in Japan. Analysis of the ownership structure of Japanese financial and commercial institutions in historical perspective reveals that control of financial and industrial capital has shifted since the Meiji era, and that the system continues to evolve. This transformation was one of the dominant factors that determined the level of cooperation and/or conflict between the state and corporate entities.

Keywords: *zaibatsu*, *keiretsu*, ownership structure, developmental state, level of cooperation

Introduction

Because of its economic success, Japanese industrial organization and the distinctive features of the Japanese corporate governance and financial systems have often been touted as a promising alternative to Western-style capitalism in achieving sustainable economic development and corporate success. The successful economic development of Japan after the Meiji Restoration astonished the world and has been analyzed from a wide variety of ideological and theoretical perspectives; these analyses have focused predominantly on the state and Japanese corporations. Especially, state-business relations are of interest to scholars in a number of disciplines and their evolution has been studied from different theoretical perspectives; e.g. Pempel (1974), Johnson (1982), Yagura & Ikushima (1986), Okazaki (1992), Samuels (1994), Ahmadjian (1996), Aoki (1988), Miyajima (2000, 2004), Teranishi (2007) and many others. Mainstream economists and theorists have debated the nature of the interventionist bureaucracy and corporate management, and their role in economic development. Most of these debates center on who played the most important role in establishing Japan's development strategy, and how the bureaucracy and corporate world influenced the nature of industrial development policy.

For example, Johnson (1982), who developed the theory of the developmental state, and others from the statist school of thought, have argued that "the state itself led the industrialization drive, that is, it took on developmental functions" (Thompson 1996:625). In the Chalmers Johnson model, the structural characteristics of the developmental state are based on institutional arrangements which are a combination of bureaucratic autonomy with public-private cooperation common to the high growth

Japanese economy. Johnson argued that the Ministry of International Trade and Industry (MITI) played a key role in the development of postwar Japan. Development policies were created and guided by the elite economic bureaucracy in MITI, which had close institutional and organizational links with private business. Johnson (1982) argued that bureaucrats and corporate managers were consistent and working jointly for one goal: "economic development". In Johnson's perspective, these co-operational links were crucial to the policymaking process and political system which gave great autonomy, power and legitimacy to bureaucrats to operate development policy.

From a similar perspective, Pempel (1974) considered Japan a successful example of state-led capitalism. These scholars argued that the state governs the economy not only through direct control of resource allocation, but also through defining the range of organizational forms the economy can take, by establishing the rules within which economic activity takes place, and by facilitating the development of formally organized governance mechanisms to achieve state goals in economic development (Gao 2001:8). Johnson (1982) and Okimoto (1989) also emphasized the role of the Japanese government in the success of big Japanese corporate groups, or *keiretsu*. Many economists in fact argue that Japan's macro level political and economic structures played pivotal roles in the success of the *keiretsu* firms during the era of high-speed economic growth (1950-1973). They argue that the Japanese government, especially MITI and the Ministry of Finance (MoF), played an interventionist role in stimulating the development of *keiretsu* firms through administrative guidance. Cowling and Tomlinson (2002) stated that "industrial policy was implemented within the discipline of a market economy and, for most of the postwar period, the role and development of the Japanese corporation appeared to be congruent with Japan's economic prosperity" (Cowling and Tomlinson 2002:384). The government's industrial development policy therefore centered on *keiretsu* firms, and the growth of large-scale corporations was an essential aspect of Japan's development strategy. "MITI's post-war industrial policy of targeting strategic industries for industrial development embodied a clear prejudice in favor of promoting the interests of larger corporations" (Cowling and Tomlinson 2002:378).

In contrast, many economists within the neoclassical school of thought have stressed the significance of market forces in Japanese economic development. These scholars argue that the market itself, but especially in relation to the activities of the big firms of *zaibatsu* then *keiretsu*, played a significant role in Japan's economic development. For example, Okazaki (1999), and Teranishi (2007) have claimed that Japan's economic success was based on its ability to centralize its economy around the *keiretsu*-type big corporations and the banks. Earlier, Caves and Uekusa (1976) had also supported this view and argued that the large Japanese corporate network organizations, first the *zaibatsu* families before 1945 and then the *keiretsu* networks after, were one of the most 'conspicuous force[s]' in Japan's rapid industrial development and transformation. These scholars argued that the organizational structure of *keiretsu* firms, in addition to their relationship with the Japanese government and banking sector, created advantages for these firms in their competition with multinational firms in both domestic and international markets, asserting that during the high speed growth era the *keiretsu* firms and 'the Main Bank system'[1] played a fundamental role in Japanese development.

In the same vein, Samuels (1994) argued that these firms had an immense influence *on* the Japanese government, especially on the decision-making processes of MITI and the MoF; indeed, Samuels (1994) asserted that such firms played a dominant role in shaping Japan's industrial development policy. For example, *keiretsu* firms devised a strategy to endorse certain industries in which these firms already had significant investments, having been active in their chosen sectors since the end of the 19th century and having had received significant benefits from government protection since that time. In other words these corporations *used* the state to achieve their own objectives (as distinct from the alternative, that the state used them). Johnson (1982) also noted that "the long standing practice of employing retired civil servants enhanced these large corporate firm's close relationships with MITI and provided a channel to influence—and possibly manipulate—economic policy" (Cowling and Tomlinson 2000:367). When the Japanese government designed its five-year development plans, the *keiretsu* firms persuaded MITI to devise policies endorsing specific industries in which they had been heavily investing since the pre-war era (under the *zaibatsu* holding companies), such as chemical industries, iron and steel, automobiles, shipbuilding and electric power. Since then, "these and other industries have benefited from measures such as discriminatory tariffs, preferential commodity taxes and import restrictions."

The Japanese State

Although there is a significant theoretical difference between Johnson's developmental state theory and Samuels' neoclassic theory, both schools of thought are agreed on the level of cooperation between the state and business elites. In their studies they focus more on the instruments of the cooperation (e.g. bureaucratic autonomy, ownership structure, vertical and horizontal *keiretsu*, cross-shareholdings, main bank systems and '*amakudari*'[2], etc.) or the consequences of the cooperation (e.g., firm performance and development). On the other hand, they gave very little attention to a possible relationship between the level of ownership dispersion and public-private cooperation. From a historical perspective, only a few studies have investigated how the ownership structure of corporations and the class origin of the ruling elites have determined the level of the cooperation and/or conflict between the state and the corporate world. Also, few studies if any have tried to theorize convincingly about a possible relationship between the decrease in *zaibatsu* power and the rise in bureaucratism or managerial capitalism.

In order to provide a better understanding of the Japanese system and answer these questions, here I focus on the state's socio-political structures, institutions, socio-

[1] It is based on the relationship between banks and clients in terms of reciprocal shareholding, monitoring and providing information and managerial services.

