What Will Become of the (Japanese) Corporation? A Comparative Perspective
(9th John Whitney Hall Lecture at Yale University, Nov. 7, 2007)
By Katsuhito Iwai

0: Introduction: From the Writings of Prof. John Whitney Hall

I am very much pleased to be back to Yale, where I taught economics as a young and poor assistant professor (I am no longer young but still poor, though) more than a quarter century ago. It was indeed one of the most productive periods in my whole academic life.

I am also very much honored to be able to give a lecture that bears the name of the late Professor John Whitney Hall. When I was at Yale, I saw him several times. But, being a mere assistant professor working on very abstract economic theory, I did not have courage to talk to him in person. But I had read some of his works and admired him in private.

Here are quotations from some of the writings of the late Professor John Whitney Hall.

> "Japan's social and institutional history, once simply an exotic curiosity,…" (*Japan, from Prehistory to Modern Times (1968)*)
> "The question which the comparative historian asks is not whether it is possible to identify in Japan a pattern of history identical with that of Western Europe. He is concerned, rather, with this question, 'Has Japanese society at any time in its history exemplified a pattern of social organization which, along with that of Europe, may properly be labeled feudal?' It is a question asked by the historian who wishes to engage explicitly in the kind of theorizing and categorizing which arises from the broad segments of human development which may embrace more than one culture." (*Feudalism in Japan – A Reassessment (1962)*)

The first fragment is from his textbook on Japan, and the rest is from his well-known article: "Feudalism in Japan – A Reassessment." I do not have time to read these passages in full, but what I gather from these passages is that Professor Hall's approach to Japanese society and history is "comparative and theoretical." It is neither (1) to treat Japan as "an exotic curiosity," nor (2) to identify in Japan "a pattern of history identical with that of Western Europe." Indeed, what Professor Hall tried to show in his numerous writings on Japan is that to study Japan, from a comparative perspective, is to broaden our understanding of human development that embraces more than one culture. It is to enlarge what is common in human institutions, what is general in human cultures, and what is universal in human societies.

Now, this tribute to Professor Hall leads me back to the title of this lecture. If you look at this power point slide, you may notice that I have made a slight change to the title from the announced one. I have placed a parenthesis around the word "Japanese".

This is to indicate that this talk is intended to be in the spirit of Professor Hall. It is to indicate that to study Japanese society, in particular, Japanese corporate system is neither to treat it as an exotic curiosity, nor to identify in it a pattern identical with that of the United States and Europe. It is rather to enlarge our understanding of what is universal in societies, or more specifically, in corporate systems, by presenting a theory that can embrace more than one economy.

So much for the Introduction, and let me start my lecture.

As some of you may know, I am a theoretical economist by training, but in the last 15 years I have also been working on the Japanese economy, especially, on the history and the structure of the Japanese corporate system. Some of my papers this lecture will be based upon are an outgrowth, indeed an unexpected outgrowth of those studies.[1] I said "unexpected" outgrowth, because somewhere in the process of studying the history and the structure of the Japanese corporate system, I began to ask myself a very naive question: "What is corporation?" and soon found myself working on a very unfamiliar territory – a territory inhabited mostly by legal scholars, sociologists, historians and philosophers, as you will now see.

1. Two Corporate Systems.

<Table 1: Important Management Goals>

	America	Japan	Europe (%)
Sustenance & Improvement of ROI	78.1	35.6	64.2
Capital Gains of Shareholders	63	2.7	10.6
Maintenance & Expansion of Market Share	53.4	50.6	61.8
Improvement of Product Portfolio	28.8	11.5	26
Maximization of Sales Volume	15.1	27.9	17.9
Increase in Own Capital Ratio	13.7	21.8	18.7
Rationalization of Production & Distribution Systems	13.7	27	27.6
Reinforcement of Global Strategy	12.3	32.8	30.9
Expansion of New Products & New Operations Ratio	11	60.8	14.6
Improvement of Corporate Social Image	6.8	18.6	18.7
Retention of Employees	1.4	3.8	6.5
Improvement of Employees' Benefits	0	7.7	0.8

Source: Keizai Doyu Kai, *Showa 63 nendo Kigyou Hakusho* (*1988 White Paper on Corporations)*, (1988).
Note: Number of corporations responding to questionnaire: 73 in America, 724 in Japan and 123 in Europe (58 in Italy, 33 in Germany, 18 in France and 14 in Great Britain).

The above table reports the results of a 1988 survey that asked corporate managers in America, Japan and Europe to pick out the three most important goals of their management policies. One can see from the entries at the first column that answers given by American corporate managers were consistent with the traditional assumption in economics that the whole purpose of the corporate firm is to maximize the returns to its shareholders. They ranked ROI (the rate of return on investment) at the top (78.1) and capital gains of shareholders second (63.0). In stark contrast to American counterparts, the Japanese corporate managers placed capital gains of shareholders at the very bottom of their ranking (2.7). True that they did rank ROI the third, but the points it gets are not so high (35.5). Instead, they put the ratio of new products and new operations at the top (60.8) and ranked market share second (50.6). These goals are more or less related to the survival and growth of the corporation as a business organization. The answers given by European corporate managers, however, were somewhat murky, due to the diversity of the countries in this category.

This study was conducted more than 20 years ago, and the outlook of the corporate managers, especially those in Japan, have changed since then. But, more recent studies have also shown that there

[1] This lecture is based upon [11, 12, 13, 14, 15].

still exists a wide difference between American and Japanese corporate systems -- the major objective of American corporate managers is the maximization of the returns to shareholders, whereas the chief concern of a large number of Japanese corporate managers is the survival and growth of the corporation as an organizational entity comprising of employees and other stakeholders. (See [11, 16, 27].)

However, in spite of this wide difference in attitudes towards the purpose of the corporation, both America and Japan are full-fledged capitalistic economies with similar corporate laws. Indeed, the current Japanese corporate law can be regarded as an amalgam of German law and American law. There thus emerges a theoretical puzzle I now have to solve: How can the same institutional framework of capitalism allow these seemingly contradictory systems of corporation to coexist in this world?

This talk's main theme is that it is the very legal concept of "corporation" (or "joint stock company") that is responsible for the coexistence of two seemingly contradictory forms of capitalism.

2. What is Corporation?

Suppose you are an owner of a small grocery shop around a corner. Whenever you feel hungry, you can pick up an apple on the shelf and eat it right away. That apple is your property, and the only thing you have to worry about is the wrath of your spouse -- your co-owner. I have chosen a grocery shop as a real-life example of the classical firm in any textbook of economics. As Fig. 1 shows, it consists of a single ownership relationship between an owner (or a group of owners in the case of a partnership firm), and assets such as apples and oranges on the shelf of the grocery store. However, as soon as a firm is "incorporated" and become a "corporation (or a joint stock company)," its ownership structure undergoes a fundamental change.

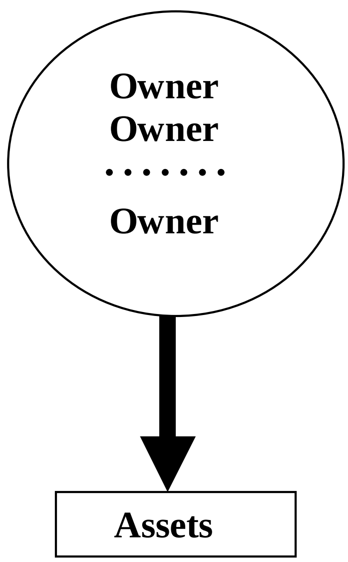

Fig. 1: Single Ownership Structure of a Classical Firm.

Then, what is "corporation"? Toyota is a corporation and GM is a corporation, and both are business (or for-profit) corporations. Yale University and University of Tokyo are also corporations, though not a business corporation.

Suppose you are a shareholder of a business corporation, for instance, a big supermarket chain. You feel hungry and found one of its stores on your way. If you enter the store, grab an apple from its shelf and eat it right away, what will happen to you? You will be arrested as a thief! Why? It is because a corporate shareholder is not the legal owner of the corporate assets. Who, then, is the owner of those corporate assets? The corporation as a “legal person” is. Then, what is a legal person? The law treats a corporation as a subject of property right capable of owning real property, entering into contracts, suing and being sued, all in its own name, separate and distinct from its shareholders. A corporation is, in other words, a “thing” that is treated legally as a “person.” And it is the corporation as a legal person that is the owner of the corporate assets.

Who, then, are corporate shareholders? The answer is, owners of the corporation. Corporate shareholders are the holders of corporate share -- a bundle of the financial and participatory rights in the corporation that can be bought and sold freely as an object of property right. Indeed, to hold a corporate share is to own a share of the corporation as a thing (an asset) separate and distinct from the underlying corporate assets. It is the corporation as a “thing” that the corporate shareholders own.

This observation will lead us to the most crucial characterization of the business corporation. In contrast to a single ownership firm or a partnership firm, a corporate firm is composed of not one but TWO ownership relations: the shareholders own the corporation, and the corporation in turn owns the corporate assets, as is shown in Fig.2.

Indeed, in this two-tier ownership structure the person/thing duality of corporation is used in an ingenious manner. In regard to things (corporate assets), a corporation acts legally as a person, as a subject of property right; and in regard to persons (shareholders), a corporation is acted on legally as a thing, as an object of property right.

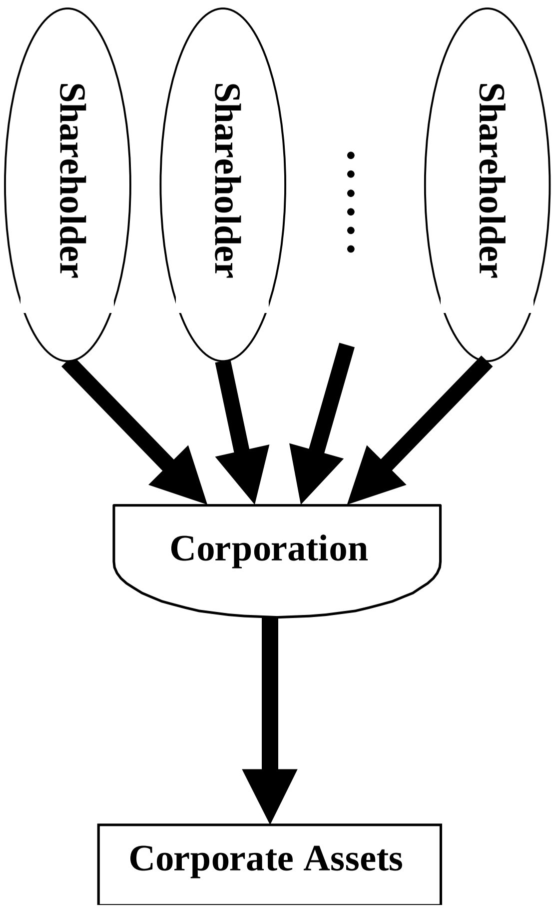

Fig. 2: Two-Tier Ownership Structure of a Business Corporation.

3. The Corporate Personality Controversy and the Comparative Corporate System

For many centuries, legal scholars and legal philosophers have debated heatedly as to what constitutes the "essence" of the corporate personality. This is called the "corporate personality controversy" – one of the most celebrated controversies in legal theory and legal philosophy. In this age-old controversy, two competing legal theories have emerged, each advancing opposing answers. They are "corporate nominalism" and "corporate realism." The corporate nominalism asserts that the corporation is a contractual association of individuals, whose legal personality is no more than an abbreviated way of writing their names together. The corporate realism, in opposition, claims that the corporation is a full-fledged entity whose legal personality is no more than an external expression of its real personality in the society. (There is a huge body of writings on this controversy. Some of the best-known works available in English are [18, 7, 5, 25]. For a comprehensive review of various theories of corporate personality before 1930, see [10]. In [12] I have given an extensive discussion on this controversy.)