[2] Johnson's (1982) statist view asserted that the *amakudari* system was a major instrument used by the interventionist bureaucracy to establish direct influence over large corporations and banks in order to implement the state's economic interests effectively.

economic paradigm, and interaction with industrial and financial capital. Previous researchers have focused on the continuous and interrelated nature of the Japanese political and economic structures, through analyses of their longitudinal and historical transformations since the end of the Meiji era. Here I will expand this research by delving into the effects of cultural identity, ownership structure, class structure and the ideologies of the state such as nationalism, militarism, and religion on the Japanese corporate governance and finance system.

A proper analysis of these issues requires more nuanced explanations of the Japanese system at the macro level, including a consideration of the transformation of the state ideology and the effects of western schools of thought on the formation of Japanese state ideology and Japan's economic system in both historical and international comparative contexts. Thus an analysis of the transformation of capitalism in the context of the world political and economic system is necessary in order to pinpoint characteristics peculiar to the Japanese system.

In short, the central endeavor of this study is to develop a theoretical framework which can be used to define and understand the nature of the Japanese system. Specifically, the framework will focus on corporate ownership and capital—both its structure and its formation and evolution since the Meiji era—in order to explore the possible factors underlying Japan's economic success. I analyze both the true causes of the ideological consensus and the cooperation between state bureaucrats and corporate managers in relation to key socioeconomic goals by stressing the role of the ownership structure, bureaucratic autonomy and managerial autonomy. From this theoretical standpoint, I argue that the level of ownership dispersion has had a great impact on the level of cooperation between the state and corporations and also on the establishment of the developmental state structure in Japan. Analysis of the ownership structure of Japanese financial and commercial institutions in historical perspective reveals that control of financial and industrial capital has shifted since the Meiji era, and that the system continues to evolve. This transformation was one of the dominant factors that determined the level of cooperation and/or conflict between the military, the state and corporate entities.

The State and Corporate Entities

If we analyze the Japanese economic system based on the level of cooperation between the State and corporate entities and the characteristics of the ownership structure in Japanese firms, together with the broad historical and institutional trends, we can distinguish three major periods:

1. The Capital Market-Based Economic System. This first period extended from the last years of the Tokugawa era to the Showa Financial Crisis of 1927. Even though the Japanese economic system had its unique characteristics during this period, we can find some similarities between the Japanese system and Anglo-American market based capitalism. Until the Showa Financial Crisis of 1927, the capital markets, primarily the equity market, were the main source of capital

for the many large industrial firms. Corporate bond issues rose rapidly during the Meiji era and became the main source of external funds for large industrial firms in the early twentieth century. Most of the big corporations financed their investment through the Japanese equity and bond markets. Individuals, mostly from *zaibatsu* families, owned and controlled the industrial and financial capital, and during this era the state followed the *zaibatsu*-centered development model. The focus of the state was to sustain the *zaibatsu* and assist their build up of Japan's industrial development. This paradigm and the political support from the ruling elites gave *zaibatsu* families privileged treatment and access to state resources, which allowed them to extend their empires. Intense conflicts between the members of the ruling elite and between individuals within social classes characterized the era.

2. The Bank-Based, State Controlled Economic System. This second period can be characterized as a bank-centered, state controlled economic system, which started with the growth of Japanese militarism after the period of "Taisho Democracy" and the Showa Financial Crisis, and which dominated the economic system until the end of the high growth era in the early 1970's with the various "shocks" arising from the floating of the dollar on foreign exchange markets and the rise in the price of oil. Between the Showa Financial Crisis in 1927 and the Korean War in the 1950s, control of financial and industrial capital shifted from the *zaibatsu* families to financial and industrial institutions. At the end of this structural transformation Japan fully institutionalized the bank-centered corporate financing and managerial capitalism system. This major transformation in the ownership and the capital structure of corporations and banks lessened the shareholders' influence on the governance of corporations and the state. The bank-centered cross-shareholding system also reduced the level of shareholder influence on managerial decision making and led to greater autonomy for the directors. Because the majority of corporations were owned by other corporations and financial institutions, Japanese managers became "the agents of the corporate social organs rather than of individual property holders." This autonomy gave managers a greater ability to cooperate with bureaucracy in order to run the corporations in alignment with the long term interests of Japanese capitalism. Thus, during the high growth era, as an autonomic new ruling class, the corporate managers and bureaucrats were able to cooperate and pragmatically transform the socioeconomic structure of Japan to align with the long-term interests of Japanese capitalism — in terms of their perceived common interest — without causing any serious social or class struggles.

3. The Market-Based Economic System. This final period started with the liberalization of the financial markets and real economy, and reached its final stage after the Big Bang reforms of 1997. "Significant structural change became apparent in the mid-1970's, leading to financial liberalization in the 1980's and

the removal of many of the controls on the financial system." (Lapavitsas 1997:2) The process of liberalization and internationalization had a serious impact on the bank-centered financial system, corporate ownership and the capital structure. Due to the liberalization of the financial markets and the real economy in the late 1970s, the bank-based cross-shareholding system weakened and the capital markets began to play a greater role in the financial system. Thus, Japanese state capitalism started a transition to the market economy and the importance of banks in corporate financing began diminishing. Since the capital markets began to play a greater role, individual and international investors have increased their level of share ownership in Japanese firms and banks. Due to structural changes in corporate ownership and financing, and increasing shareholder power on the corporate governance, both the state's influence on Japanese firms and the level of cooperation between the state and the corporate world have diminished.

In this study I have aimed to analyze the causes and evolution of each of these three periods and tried to answer the questions of why and how the fundamentals of each system changed, resulting in a new economic structure. Answering these questions can give us a clear perspective for understanding the functions of the state, big corporations, and financial institutions characteristic of the corporate ownership structure and the international political and economic fundamentals in Japanese economic development.

Zaibatsu Corporate Governance

We can distinguish Japan's cultural collectivism in the establishment of *zaibatsu* corporate governance. Until the end of the Edo period, family members owned the entire group of companies and centralized control of the affiliated firms. The business strategies and investment decisions were verified collectively through a family council. The exact pattern of corporate governance varied from one family to another, but Mitsui corporate structures acted as a role model which some other *zaibatsu* families followed. For example, as Yasuoka (2002) pointed out, the corporate governance structure of the Yasuda family in particular was closely patterned on the Mitsui model. The Yasuda family used Mitsui as a point of reference for creating their inter-corporate organization.