The corporate personality controversy is not the thing in the past. The rivalry between corporate nominalism and corporate realism has continued up until now. On the one hand, the contractual theory of the firm, whether it is an agency-theory version or a transactions costs economics version, is a direct descendent of corporate nominalism. (See, e.g., [4, 1, 17, 8, 30].) On the other hand, the so-called evolutionary theory of the firm or knowledge-base view of the firm or core-competence view of the firm can be interpreted as a modern representative of corporate realism. (See, e.g., [3, 23, 24, 25, 29].) The former regards the "private corporations" as "simply legal fictions which serve as a nexus for a set of contracting relationships among Individuals." ([17], p. 310.) The latter posits corporate firms as "organizations that know how to do things, ... while individual members come and go." ([31], p. 136.) The corporate personality controversy is far from a relic of the past.

It is not hard to see that the age-old controversy between corporate nominalism and corporate realism and the more recent rivalry between the contractual theory of the firm and the evolutionary theory of the firm more or less correspond to the difference between the American corporate system and the Japanese corporate system.

What I would like to do now is to "end" this controversy once and for all. It is, however, not by declaring victory for one side or the other. It is rather by declaring victory for both sides by means of elucidating two legal mechanisms, through which the legal concept of the corporation is capable of generating two seemingly contradictory corporate structures ----- one approximating corporate realism and the other approximating corporate nominalism.

Indeed, if we only look at the downstairs of the two-tier ownership structure depicted in Fig. 2, the corporation appears as a person owning and managing corporate assets, and we draw near to the position of corporate realists and that of the Japanese corporate system. If we look only at the upstairs, the corporation appears as a thing owned and controlled by shareholders, and we draw near to the position of corporate nominalists and that of American corporate system.

We can go further. What I am going to demonstrate is that there are even ways to eliminate either thingness or personality from the corporation, thereby turning it into a full "person" or a mere "thing", respectively.

4. How to Make a "Realistic" Corporation

Let me begin with a way to eliminate thingness from corporation. We know that as a legal person a corporation can own things and that as a legal thing a corporation can be owned by persons. This implies that a corporation as a person can in principle own itself as a thing. Indeed, nothing prevents us from imagining a corporation that becomes its own controlling shareholder by holding a majority block of its own shares under its own name, as is shown in Fig. 3. If this were indeed possible, that corporation would be free from any control by real human beings (natural persons) and become a self-determining subject. It would thus acquire a full personality in the province of law.

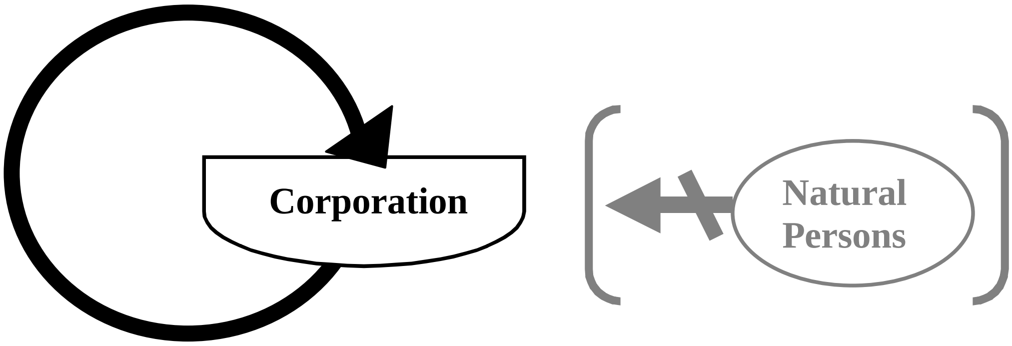

Fig. 3：A (Hypothetical) Self-Owning Corporation.

One might dismiss all this as idle speculation. Some countries prohibit a corporation from repurchasing its own outstanding shares. And, in many other countries that allow share repurchases, the repurchased shares usually lose their voting rights in shareholders meetings. In the real economy, therefore, it appears impossible for the corporation to become its own owner.

There is, however, an important leeway to this. Imagine a situation where two corporations, A and B, hold a majority of each other’s shares. The corporation A as a person owns the corporation B as a thing, and the corporation B as a person in turn owns the corporation A as a thing. As is shown in Fig. 4, even though each corporation does not own itself directly, it does indirectly through the intermediacy of the other corporation. One might still object to the practical possibility of this leeway by pointing out that some countries impose legal limits on the extent of cross-shareholdings between corporations.