The Sumitomo and Yasuda affiliated firms were almost entirely owned and directed by the single head of the family. "In contrast, the Iwasaki family, the owners of Mitsubishi, had direct control because it was a newly-developing firm. It remained an 'entrepreneurial firm' in the sense that its founders still owned and managed the enterprise, whereas Mitsui and Sumitomo, which already had long histories lasting several hundred years, had evolved past that stage" (Abe 1997:300-301). The Mitsui family's "eleven branches" used their family wealth as a group. The family members acted as a unit in accordance with formal household rules and managed their affluence collectively. "The sons of founder Takatoshi Mitsui formed a strong affiliation and established many house rules for the management of business and family affairs" (Yasuoka 2002:51). In the early 18th century, the Mitsui family's eleven branches devised a family council, the "*omotakata*," to administer Mitsui business interests and to sustain a balance of power among the family's constituents. During the early years of the Mitsui Empire, management and control of the family wealth were centered in the *omotakata*. That council had very rigid roles to carry out its mission to pass on family wealth to the succeeding generations.

During the Meiji Era, the Mitsui family extended their business aggressively into banking, commerce, and mining industries (Morikawa 1980). Each firm was established using only the family wealth as an autonomous firm. Therefore it was essential for the Mitsui family to establish a centralized system in order to control these firms vertically, and to hire professional managers to direct Mitsui firms. This was called the "*banto seiji*" (Yasuoka 2002 :51) system of management. "These systems underpinned its rise to prominence and allowed Mitsui to maintain its dominant position virtually unchallenged." Allen (1937) and Teranashi (2005) noted that these managers were drawn from all classes of society, but were mostly either sons of former samurai who were well-educated at the top Imperial Universities, or high-ranking government officials.

Nakamigawa tried to separate the Mitsui family from day-to-day management by creating a Board of Directors in 1896 to coordinate overall policy and policies of the individual companies as well. This was the so-called "Nakamigawa reform," which consisted of firmly establishing an autonomous and independent management which had severed its hereditary connection with governmental authority. This allowed it to break free from its traditional role centered on money-lending and commerce, and advance to become a body concerned with manufacturing industry. After the Nakamigawa reforms professional managers played a central role in managing the Mitsui enterprises and the influence of the family members on the corporate control was reduced. But the process of separating the family from the management couldn't be successfully completed due to the death of Nakamigawa and strong opposition from family members. The family council strengthened its jurisdiction over the boards of directors of affiliated firms in managing the companies. The affiliated firms were required to confer with the family council on many occasions, especially pertaining to capital investments. Mitsubishi also "moved from a centralized structure to a more decentralized one towards 1908 because of product diversification. In the 1910s, each division became an independent joint stock company (Morikawa 1970:79) During WWI the Mitsubishi family gave autonomy to its corporate firms' managers to act more independently due to the rapid expansion of its business.

The extension and coordination of constantly changing structure required an appropriate management organization. Okazaki (2000:18) argued that "expansion and diversification of the businesses caused problems which resulted from asymmetric information, namely adverse selection and moral hazard of the agents who executed the businesses. In order to resolve these problems, *zaibatsu* introduced organizational innovation." In 1909, the Mitsui family council took major steps to reorganize their corporate governance structure based on the British "pyramidal business group" form of holding company, to better monitor and coordinate the family companies. The Mitsui family converted their directly operated main firms, Mitsui Bank, Mitsui Trading and

Mitsui Mining, into joint stock companies under the vertical control of the Mitsui Gomei holding company. The holding company owned and controlled the total stock of each affiliated company.

The holding company exercised complete control and had a strong monitoring and auditing function over the affiliated companies. "In many cases, the relevant sections of the holding company, such as audit and inspection sections, checked the budget and financial data of the affiliated companies, while the decisions of the board of directors were approved by the holding company ex ante and ex post. There existed systematic rules on the allocation of powers between the holding company and the affiliated companies" (Okazaki 2000:18). Directors of each company were interlocked to improve coordination and monitoring. Their "organ" banks played the central role in the holding-company operations. Nevertheless the rapid expansion into different business sectors made the management system more complex, making it more difficult to have overall control through one center. Morikawa (1970:63) argued that the individual fields operated under the exclusive control of subsidiary companies, which were given autonomous authority. "As the subsidiary companies were formed out of firms of long standing, and because they enjoyed an overwhelming influence in their respective fields, they were able to assume the right to act at their own discretion in their dealings among themselves as well as with the central headquarters."[3]

In the early 1900s, not only the Mitsui family and other *zaibatsu* but also the Japanese economy were growing rapidly. Japanese military expansion was giving momentum to economic growth. Within this economic and political structure, Mitsui and other *zaibatsu* families were investing heavily in military related industries. Morikawa and William (1994) suggested that Japan's economic growth and the natural shift from light to heavy industry, which the military build-up accelerated, required massive amounts of capital. The family's new investments in heavy and chemical industries were mostly financed through capital from the Mitsui Bank and Mitsui Mining. The family had a strong policy against borrowing from the capital markets due to their concern about losing control of their firms. Until the end of the First World War, the *zaibatsu* families were able to finance this rapid expansion through their organ banks and the retained earnings of their affiliated enterprises. But at the end of the war, the families needed massive amounts of capital to finance their long-term investments in heavy industry and chemicals. The government's direct and indirect subsidiaries helped to cover some of these capital needs but the rest of the capital needed financing through selling the equity they held in the stock market. In the case of the partnership or the limited partnership, the central offices could not get money by mortgaging stocks, and could not issue debentures either. So to procure the money to meet the (military) demand for defense materials, they had to revolutionize the form of their central offices. Hence a part of stock of the central office was offered to the public, though those who could buy them were restricted to either officers and employees of the *zaibatsu* or to affiliated companies, because the owners feared interference from the outside members among the stockholders. Nevertheless many individual investors, such as big landlords

[3] Ibid; 63

and merchants, also bought significant amounts of *zaibatsu* equities.

The Mitsubishi family was the most liberal of the *zaibatsu* families in offering shares in its holding company and affiliated firms, such as group banks, mining and trade firms, to the public in the early 1920s. The Mitsui and Sumitomo families were more conservative in this respect and tried to keep holding companies as closed to the public as they could. They only offered the holding companies' and first tier companies' shares to the public when it was necessary after the Showa crisis, as a stratagem to counter pervasive criticism. "Mitsui in 1928 owned an average of 69.4 percent of the shares in the ten largest Mitsui-affiliated firms" (Yamamura 1964:544), although this percentage diminished significantly after the public offering. In the course of that process, there was rapid growth in crossholdings of shares between firms within each group. As a device to raise equity capital without diluting group ties, cross shareholding was widely introduced after the early 1930s. In the case of Mitsui, Mitsui Gomei (the holding company) began extensive sales of shares of group companies after 1932. Most of the purchasers were financial institutions in the same group, such as Mitsui Life Insurance, Mitsui Trust, Mitsui Bussan and Taisho Insurance. The Sumitomo, Mitsubishi and other *zaibatsu* families followed the same pattern and amplified their cross shareholding ties by selling holding company shares in the group banks and other firms in their networks. As a result the *zaibatsu* family members started to relax their control of the member firms within the group. Moreover, the degree of cross-shareholding among *zaibatsu* firms increased drastically and the managements of the affiliated firms become more autonomous. These changes intensified with the economic planning for war under the military regime.

The Showa Financial Crisis of 1927

The Japanese economy experienced severe economic crises in the 1920s. The Showa Financial Crisis in 1927 was especially severe and led the Japanese government to completely change its policies governing the regulation of the economic system, including tighter regulation of the *zaibatsu* firms. In the mid 1920s, the world-wide recession and the repercussions of the earthquake of 1923 in Tokyo slowed Japanese economic growth. These new economic conditions produced a tremendously volatile Japanese economy, leading to a financial crisis. After the Great Depression, Japanese international trade dropped dramatically and many textile and cotton-shipping workers lost their jobs. In addition to the effects of the Tokyo earthquake and the Showa Financial Crisis, a significant structural crisis faced the Japanese economy. Rural Japan experienced the worst effects of the economic catastrophe. Because most Japanese military officers and bureaucrats were from rural areas, their anti-capitalist world views grew more extreme. Gao (1997) argued that structural crises in the capitalist world forced the Japanese ruling elite to adopt the state paradigm and depart from liberal capitalism. Thus rather than relying on classical economic theories, Japanese ruling elites sought a radical solution.

A strong economic and political relationship between *zaibatsu* families and bureaucratic elites was established in the Tokugawa era and continued to grow until the

1927 Showa financial crisis. Until this point, the state’s economic development paradigm was based on the *zaibatsu*-centered development model. The focus of the state was to enforce and anticipate *zaibatsu* property rights to fortify Japan’s industrial development. This paradigm and the political support from the ruling elites gave *zaibatsu* families privileged treatment and access to state resources, which allowed them to extend their empires. When the Japanese bureaucracies endeavored to restructure the economic system after the Showa crisis, “maintaining political stability and allocating resources came to have higher priorities than protecting the liberties of private enterprises in the state policy.” (Gao 2001:3) At this point, the Japanese ruling elite realized a *zaibatsu*-centered development model could no longer competently govern the economy because the desire to maximize wealth was the direct cause of the structural crisis of the Japanese economy. The industrial bureaucrats of the Ministry of Commerce and Industry (MCI) believed that it was necessary for the state to lessen shareholder power over corporate governance to establish absolute state control of the economy. Thus, the property rights of private companies—including those of *zaibatsu* firms—were restricted. Also, they strengthened regulations that restricted the power of shareholders over corporate management (Okazaki et al. 1999:7).

State Control of the Economy in the 1930s and 40s

War mobilization in the 1930s led to state bureaucrats having a great deal of power to control all fundamental aspects of the economy. As Rice (1979) noted, both sides of the political spectrum put forth theoretical and ideological justifications for economic controls during the 1930s. Both left- and right-wing Japanese political movements, especially some military officers and state bureaucrats, harshly criticized the *zaibatsu* families and their business practices as the cause of Japan’s economic problems. Okazaki (2000) and Morck and Nakamura (2007) noted that the government chastened *zaibatsu* families for not cooperating with national policy and their unpatriotic short-term focus on family business interests. Meanwhile Japanese right and left wing intellectuals recommended severe modifications of capitalism through the separation of capital ownership and industrial management, a transformation of economic ethics, a tightly organized economic structure based on cartels, and comprehensive economic planning. According to this new economic paradigm the state would dissolve the *zaibatsu* and create systematic cartel organizations to facilitate the separation of management and capital. To able to control the economy "enterprises [should] be freed from the domination of capital.”

Within this new paradigm, to replace the *zaibatsu* role, the state launched mandatory cartels and compulsory trade associations to manage the economy (Gao 2001). The state bureaucracy began working directly with the mandatory cartels and compulsory trade associations to diminish *zaibatsu* family influence on the economic system to better manage the economy. With this structural and ideological alteration, the Japanese bureaucracy first aimed to establish absolute control over both administration and legislation. It then shifted its priorities from *zaibatsu*-led industrial development to maintaining sociopolitical stability and managing resource allotment by supporting the managerial capitalism.

The influence of Japanese militarism on economic and political life continued to grow. In the context of these political conditions, Japanese nationalists assassinated several politicians and *zaibatsu* family leaders. The extremists specifically targeted the Finance Minister, Junnosuke Inoue, and the head of the Mitsui holding company, Takuma Dan, and assassinated the two men in the early 1930s in a period marked by political violence. Young military officers killed Prime Minister Tsuyoshi Inukai on 15 May 1932 (the May 15 Incident); the assassination marked the end of party-led governments. Japan had military-backed non-party governments from that time until August 1945. All members of the Mitsui family withdrew from top management positions and some stock was sold to the public after the assassination of Takuma Dan and the May 15 Incident. The other *zaibatsu* leaders also removed themselves from controlling positions in companies directly involved in production and transformed these companies into organizations for managing assets (Yasuoka 2002:51). *Zaibatsu* families had been hesitant to open their holding companies to the public since the Meiji era, but increased criticism forced the families to make some structural and legal changes in their corporate governance systems, such as shifting from partnerships to corporations and reducing their shares in the holding companies and affiliated firms. These shifts in *zaibatsu* corporate governance were responses to the changing environment.

Militarism completely governed the Japanese economy after the May 15 Incident. Finance Minister Korekiyo Takahashi engineered and successfully executed an economic and fiscal program inspired by Keynesian policy. Takahashi significantly increased monetary and fiscal expenditures and expanded the military budget. He used the BoJ's policy of low interest rate financing and the exchange rate depreciation to finance the budget deficit. On a short term basis, the expansionary macroeconomic policy stimulated the Japanese economy. However, Takahashi then slowed the fiscal expenditure increases, including military spending, and cumulative frustration with these economic decisions led a group of young military officers to assassinate Takahashi in the February 26 Incident of 1936.

After Takahashi's assassination, the military established complete economic control. The Temporary Funds Adjustments Law of 1937 created the *kikakuin*, or Planning Agency, to centralize economic planning and administration. This required boards to obtain government approval before most important corporate decisions, such as changing their articles of incorporation and issuing equity or debt. With this act, the military government hoped to gain broad jurisdiction over the financial system and then allocate long-term financing for war-related industries (Hoshi and Kashyap 2001:54). In turn, the National Mobilization Act of 1938 allowed the government to control, regulate and mobilize all major aspects of the economy, including production, capital markets, the labor market, and natural resources in order to use the economy to meet national strategic goals (Rice 1979:696). The new regulations led to structural changes that significantly changed *zaibatsu* behavior. As noted earlier, "the military condemned *zaibatsu* families for an unpatriotic 'short term focus' on the current earnings and dividends of their apex firms" (Morck and Nakamura 2007:41). This condemnation compelled the *zaibatsu* to widen ownership to employees and the public; the major enterprises began to share equity; the dominant *zaibatsu* focus shifted from family-controlled holding companies to major industrial concerns; and the role of the *zaibatsu* bank became central to the groups' strategic programs. Taking advantage of this trepidation, the military took over the investment policies and strategic decisions of the *zaibatsu* firms. The military regime's economic and financial regulation caused major transformations in *zaibatsu* corporate ownership and governance structure.