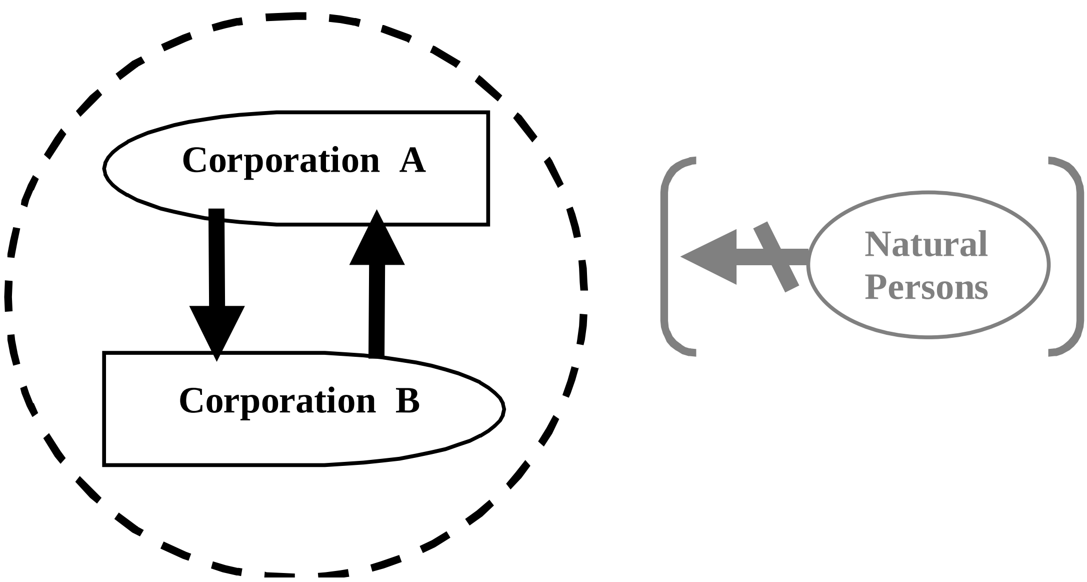

Fig. 4 : Mutually Holding Corporations.

Yet, it is possible to circumvent even these limits. Suppose that twelve corporations get together and that each holds 5 percent of each of the other's shares. Then, simple arithmetic ((12 - 1) x5% = 55%) tells us that a majority block of each corporation's shares could be effectively sealed off from real human-beings, without violating legal restrictions on cross-shareholding in any of advanced capitalistic countries. These twelve corporations would indeed become their own owners at least as a group, as is depicted in Fig. 5. It is therefore practically impossible to prevent corporations from becoming their own owners, if they so wish. We have now reached the paradigm of corporate realism -- by extensive cross-shareholdings corporations can get rid of their thingness and become self-determining subjects in the system of law.

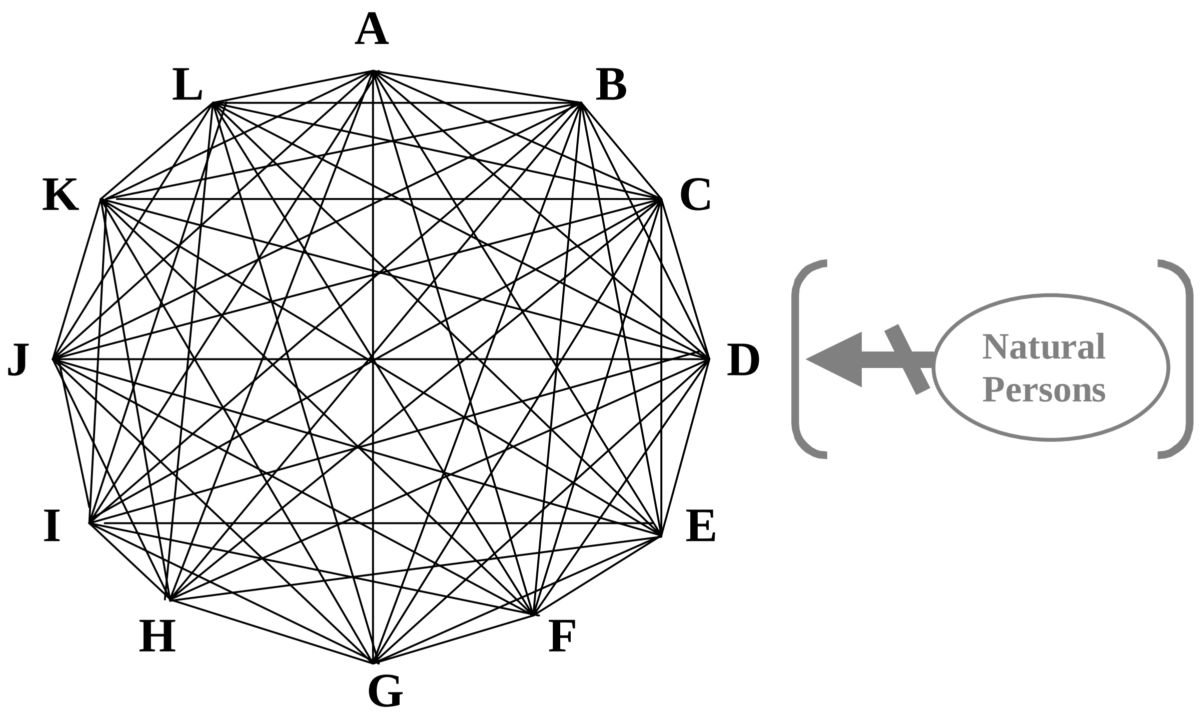

Fig. 5: Cross-Shareholdings Among 12 Corporations.

5. How to Make a "Nominalistic" Corporation.

The way to eliminate the personality from a corporation is much simpler: it is to have someone own more than fifty percent of its shares. That someone then acquires an absolute control over the corporation. The corporation is deprived of its subjectivity and turned into a mere object of property right. Legally speaking, the corporation is still the sole owner of the corporate assets, but in practice it is the dominant shareholder who can exercise the ultimate control over these assets. We are certainly in the world of the corporate nominalists here.

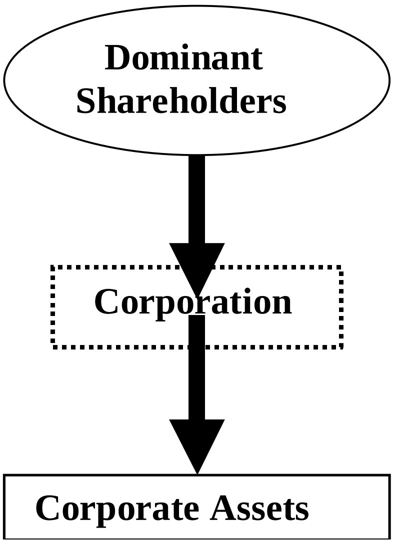

Fig. 6: A 'Nominalistic' Corporation.