After 1939, the Japanese government controlled and regulated the economy even more rigidly. The Ministry of Commerce and Industry (MCI) initially focused on regulating the distribution of funds, and later strengthened regulations restricting the power of shareholders over corporate managements (Okazaki 1999:77). In December 1941 the Japanese declared war on the USA and its allies. Shortly after the beginning of World War II, the Japanese cabinet proposed new ideas for company organization, in their *Keizai Shintaisei Kakuritsu Yoko*. This "regarded the company as an organic body composed of capital, management and labor, in stark contrast with the classic capitalistic concept of shareholders' sovereignty embodied in the Commercial Law" (Okazaki and Okuno-Fujiwara 1997:35). Under this proposal, the Minister of Finance strictly controlled dividend payments and prohibited firms from paying dividends greater than eight percent. The government attempted to reduce the power of shareholders, and to force firms to devote all profits to new investment (Morck and Nakamura 2003:51). Okazaki and Okuno-Fujiwara (1997:36) explain that "the government aimed at changing corporate goals themselves so that the profit decline should not check production incentives. For this purpose the government tried to reduce shareholders' power, on the presumption that it was shareholders that forced the corporate managers to maximize profits." Rice (1979:696) noted that the military government exerted even more control by allowing for government appointment of cartel presidents. Other government decisions eradicated the rights of boards to set dividends (1939) and to assign executives (1943), shifting these rights to the *kikakuin*. Economic controls peaked when the Munitions Companies Act of October 1943 placed strategically significant *zaibatsu* firms directly under government control (Hoshi and Kashyap 2004:60). Japanese militarism had a number of persistent impacts on the finance and corporate governance system, most notably transforming the system from market-based financing to central-bank-based financing. The military government's wartime regulations reduced the appeal of capital markets for investors who subsequently transferred their investments from security markets to banks (Hoshi and Kashyap 2001:570). The government strongly supported this move because it was easier for the Ministry of Finance to transfer the nation's savings into the war industries through the banking system.

The Allied Occupation and After

Important features of the financial structure and wartime policies concerning financial markets continued virtually unchanged during the postwar Allied Occupation. More importantly, although the goals of the postwar government shifted dramatically from military production to civilian, industry-based production and rapid economic growth, many of these policies served as the foundation and framework for the postwar financial system, and persisted almost until the twenty-first century (Johnson 1982; Gao 2001).

At the end of WWII, the U.S. government blamed *zaibatsu* holding companies and other large industrial companies with military links for Japan's war effort and imperial expansion in East Asia. The Occupation administration argued that militarism in pre-war Japan was strengthened by the presence of the *zaibatsu* and their connections with the military and politicians (Odagiri 1992: 171). Defeat and reform had disposed of two obstacles to an effective industrial policy: the independent *zaibatsu* and an anti-capitalist military. However, the industrial bureaucracy itself was relatively untouched by the purge of those civil servants held responsible for the war while the occupation authorities' attempts to first reform and then revive the Japanese economy enhanced the role of the state (Fulcher 1988: 246). The U.S. established the Holding Companies Liquidation Commission to oversee the dissolution of the *zaibatsu*. As Okazaki (2001) has noted, the commission relied on market share to determine the ten major *zaibatsu*: Mitsui, Mitsubishi, Sumitomo, Yasuda, Furukawa, Nissan, Okura, Nomura, Asano and Nakajima. Nine of them (excluding Nakajima) accounted for 15% of total paid-in capital in Japan in 1937. The occupation authorities attempted to establish a dispersed ownership structure for the *zaibatsu*.

Since most of the *zaibatsu* parent companies were holding companies with large corporations under their control, the controlling families were forced to release their controlling stocks in the holding company to the Holding Company Liquidation Commission in exchange for long-term non-negotiable government bonds. Shortly thereafter, the stock was released to the open market. Subsequently, occupation forces proscribed the holding companies and requested that the *zaibatsu* firms remove family members and other influential business leaders from their boards and not use *zaibatsu* names, trademarks, and logos. "The banking sector, in which no single bank held a clearly dominant market share, was relatively unaffected by the occupation, although banks had to give up their shares in non-financial companies. Many pyramidal structures in non-financial sectors also remained, and were carried over to the postwar era in the form of vertical *keiretsu*, also called capital *keiretsu*" (Morck and Nakamura 2003:64). At the end of the transformation the prewar structure of the *zaibatsu* – characterized by holding companies, layers of subsidiaries, and family stock ownership – was basically dead (Hoshi and Kashyap 2004:8-63).

The dissolution of the *zaibatsu* changed the nature of Japanese corporate governance and finance. Bisson (1954) has noted that more than forty percent of all companies changed ownership structure during this period. According to Aoki (1988) and Yafeh (2000), individual investors, company employees and residents of cities where the companies operated purchased most *zaibatsu* shares. For the first time in Japanese financial history, individual investors held more than seventy percent of all corporate assets in Japan. However, this pattern of ownership structure did not persist for long. A high inflation rate and an unstable economy led most individual shareholders to sell their stocks to Japanese companies through the Tokyo Stock

Exchange. Aoki and Patrick (1994:16) argued that at the end of the war, occupation authorities dissolved the *zaibatsu* and made holding companies illegal, but could not change the financial system through major structural reforms. Although *zaibatsu* family members lost their shares in *zaibatsu* banks, the 'big five'[4] *zaibatsu* banks and other city banks retained power and other member firms acquired most of their stock via cross shareholding between ex-*zaibatsu* network members. Thus, many aspects of the wartime corporate finance and governance system remained intact and continued to dominate the real economy.

During the Korean War, many ex-*zaibatsu* firms reunited with other *zaibatsu* member firms in the *keiretsu* network. The war created an immense demand for Japanese industrial products, and consequently the "Japanese industrial structure shifted from a light to a heavy and chemical industry orientation" (Dicken and Miyamachi 1998:56). Many ex-*zaibatsu* firms viewed these structural changes as an opportunity to reorganize and resume previous growth. However, capital shortages (due to a capital crunch in the financial system during the Korean War) caused problems for the firms and they were unable to increase production capacity. The banking system and stock market were unable to create a capital surplus for investment. Therefore, the only option available to many ex-*zaibatsu* firms looking to expand their business was to seek capital from other "friendly" firms or intergroup financing Weinstein and Yafeh (1998).

Miyajima (2000) and Morck (2005) explain the advantages of this type of internal funding. In the words of Morck (2005:444):

> "*External funds cost more than internal funds, a freestanding undiversified company is subject to the vagaries of cost and demand in a single industry. A group bank, or an apex firm that acts as a de facto bank, can move funds from member firms where they accumulate to where they are needed. Since the group bank has better information about the investment opportunities available to each firm, it can do this at much lower cost than could outside banks or financial markets.*"

Shortly after the Korean War began, the government amended the Anti-Monopoly Act so that financial institutions were allowed to hold 10 percent equity in non-financial firms. The Treaty of Peace with Japan, which took effect in 1952, allowed the formation of presidents' clubs, which were instrumental for the re-establishment of ex-*zaibatsu* firms and the formation of new financial groups (Carson and Traynor 1997:213). As a part of the recapitalization process, ex-*zaibatsu* firms began to buy shares in companies with which they had business ties during the prewar era. (Hoshi and Kashyap 2004:126) As Lazonick (1999:607) notes, "by 1955 cross-shareholding—according to its broadest definition as stock in the hands of stable shareholders—represented 25% of outstanding stocks listed on the Tokyo Stock Exchange, and by 1960 it was about 40%."

The increasing fear of communism in Asia after the Maoist revolution in China and during the Korean War led the Japanese government, and to some extent the U.S.

[4] Mitsubishi, Mitsui, Sumitomo, Yasuda, and Daiichi were the big five financial monopolies.

government, to support the re-establishment of the ex-*zaibatsu* firms under the *keiretsu* structure. In addition, throughout the 1960s, the U.S. government and other international organizations increasingly pressured the Japanese government to integrate the Japanese economy into the capitalist economic bloc by liberalizing the Japanese financial system and opening the domestic market to foreign companies. As a result, subsequent to Japan's accession to the Organisation for Economic Co-operation and Development (OECD), most Japanese firms feared hostile takeovers by foreign companies. Okumura (1993) and Dicken and Miyamachi (1998) argue that liberalizing the Japanese economy and financial system forced company executives to increase their cross-shareholding links in the bank-centered *keiretsu*. At the same time, the former *zaibatsu* banks played a very active role in re-establishing the *zaibatsu* networks. The banks "retained most of their prewar business relationships with their fellow former *zaibatsu* member firms and were referred to as the main banks of these client firms. These networks of relationships were critical in the formation of the *keiretsu* in the 1950s and 1960s, for the former *zaibatsu* banks often organized the white squire equity placements that constitute the *keiretsu*" (Morck 2005:440).

To reduce the likelihood of hostile external takeovers and facilitate competition with international companies, the ex-*zaibatsu* member firms of Mitsui, Mitsubishi, and Sumitomo, as well as other major industrial firms, reconnected horizontally and vertically around their main banks by purchasing each other's assets. Because expanding share ownership created uncertainty in the relationship between management and owners, the old *zaibatsu* firms wanted to expand their crossholdings of shares with their banks. The increasing autonomy of management strengthened the banks' control over firms. The main banks provided the financing necessary for the apex firms to establish cross-shareholding among their business partners. The arrangements took three main forms: "large, inter-market groups; vertical lineups of subcontractors and other suppliers; and vertical tie-ups with exclusive wholesalers and retailers in distribution" (Schaede 2006:8). In addition, apex firms and banks began to hold one another's assets: "Over time, as business relations among financial and industrial enterprises changed, the web of cross-shareholding became more intricate" (Lazonick 1999:607). As a result, the number of individual shareholders decreased and "in the early 1950s a new ownership structure emerged: instead of individuals, most Japanese companies were now owned by other companies and by financial institutions, most notably large commercial 'city banks'" (Yafeh 2000:84). Hodder and Tschoegl (1993:50) note that "the proportion of companies in this category surpassed 60% in 1975, and since that time 60-70% of corporate shares have been kept off the market through cross-shareholding."

The *keiretsu* networks, the main bank system, and the government institutions (MITI, the MoF and the BoJ) became the leading players in postwar economic development. Many economists considered the Japanese *keiretsu* as a source of 'strategic advantage' for Japanese firms in the global arena. They argued that their organizational structure, and also their relations with the Japanese government and banking sector, created competitive advantage for the *keiretsu* firms to compete with multinational firms in domestic and international markets. The close cooperation between those government organizations and the *keiretsu* firms provided many advantages in the expansion of their networks of companies. Japanese government had an immense influence on the *keiretsu* firms, especially the decision-making processes, to mobilize the nation's savings to invest in strategic industries. The Japanese financial system was systematically providing funds for *keiretsu* industrial investment. The Japanese government implicitly guaranteed all the *keiretsu* group banks' investments in the capital-intensive, large-scale heavy engineering and chemical industries and created regulations to subsidize the *keiretsu* group banks. With this high level of investment, Japan achieved significant industrial development during the high growth era. Thus, the work of MITI, MoF, Japanese banks and the *keiretsu* firms was very closely intertwined during the era of rapid growth; however, over time, due to structural changes in corporate financing and the ownership structure of corporations, MITI's influence on the *keiretsu* firms lessened. Ironically, the very success of bank-loan capitalism eventually undermined the privileged position of the state (Ozawa 1999:355).

The Era of Slow Growth

When Japan completed its industrialization process, the major dynamics of the system started to transform themselves to adapt to the new global and political environment. The oil shock in 1973 was a turning point for the Japanese economy. Following the end of the high growth era, Japan had to face slower growth and financial instability. In this period Japanese financial institutions and *keiretsu* firms had to face domestic and international structural challenges, which occurred because of the structural changes in the *keiretsu* production system such as outsourcing and downsizing, as well as other monetary and financial factors due to major financial liberalization reforms.

After the oil shock, Japanese economic growth slowed significantly. However the deceleration was not due solely to high oil prices. Most economists believed that Japan had reached the limits of its growth potential before the oil shock, and the oil shock merely accentuated the transition. The Japanese government believed that increased government spending would help the Japanese economy recover. A persistent imbalance between savings and investment levels, combined with increasing anxiety within the financial system, forced the Japanese government to increase spending and run a large fiscal deficit to support economic growth and balance the financial system. Cargill et al. (2000) argued that the MoF was looking for new money to finance its growing spending. The Japanese government decided to use direct financing through expanded securities markets and the BoJ issued special government (deficit) bonds to finance the Japanese governments' increasing public spending. The BoJ sold large amounts of bonds by easing interest rate controls.

Japanese financial institutions (primarily major banks and insurance companies) purchased these government bonds. "This massive issuing of government bonds became the driving force in changing the Japanese financial system from one based on the banking sector to a more Western-style system based on capital markets" (Korkie and Nakamura 1997:115). "The large secondary market for bonds undermined the previously instituted interest-rate controls. Because government bonds were now traded at market prices, investors avoided other financial assets, such as deposits, whose interest rates were artificially low" (Hoshi and Kashyap 1999:135). This policy change speeded the development of the security markets. Japanese firms were able to raise massive amounts of low interest funds by issuing convertible bonds with stock options and this structural change forced Japan to liberalize its financial and corporate governance system.