This is of course a common sense. But I now argue that the so-called corporate raiders are daily putting this legal mechanism into practice in the real economy.

That a business corporation consists of two-tier ownership relations implies that it contains in it two kinds of "things" — the corporate assets and the corporation itself. This fact immediately implies that there are also two kinds of values residing in a business corporation. They are, respectively, the value of corporate assets and the value of the corporation as a thing. The former can be defined as the present discounted value of the future profit stream that would accrue from the most efficient use of these assets. This can also be called the "fundamental" value of the corporation. The latter can be identified as the total share price of the corporation in the stock market. And the business of corporate raiders is to exploit the potential difference between these two values by buying corporations whose stock market values are lower than the fundamental value of the underlying assets. In the process, they do become dominant shareholders and turn the target corporation into a purely "nominalistic" corporation.

Corporate raiders thus help to realize the idea of corporate nominalism in this world. It is indeed claimed that even if they are not daily raiding corporations, the mere perception that they may at any time enter the scene works as an effective threat to incumbent managers, steering them away from management policies that may fail to realize the corporate assets' fundamental value. If this is indeed the case, the stock market is said to function as the "market for corporate control." (For the notion of the market for corporate control, see [21].)

6. The Indeterminacy Principle in Corporate Law

I have thus shown that the corporate law is endowed with two legal mechanisms – one turning a person-cum-thing corporation into a full person, and the other turning a person-cum-thing corporation into a mere thing. Indeed, each society can choose any position along a long spectrum that runs from a purely "realistic" to a purely "nominalistic" structure, on the basis of or at least under the influence of economic efficiency, political interests, ideological forces, cultural traditions, historical evolution and other extra-legal factors. My contention is that in the long history of their capitalistic development the Japanese economy and the American economy have chosen from this long legal menu the position close to the “realistic” end and the position close to the “nominalistic” end, as their dominant corporate structure, respectively.

One of the distinguished features of the post-WWII Japanese economy was the extensive cross-shareholdings among large corporations. Table 2 shows cross-shareholdings among core 20 corporations of Sumitomo group in 1993. Indeed, Japan used to have six major corporate groups (Mitsubishi, Mitsui, Sumitomo, Daiichi-Kan-Gin, Fuji, and Sanwa), each of which was clustered around a main bank, extended over the whole industry, and connected through mutual holdings of shares and mutual exchanges of directors. The percentage of cross-shareholdings reached as high as 32.9% of the total shareholdings of publicly-held corporations in 1990. In contrast, the stock market in America is known to have served as the "market for corporate control" far more effectively than that in Japan.

<Table 2: Cross-Shareholdings among Core 20 Corporations of Sumitomo Group, 1993>

HOLDER % ¥ ISSUER	S. Bank	S. Trus Ban	S. Life	S. Mar Ins.	S. Corp	S. Coal Mini	S. Cons	S. Fore	S. Che	S. Bake	Jap Glas	S. Cem	S. Meta	S. Meta Mini	S. Ligh Meta	S. Elect	S. Heav	NEC	S. Real Esta	S. Stor	TOTAL
S. Bank	----	2.8	6.1	1.8	1.7	0.0	0.0	0.1	1.1	0.2	1.1	0.2	1.3	0.4	----	0.9	0.2	1.1	0.1	0.2	19.3
S. Trust Bank	3.3	----	4.2	1.5	2.5	0.0	0.0	0.2	1.2	0.5	1.4	0.5	2.3	1.2	0.0	1.7	0.4	2.8	----	1.5	25.3
S. Life	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----
S. Marine Ins.	4.4	6.3	4.6	----	2.3	0.1	0.1	0.1	1.2	0.3	1.2	0.3	1.0	1.0	----	0.9	0.6	1.8	0.1	0.8	27.1
S. Corporation	4.8	5.8	5.1	2.9	----	0.1	0.0	0.3	1.6	0.3	1.0	0.4	2.7	1.7	----	1.0	0.8	3.7	0.1	0.4	32.8
S.Coal Mining	4.8	4.0	2.5	2.4	3.4	----	0.8	----	2.5	----	0.4	1.0	4.9	2.1	----	----	1.7	4.2	----	0.2	34.8
S.Construct'	4.4	2.9	5.8	1.4	----	3.1	----	0.6	1.1	----	0.6	2.3	----	3.3	----	1.0	----	----	0.4	0.2	27.0
S. Forestry	4.3	7.0	7.2	----	2.6	0.1	0.4	----	----	0.4	----	0.3	----	7.3	----	----	0.2	1.4	----	----	31.1
S. Chemical	4.7	5.3	8.9	1.4	1.3	0.0	0.1	0.1	----	0.1	0.4	0.3	----	0.2	----	0.3	0.2	0.5	0.0	0.2	23.9
S. Bakelite	4.8	7.1	5.9	1.3	2.1	----	0.3	0.4	21.6	----	0.3	0.5	0.9	----	----	0.3	----	1.3	0.4	0.1	48.2
Japan Glass	5.0	6.8	5.5	2.3	1.6	----	0.1	0.1	1.2	0.5	----	0.8	----	0.3	----	----	0.6	----	0.5	0.2	25.6
S. Cement	4.6	5.4	8.5	1.0	2.3	1.9	0.6	0.4	1.1	0.4	0.8	----	1.0	1.1	----	0.3	2.2	0.8	0.2	----	32.8
S. Metals	4.0	6.2	5.5	----	1.6	0.1	0.0	----	----	0.1	0.1	0.1	----	0.5	----	0.3	0.2	0.6	0.0	0.1	19.2
S.Metal Min’g	4.6	10.0	4.8	1.5	2.5	0.1	0.2	0.3	----	----	0.3	0.7	0.8	----	----	1.0	0.3	2.4	0.1	0.1	29.6
S.LightMetals	4.7	5.8	4.0	1.4	4.0	----	----	----	1.3	----	----	0.4	23.3	0.9	----	0.8	0.6	0.8	----	0.2	48.2
S. Electrics	3.8	5.4	7.0	----	0.8	0.0	0.0	----	----	----	----	0.1	----	0.8	----	----	0.1	2.4	----	0.1	20.6
S. Heavy Ind.	4.6	6.4	7.8	2.5	3.0	0.1	0.1	0.1	----	----	0.5	1.3	----	0.7	----	0.7	----	----	----	0.3	27.9
NEC	5.0	4.8	6.8	2.6	2.2	0.0	0.0	0.1	0.4	0.1	0.2	0.1	0.7	1.0	----	2.2	0.1	----	0.0	0.2	26.4
S. Real Estate	3.4	5.1	2.3	1.6	0.5	0.0	0.2	----	0.4	0.2	0.7	0.1	0.5	0.3	----	0.5	----	0.7	----	0.5	17.2
S. Storage	4.7	6.7	8.4	5.4	2.4	----	0.3	----	1.5	0.1	0.8		2.2	----	----	0.9	0.9	3.9	0.3	----	38.5

Sources: Toyo Keizai, *Kigyo Keiretsu Soran ‘95 (Survey on Corporate Groups, ‘95)*, (Toyo Keizai Shinpo Sha, 1995).
Note: ‘0.0’ means a very small percentage, and ‘----‘ means no holding.

I believe I have resolved the paradox I stated at the outset of this talk. Because I have now shown that in spite of their seemingly irreconcilable differences, Japanese corporate capitalism and American shareholder capitalism are but two extreme forms of the genus Capitalism.

7. The Future of the Corporate System in the Post-Industrial Capitalism

It is no secret that the traditional Japanese-style management has completed its historical mission. The stock market and property market bubbles burst in the late 1980s. The financial markets were belatedly but rapidly liberalized in the 1990s. And the wave of globalization began to expose Japanese corporations to mega-competition in the world markets. All these movements have weakened the traditional ties between major banks and industrial corporations and loosened the tight network of corporate cross-shareholdings. In fact, the percentage of cross-shareholdings declined to 12.0% in 2006, and the six major corporate groups are now consolidated into three (Mitsubishi-Tokyo-UFJ, Mitsui-Sumitomo, and

Mizuho).

Do these facts mean that the long-run tide of the corporate system is in the 'nominalistic' direction? Is there a convergence towards the American corporate system?

The answer is, however, NO. Indeed, I am also discerning another strong tide that is moving in the opposite direction. It is a tide brought about by the transition of the advanced capitalistic economies from the stage of ‘industrial’ capitalism to the stage of 'post-industrial' capitalism.

7. Two Sources of Inefficiency in Corporate Organization

In order to explain this, I have to re-examine the nominalism/realism dichotomy of corporate forms from the standpoint of economic efficiency. We have learned from the recent literature in economics that two/ /of the most important sources of inefficiency in economic organizations are Moral Hazard Problem and Hold-up Problem.

First, by the moral hazard problem I mean the inefficiency caused by the separation of control and ownership in corporate organization. Insiders of an organization, such as workers, engineers, researchers, and managers, may take advantage of the shareholders’ weak monitoring of their performances and covertly pursue their private interests at the expense of shareholders. For instance, managers may build their perks, engineers may indulge in toy-makings, and workers may simply goof off.

The hold-up problem, on the other hand, is concerned with another kind of inefficiency. For an corporate organization to survive and grow, its workers, engineers, researchers, and managers, have to develop skills, know-how, technologies, communication-networks, visions, etc. that are specialized to the organization. In economics, they are called “organization-specific human capital”. But, these employees are in a vulnerable position. It is because the organization-specific human capital has by definition little value outside of the organization. Once these employees have invested their time and efforts in organization-specific human capital, their vulnerable position may be taken advantage of by shareholders who are seeking only short-term returns. For instance, a corporate raider may buy out their corporation and then slash the fund for research and development in order to increase the dividend payout. For fear of such potential exploitation, these employees are very reluctant to commit themselves to organization-specific human capital, even if their accumulation would enhance the economic value of the corporation. This is called the hold-up problem, and the so-called incomplete contract theory in economics is all about this.

8. Cost/benefit of Two Corporate Systems

What I would like to suggest here is that there is a real trade-off between these two kinds of inefficiency, and that the choice of the legal form of corporation -- whether it is nominalistic or realistic -- depends very much on this trade-off.

It is evident that the nominalistic form of corporation has an advantage over the realistic form with respect to the moral hazard problem. It allows the shareholders to monitor the performance of managers and other core employees or it allows the stock market to pressure the managers to maximize returns to shareholders. But I also maintain that the realistic corporation also has an advantage over the ‘nominalistic' corporation with respect to the hold-up problem. In the case of realistic corporation, its commitment to the survival and growth of its own organization can work as a shield for organization-specific human capital and protect the core employees from potential hold-ups by outside shareholders. It thus encourages those core employees to commit themselves to investment in organization-specific human capital. Indeed, I even claim that the realistic corporation, with its long-term commitment to the survival and growth of its organization can function as a de facto owner of organization-specific human capital.

9. From Industrial to Post-Industrial Capitalism.

Now let us come back to what I have referred earlier -- the transition of capitalism from the industrial stage to post-industrial stage. By the transition to post-industrial capitalism I mean a recent shift in the major source of profits, from scale economies of large factory systems, to skills, know-how, technologies, communication networks, visions, and leadership of workers, engineers, researchers, and managers. What is critical to the long-run competitiveness of business corporations is no longer the physical capital, but human capital, especially knowledge-based human capital. There is a growing body of literature suggesting that the capital values of human assets and other “intangibles” have shown a phenomenal rise in recent years in the U. S. and other advanced capitalist economies. (See, for instance, [2], [5], [9].)