"Financial deregulation, which started with the creation of a secondary market for government bonds, gradually spread to markets for corporate bonds and equities" (Hoshi 2001:6). Financial institutions demanded liberalization of the financial system, such as entering into the securities business, removing strict restrictions on selling government bonds to the public, and establishing a bond futures market to promote bonds and equity markets. Meanwhile global neo-liberal movements during the 1980s forced the Japanese government to complete the liberalization process and open the domestic market to foreign investors. The Ministry of Finance accepted most of these major policy changes. Kashyap (2004) has noted that, in order to help the Japanese banking system match international competition by the mid-1980s, the government had lifted all restrictions relating to different financial options, including deregulating interest rates, not requiring firms to raise funds in the securities and investment market, implementing a freely floating exchange rate, and allowing banks and firms to take part in the capital market (Monzur 2004:5). "Many new financial products became available under the liberalized rules. In addition, weakened foreign exchange controls (due to the reform of the Foreign Exchange and Control Act in 1980 and the end of the "real demand principle" in 1984), allowed Japanese corporations to raise funds internationally" (Hoshi 2001:2).

After these deregulations, Japanese multinational corporations were able to bypass banks and access the Japanese and international corporate bond markets to finance their investments at considerably lower cost. Since then, Japanese firms have drastically reduced their dependence on bank loans and shifted their corporate financing from banks to the bond market, and the proportion of convertible bonds in all corporate bonds issued increased from 9% in 1980 to 63% in 1985. Big firms raised more funds through financial markets. For example, Yamori and Asai (2006:4) have pointed out that Japanese companies raised approximately $519 billion in the first five years after the lifting of bond market restrictions. The amount of new corporate straight bonds issued, which was only one trillion yen in 1988, reached 12 trillion yen in 2003. Because of the structural changes in the Japanese economy, the banking industry suffered from huge overcapacity problems. Hoshi and Kashyap (1999:2) argue that the MoF couldn't take the necessary steps to modify the system once it accomplished its mission. Therefore "the disequilibrium created by the gradual and lopsided deregulation in the Japanese financial system played an important role" in the banking crisis in the 1990s.

In the 1990s, the Japanese financial system faced several difficult structural problems, which were predominantly related to Japan's monetary and fiscal policies in the 1980s. The low GDP growth, Japanese FDI, insufficient domestic demand, the weak financial system, and the structural inefficiencies were the some of the main problems in the Japanese economy. For the duration of this period, Japan's financial structure faced serious institutional changes that were directly related to the liberalization and internationalization of the Japanese economy. These institutional changes led to the deterioration of Japan's early postwar policy of segmentation, which was the main rationale behind the real estate and stock price bubble. Due to these structural changes in the financial system, the Japanese banking system experienced a serious structural crisis in the 1990s.

At the end of the crisis in the 1990s, "the banks had to sell many of the shares they held in Japanese firms in order to raise cash and satisfy their capital requirements" (Nakamura 2006:241). The MoF ordered all banks to sell off their equity shares in their clients' firms to increase their capital adequacy ratio to over the 4 percent level. This policy significantly weakened the main bank structure. The banks started to sell their equities on the stock markets. This incident happened during a period of financial deregulation, and therefore the Nikkei stock declined by over 80 percent. Ahmadjian and Song (2004:31) argue that most of the shares sold by commercial banks and life insurance companies during the 1990s were bought by foreign institutional investors and trust banks. The proportion of listed shares under foreign ownership increased from about 5% in 1991 to 26% in 2010 (Tokyo Stock Exchange highlight). Because foreign investment firms increased their market share in the Nikkei index and were far more active traders than most Japanese shareholders, they played a major role in the policy-making process in the Japanese financial system. Foreign investment firms questioned state intervention in the economy, stable cross shareholding, and the main bank and *keiretsu* systems. These firms demanded that the cabinet revise certain aspects of the Commercial Code to streamline the relationship between management and shareholders and protect shareholder rights. In sum, foreign firms forced the Japanese government to transform Japan's bank-based, state-controlled financial system to an Anglo-Saxon, market-based financial system.

Due to the Japanese economic slowdown, many Japanese scholars argued that the state-controlled main bank system was not allowing Japanese corporations to compete in the global market. They argued that the Japanese financial system needed to fundamentally change its corporate governance structure in order to adapt to the new global economic reality. Meanwhile, International financial firms were strongly encouraging Japanese corporations to implement an Anglo-American corporate governance system. Changes such as better disclosure, increased transparency, expanded shareholder rights, board independence, a higher ROE rate, and a reduction in share cross-holding, were among the issues cited as essential for improving Japan's competitive position (McGuire and Dow 2003:378). And before long, the Japanese government couldn't resist the immense pressures from the international organizations and the business world, and they started to cooperate with academics and business associations to reform the corporate governance system. MITI and the MoF also wanted to carry out these reforms because they believed that in many strategic sectors such as information technology and the finance industry, Japanese international firms, mostly the *keiretsu* members, were falling behind their competitors, not only in the global markets but also in the domestic arena. Therefore they were interested in reforming the

Japanese corporate governance model to give the necessary administrative flexibility to the firms to choose their own corporate governance system to make them more competitive in the global arena in relation to their international counterparts.

In the early 2000s the Government revised the Commercial Code to protect shareholder rights by streamlining the relationship between management and shareholders. “Many of the changes at the firm level originated with Sony, a company with particularly high levels of foreign ownership and participation in foreign markets” (Ahmadjian and Song 2004:12). Although only the some of these structural reforms were accepted by the corporate world, this process revealed the residual power of the state to control the financial system and the real economy, but in addition it weakened the traditional relationship between the state, the banks and the *keiretsu* firms. With the influence of neo-liberalism and structural changes in corporate ownership, big businesses, mostly the *keiretsu* firms, demanded the reduction of state intervention in the economy. When the shareholders increased their power and influence over corporate decision making, the directors of Japan’s large firms lost their autonomy, and thus became more concerned with shareholder rights and began to dispute MITI’s powers; in many cases corporate directors pursued their own shareholder interests rather than complying with MITI policies.

Conclusion

This study has aimed to analyze the nature and fundamentals of state capitalism in Japan and the evolution of the dominant forces in the economic system since the Meiji era. Morris-Suzuki (1989:24) argued that “Japan’s economic structure should not be seen as being immutably determined by culture or history, but rather as being a changing system, constantly open to reshaping and redirection through the activity of organized social [and economic] forces.” As Morris-Suzuki (1989) has discussed, we cannot describe a ‘unique’ Japanese model because when we analyze the Japanese system in a historical perspective, we can clearly see that the level of ownership dispersion and also all the social and economic fundamentals in the system have been changed systematically during the last two centuries, and the system is continuing to transform itself. The dynamic of ‘organized’ social and economic forces gives a great ability to Japan to transform its basic structures in the social and economic system, when it is necessary.