I maintain that it is the exhaustion of the ‘industrial reserve army’ -- the surplus population deposited in rural areas and supported by communal networks -- that is the ultimate cause of this massive phase-transition of capitalistic system from ‘industrial’ to ‘post-industrial.’ (In fact, what I am maintaining is that the industrial capitalism is a form of capitalism that presupposes the dualistic structure a là Arthur Lewis [19].) The consequent rise in real wages has reduced the profit margins of the existing production facilities and distribution networks so that capitalist enterprises are able to reap profits only by undertaking what Schumpeter [26] called “innovations.” By innovations Schumpeter designated a broad range of events which includes “the introduction of new commodities..., the technological change in the production of commodities already in use, the opening-up of new markets or of new sources of supply, Taylorization of work, improved handling of material, the setting-up of new business organizations … -- in short, any ‘doing things differently’ in the realm of economic life.” Obviously, in order to do things differently, capitalist enterprises need ideas, know-how, coordinating skills, forecasting capabilities, strategic prowess, strong leadership, etc. of real human beings.

10. The Increasing Importance of Organization-specific Human Capital

I said that the knowledge-based human capital now occupies the central place in post-industrial capitalism. But, this does not mean that any knowledge or any information can be the source of profits for business corporations. Even if one has a very brilliant idea, if that idea can be accessed easily by others, or if that idea can be imitated easily by others, it has no or little economic value.

In the age of post-industrial capitalism only the difference matters! That is, only the knowledge that is enclosed within an organization and cannot be easily transferred to outside of the organization can generate positive profits for business corporations. This is precisely what I have called organization-specific human capital.

11. Inalienability of Human Capital

What does this mean to our nominalism/realism dichotomy of corporate form?

The single most important characteristic of human capital is its inalienability. Money can buy factories, machines, offices, land, and other physical capital. Physical capital is alienable. Money, however, cannot directly buy ideas, know-how, skills, human-networks, visions, and other human capital, because they are all some forms of knowledge stored inside of human brains or gray cells. Human capital is inalienable. The only thing money can do is to provide a variety of incentives that would encourage the employees to invest their time and efforts on organization-specific human capital.

In the era of traditional industrial capitalism where the large factory system was the major source of profits, it was the shareholders who held an upper-hand in the balance of power within a business corporation, because they are the ultimate suppliers of money that can buy factories and other productive facilities. Of course, you needed a lot of employers to operate factory system, but their role within a corporate organization remained subordinate to physical capital, and hence subordinate to the shareholders.

In contrast, in this new era of post-industrial capitalism, the physical capital has surrendered its central position to the knowledge-based human capital that money can no longer buy and control. The balance of power within a business corporation is clearly tilting away from suppliers of money towards suppliers of knowledge-based human capital, especially to those who contribute to organization-specific human capital, that is, from shareholders to workers, engineers, scientists, and managers who had made a long-term commitment to the corporation.

12. Choice between Two Co. Systems

Let me summarize what I have argued so far about the choice between two corporate systems. There are two fundamental sources of inefficiency in corporate organization -- Moral hazard problem and hold-up problem. And there is a trade-off between them.

Indeed, nominalistic corporate system is able to solve or at least mitigate the moral hazard problem, but only at the expense of the hold-up problem. The nominalistic corporation is thus better adapted to the stage of industrial capitalism, because its major source of profits is physical capital, over which shareholders had a direct control, whereas human capital was only a helping factor to run the physical capital efficiently.

On the other hand, realistic corporate system has a comparative advantage in minimizing the hold up problem, but of course at the expense of moral hazard problem. To the extent that organization-specific human capital plays a central role in corporation’s capability of generating profits, I expect many business corporations will adopt realistic forms in this new era of post-industrial capitalism.

13. A Recent report from Japan

I would like to wind up my talk by presenting the most recent questionnaire study on corporate objectives in Japan, shown in Table 3. This study was conducted by Kazuhiro Tanaka [30]. He posed to Japanese corporate executives 9 questions and asked them to scale their answer from 1 to 7. One of the question is “Should the share value be maximized?” If the answer is yes, he or she should choose 1, and the answer is no then 7. The executives are also allowed to choose numbers in between. Another question is: “Who owns the corporation – shareholders or core employees?” If the answer is “shareholder” the point is 1, and the answer is “core employees” the point is 7. In each question Professor Tanaka also asked another question: What would have been your or your predecessor’s answer 10 years ago.

<Table 3: Recent Questionnaire Study on Corporate Objectives in Japan>

·Should Share-value be Maximized? Yes 1 ←-→ 7 No
·Should Shareholders be the Sole Power holder? Yes 1 ←-→ 7 No
·Are Employees Mere Inputs to Production ? Yes 1 ←-→ 7 No

Average Score	Total	Shareholder-Orientated	Intermediate	Employee-Orientated
Present	3.7	2.9	3.9	5.1
	↑	↑	↑	↑
10 Yrs Ago	4.5	4.4	4.8	4.9
Frequency	231	64	110	57

Now, if you look at this column for the total, you can discern a strong trend in the nominalistic direction in contemporary Japan. 10 year's ago the average point was 4.7, but now it is only 3.7.The Japanese corporations seem to become increasingly shareholder-orientated. That is exactly what economists, both inside and outside Japan, believe is happening in Japan. Yet, what captured my attention when I looked at these numbers was something different. Professor Tanaka divided the group into three sub-groups. And what I noticed was the third subgroup.-- the corporations whose current average is above 4.5, that is, employee-orientated corporations. Their score remains the same. In fact, to such questions as: should the shareholders be regarded the sole power holder of the corporation? Or are the employees mere inputs for production of profits? Their score has increased markedly.

Despite the decade-long pressure from all around the world to move towards shareholder-orientation, they persisted doggedly to remain employee-orientated. And the position of these employee-orientated corporations is currently being justified by the most post-industrial corporation like Google. As you know, when Google made its shares public in 2004, they arranged the whole thing in such a way that the class A stocks that were sold for general public had only one tenth of the voting power of the class B stocks that are held by the insiders, including their cofounders, Messrs. Brin and Page. It was to ensure that their corporate decisions and their organizational identity should not be influenced too much by those shareholders who are seeking only short-term returns.

14. What Will Become of the Corporate System?

I hope you have already seen the reason why I have placed a parenthesis around the word "Japanese" in the title of this talk. This is to avoid the misunderstanding that this is a talk of Japanese Chauvinist. I am not.

Indeed, I can now drop the word Japanese completely from the title. Because my discussion about the nature as well as the future of the corporate system has not been Japan-specific; it has been totally theoretical. It is not only about the Japanese corporate system but also about the corporate system in general, including the American system, the Chinese system, the Korean system, the European system, and many other corporate systems.

In any case, I am not here to argue that one form of corporation is better than the other. I am here to argue that both forms are legally, philosophically, and economically possible forms of corporations. Indeed, I just believe that too much shift to the nominalistic direction may be counterproductive to the value creation of the corporation and ultimately counterproductive to the wealth creation of the economy as a whole. It is because in this NEW era of POST-industrial capitalism, luckily it is our brains, yours and mine, that are more important than shareholders' money.

References

[1] Alchian , A . and H. Demsetz, "Production, Information Costs, and Economic Organization," American Economic Review 62, 1972, 777-795.
[2] Blair, M. and S. Wallman, Unseen Wealth, Washington D.C.: Brookings Institute Press, 2001.
[3] Chandler, A., Scale and Scope: The Dynamics of Industrial Capitalism, Cambridge: Belknap Press 1990.

[4] Coase, R., "The Nature of the Firm," Economica N.S. 4, 1937, 386-405.
[5] Corrado, C., J. Haltinger, and D. Sichel eds., Measuring Capital in the New Economy, Chicago: University of Chicago Press, 2005.
[6] Dan-Cohen, M., Rights, Persons, and Organizations, Berkeley: University of California Press, 1986.
[7] Dewey, J., "The Historical Background of Corporate Legal Personality," Yale Law Journal 35, 1926, 655-673.
[8] Easterbrook, F. and D. Fischel, The Economic Structure of Corporate Law, Cambridge: Harvard University Press, 1991.
[9] Hall, R., "E-Capital: The Link between the Stock Market and the Labor Market in the 1990s," Brookings Papers on Economic Activity, 2000, 73-118.
[10] Hallis, F., Corporate Personality: A Study of Jurisprudence, Oxford: Oxford University Press, 1930.
[11] Itami, H. (eds), Corporate Profitability in Japan and U. S., (in Japanese) Tokyo: Yuhikaku, 2006.
[12] Iwai, K., "Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance," American Journal of Comparative Law 47, 1999, 583-632.
[13] Iwai, K. "The Nature of the Business Corporation-- Its Legal Structure and Economic Functions," Japanese Economic Review, 53 (3), 2002, 243-273
[14] Iwai, K., What Will Become of the Corporation? (in Japanese), Tokyo: Heibonsha, 2003.
[15] Iwai, K., "Do Corporations Belong to Their Shareholders?: U.S.-Style Shareholder Rights Orientation Will Not Become the Mainstream in the Twenty-First Century," Japanese Economy 33 (4), 2006-7, 6-15.
[16] Jacoby, S., H. Nason and K.Saguchi, "The Role of the Senior HR Executive in Japan and the United States: Employment Relations, Corporate Governance, and Values," Industrial Relations: A Journal of Economy and Society 41(2), 2005; 207-241.
[17] Jensen, M. and W. Meckling, "The Theory of Firm: Managerial Behavior, Agency Costs and Ownership Structure," Journal of Financial Economics, 3, 1976, 305-360.
[18] Kindleberger, Charles P., Europe's Postwar Growth: The Role of Labor Supply, Cambridge, Massachusetts, Harvard University Press, 1967.
[19] Lewis, W. Arthur, "Economic Development with Unlimited Supplies of Labor," Manchester School of Economic and Social Studies, Vol. 22, 1954, pp. 139-91.
[20] Maitland, F. M., "Translator's Introduction," to Otto Gierke, Political Theories of the Middle Age, Cambridge: Cambridge University Press, 1930.
[21] Manne, H., "Mergers and the Market for Corporate Control," Journal of Political Economy 73, 1965, 110-120.
[22] Minami, Ryoshin, The Turning Point in Economic Development: Japan's Experience, Tokyo, Kinokuniya, 1973.
[23] Nelson, R. and S. Winter, An Evolutionary Theory of Economic Change, Cambridge: Harvard University Press, 1982.
[24] Penrose, E., The Theory of the Growth of the Firm, Oxford: Oxford University Press, 1969.
[25] Prahalad, C. K. and G. Hamel, "The Core Competence of the Corporation," Harvard Business Review 68, 1990, 79-91.
[26] Schumpeter, J. A., Capitalism, Socialism and Democracy, 3rd ed., New York: Rand McNally, 1950.
[27] Tanaka, K., "Shareholders Sovereignty vs. Employees Supremacy: Dilemma of Publicly-held Corporations in Japan," (in Japanese) RIETI Discussion Paper Series 06-J-035, Tokyo: RIETI, 2006.
[28] Teubner, G., "Enterprise Corporatism: New Industrial Policy and the "Essence" of the Legal Person," American Journal of Comparative Law 36, 1988, 130-155.
[29] Wernerfelt, B., "A Resource-Base View of the Firm," Strategic Management Journal 5, 1984, 171-180
[30] Williamson, O., The Economic Institutions of Capitalism, (Free Press), 1985.
[31] Winter, S., "On Coase, Competence, and the Corporation" Journal of Law, Economics, and Organization 4, 1988, 163-184.