In this study, I have argued that analysis of the ownership structure of Japanese financial and commercial institutions through a historical perspective reveals that the systematic control of the financial and industrial capital has shifted since the Meiji era, and the system continues to evolve. This transformation was one of the dominant factors that determined the level of cooperation or/and conflict among the state and corporate entities. Between 1927 and the mid-1950s for example, the control of capital accommodation shifted away from individuals (mainly the oligarchs in the *zaibatsu* families) and toward institutions (mainly banks and corporations). During this era, the decrease of *zaibatsu* power and the rise of bureaucratism and managerial capitalism in the Japanese economy was not simply an abnormal provisional phenomenon resulting from the impact of fascism, and it was not only the result of the US occupation. Japanese militarism and the U.S. occupation hastened and legitimated the removal of *zaibatsu* oligarchies from power and the occupation break-up of the *zaibatsu* only completed the process of declining family control and the shift in power to corporate managers. The *zaibatsu*-led development model successfully completed its mission in the early 1930s and it was necessary for the state to diminish shareholder power over corporate governance to establish absolute control over the economic system. When corporate managers became more autonomous from shareholder influence, it was easier for bureaucratic elites to establish an ideological consensus and higher degree of cooperation with corporate managers than with the *zaibatsu* families and shareholders themselves.

The similar social classes, ideologies, social norms, and educational backgrounds of state bureaucrats and corporate managers allowed the two groups to establish an ideological consensus on developmentalism as members of a new 'autonomic' ruling class. The autonomy of the state and the corporate elites drawn from the dominant economic class and social groups gave bureaucrats and corporate managers great power to carry out effectively long-term economic development strategies — in alignment with the national interest— without the influence of class interests. Also, unlike the *zaibatsu* families and other shareholders, there was no significant conflict between the state bureaucrats and corporate managers; rather, they had a common interest in developmentalism and managerial capitalism. Thus, ruling elites forced separation of ownership and management to establish absolute control in both administration and legislation, enhancing control by the state over the economy. This structural shift in state policy was the one of the main dictators of the level of cooperation and/or conflict among the military, the bureaucratic elites, and the *zaibatsu* families. Subsequently, the conflict between these new elites and *zaibatsu* families dominated prewar politics. At the end of this conflict between the new ruling elites and *zaibatsu* families, *zaibatsu* family power over corporate governance diminished and managerial capitalism became the major governance structure in the Japanese economy.

This transformation reduced the shareholders' power over the governance of corporations and led to greater autonomy for corporate directors. Because of differences in their corporate governance and ownership structures, *keiretsu* group managers had more autonomy to make strategic decisions than managers of *zaibatsu* firms earlier. Unlike the *zaibatsu* network, there is no single family or firm which has the majority of the controlling stock, and there is no central authority like a "holding company with the power to direct the other firms." (Hoshi and Kashyap 2001:11) "*Keiretsu* group companies do not have a hierarchical structure; each member firm has an equal role in shareholding and transactions" (Abe 1997:303) and "no company was dominant in terms of its ownership stake; rather, each group member owned, on average, 1-2% of the shares of other group members" (Schaede 2006:29). In most cases, the main banks and general trading companies (*sogo shosha*) (See Dicken and Miyamachi 1998:56) were the biggest shareholders and had the authority to monitor and ultimately control the companies' corporate governance and investment decisions. The main banks not only possessed significant amounts of equity in the *keiretsu* firms, but also provided necessary capital for investment. These relationships substantially reduced the real cost of financing and increased the quality of monitoring. In the context of this unique financial structure, the state was able to amplify its influence over Japanese firms by acting as a hidden shareholder in the corporations — a strategic investor and/or guarantor — through controlling access to bank financing; thus, it was essential for corporate managers to cooperate with the state bureaucracy to further their mutual interests.

Through managerial capitalism Japanese executives gained more autonomy to make operational and strategic decisions, so they were able to cooperate with the state bureaucracy and run their corporations in line with the long-term interests of the developmental state. Thus, "the Japanese state and the private sector shared a role in the economy, and both public and private sectors perfected the means to make the market work for developmental goals" (Johnson 1995:8). Thus, during the high-growth era, *keiretsu* management pursued growth-oriented behavior based on the state's long-term strategy for the entire group, rather than considering shareholders' interests, stock price maximization or return on investment (ROI). The close relationship between the government, *keiretsu* firms and financial institutions allowed Japan to complete its industrial development process successfully.

The bank-centered *keiretsu* corporate finance and governance model fully met its objectives and successfully completed its mission to achieve industrial development during the postwar era. Once Japan succeeded in catch-up industrialization, however, the bank-centered financial and corporate governance model inevitably declined in importance. Ironically, the very success of bank-loan capitalism eventually undermined the privileged position of the banks (Ozawa 1999:355). Thus, the bank-centered Japanese financial system went through major reforms and structural changes after Japan completed its industrialization in the mid-1970s. Meanwhile neo-liberal movements in the world during the Reagan and Thatcher administrations in the U.S. and United Kingdom forced the Japanese government to complete the liberalization process and open domestic markets to foreign investors. The main objective of the liberalization was making the Japanese market more internationalized. As the banking system did not function well in this situation, and also given the international pressure on the Japanese government to open the Japanese financial system to multinational financial firms, the MoF couldn't resist strengthening market-based finance, and started to deregulate the securities markets and modernize banking regulations.

Also during this era, the bank-based cross-shareholding system weakened and capital markets began to play a greater role in the financial system. Since capital markets began to play a greater role, individual and international investors increased their level of share ownership in Japanese firms and banks. This process of liberalization has had a serious impact on both state capitalism and the bank-centered financial and corporate governance system and forced Japan to transform its economy to an Anglo-Saxon market-based financial system. However the Japanese corporate world has not completely transformed their corporate governance system. As they always have done, they have just adapted certain parts of the Anglo-American corporate governance model to the Japanese system. Therefore the transformation of the Japanese corporate system has occurred only in certain parts of the system and the Japanese corporate world has continued to practice traditional corporate management forms, and this partial transformation has revealed the residual power of the state to control the Japanese corporation and financial system, reduce firms' dependency on bank-based financing and has weakened the traditional relationship between the state, banks and *keiretsu* firms.

When we analyze the Japanese system based on this historical and theoretical perspective we can conclude that the main feature of the Japanese system was the ability of organized social and economic forces to establish legitimacy and public support for the paradigm of developmentalism, and transform and adapt their socioeconomic foundation and the society's base according to the rapidly changing domestic and international political and economic fundamentals. Thus, there is a dialectic relationship between ownership structure and economic change in Japan: the system is not determined by a static economic system and ownership structure, or unique national character, culture or religion, but is rather determined by dynamic organized social and economic forces.

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