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Chapter 6: Foreign Multinational Corporations and Japan's Evolving Syncretic Model of Capitalism

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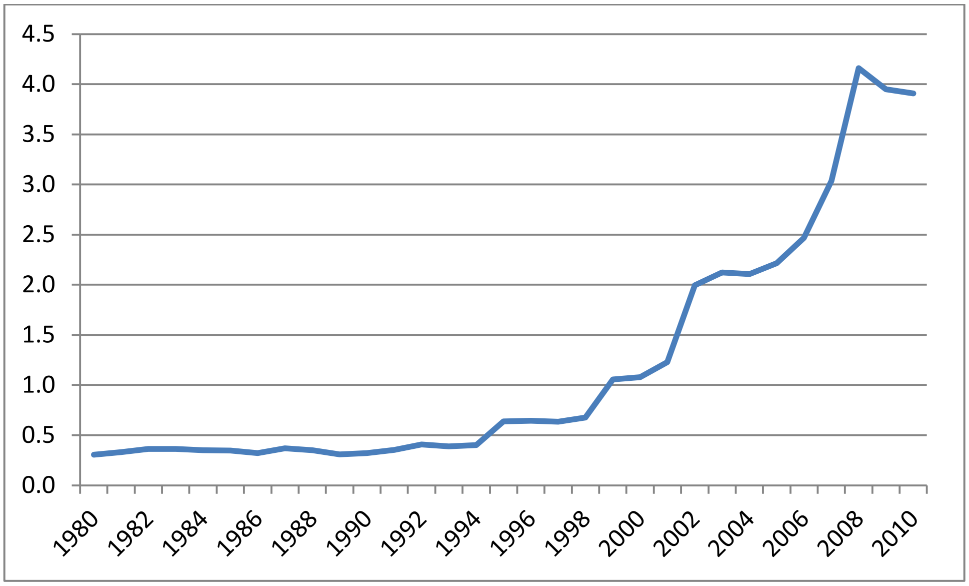
Introduction

This chapter examines the relationship between foreign Multinational Corporations (MNCs) and Japan's evolving model of capitalism. Japan's postwar political economy developed with a markedly lower presence of MNCs than almost all other developed and developing countries. Inward Foreign Direct Investment (FDI) into sectors deemed strategic, such as finance, automobiles, and telecommunications, was strictly limited.

However, beginning in the mid-1990s, Japan experienced the largest surge of inward FDI in its entire history. Chart 1 shows how inward FDI stocks as a proportion of GDP grew from less than 0.5%--a level it had maintained for decades—to just over 4% in 2008 before dipping slightly by 2010. (See Chart 1).[1]

[1] We should note that inward FDI is not a perfect proxy for foreign MNC presence. For a fuller discussion, see Kenji E. Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes" (Ph.D. Dissertation, University of California Berkeley, 2010).

Chart 1. Japan's Inward FDI Stock as a Percentage of GDP (1980-2010)



Source: UNCTAD

Much of the inward FDI flows were concentrated in the very sectors that had been relatively closed. These included pharmaceuticals, automobiles, telecommunications, and the financial sectors of banking, insurance, and securities.[2] (See Table 1)

The degree to which foreign MNCs became prominent players in these sectors since the late 1990s was unthinkable a decade earlier. In the 1980s, foreign MNC access to Japanese markets had been a major issue in trade wars between Japan and its trading partners. By the early 2000s, however, Nissan and Mitsubishi were foreign-managed, the venerable Long Term Credit Bank was bought out by an American investment fund, foreign insurers were insurance market leaders, Vodafone was one of the three nationwide cellular carriers, and Pfizer was soon to overtake Japanese firms as the largest domestic pharmaceuticals employer. Foreign MNCs in the financial sectors were by far the strongest financial performers through the 2000s, and in all industries, MNCs influenced the dynamics of competition by introducing new business models.[3]

[2] The Ministry of Finance (MOF) sector labels are chemicals, machinery, telecommunications, finance and services, and services.

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Not only did foreign MNCs become prominent players in their respective industries, but many were notable in overtly departing from traditional Japanese corporate organization, norms, and strategies. Many paid higher wages (some extremely so), but with less job security (far less, for most). Some aggressively departed from traditional keiretsu supplier arrangements. Others shaped business models that flew in the face of the prevailing Japanese convention, for example by taking advantage of regulatory loopholes. Yet, the new practices introduced by foreign firms did not entirely replace those of their Japanese competitors. Nor did all foreign firms depart dramatically from Japanese practices in all respects. In short, *foreign MNCs were drivers of syncretism in Japan's political economy. Many introduced new norms, practices, and organizations into a variety of sectors that became bifurcated between the traditional and the new.*

In the broader theoretical context, these developments can be viewed as an interaction between multiple capitalist systems. In the comparative capitalisms literature, Japan is almost always categorized, along with Germany, as a non-liberal, or coordinated-market economy. Japan and Germany occupy the opposite end of the spectrum from the US and Great Britain, labeled Anglo-American, or liberal market economies.[4] Japan's experience provides conditions akin to a natural experiment—what happens when Anglo-American firms enter coordinated market economies? This gets us to the heart of debates over comparative capitalisms and institutional change; what drives institutional change, and how is globalization unfolding for diversely organized political economies?

The critical question when considering how MNCs can drive globalization, using Japan's experience is *to what degree did foreign MNCs in Japan drive institutional change?* Or, conversely, *to what degree was their entry a result of institutional change?* This can be determined through a historical analysis of how institutions changed in relation to the influx of MNCs and their adoption of new practices.

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[3] Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes".

[4] Suzanne Berger and Ronald Philip Dore, *National diversity and global capitalism* (Ithaca, N.Y.: Cornell University Press, 1996); Kozo Yamamura and Wolfgang Streeck, *The end of diversity? : prospects for German and Japanese capitalism* (Ithaca, NY: Cornell University Press, 2003); Peter A. Hall and David W. Soskice, *Varieties of capitalism the institutional foundations of comparative advantage* (Oxford England ; New York: Oxford University Press, 2001). For an overview of this literature, see Gregory Jackson and Richard Deeg, "From comparing capitalisms to the politics of institutional change," *Review of International Political Economy* 15, no. 4 (2008).

[Insert Table 1 as full page landscape]

WHICH INSTITUTIONS? NATIONAL AND FIRM-LEVEL

To answer questions of institutional change, we must begin by determining which institutions we are analyzing, and what we mean by institutions.[5] Here, the comparative capitalism literature usefully provides us two levels of analysis – national and firm.

At the national level, the “Japanese model” of political economy is associated with several distinctive features, such as enterprise-based unions, long-term employment with seniority wages, the main bank system, keiretsu business networks, and “corporatism without labor,” in which peak associations confer with one another, but without organized labor.[6] These features can be considered institutions if we follow North in considering institutions to be “rules of the game” established by formal and informal rules that pattern the strategic interactions among actors.[7] The “Japanese model” is therefore a constellation of institutions.[8]

Conceptions of national models are derived from observations at the firm level, usually in key sectors within finance and manufacturing. The Varieties of Capitalism (VoC) framework articulated by Hall and Soskice is most explicit in building national-level typologies from firm-level activities. In their conception, distinct solutions to a series of firm-level coordination problems drive the diversity of capitalist systems. The areas include: 1) industrial relations – how firms coordinate with labor as a class or interest group over areas such as wages and working conditions; 2) vocational training and education – how firms obtain appropriate skilled workers; 3) corporate governance – how firms finance activities; 4) inter-firm relationships – the coordination between firms and their suppliers, clients, and others; and 5) employees – the means

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[5] See, for example, John L. Campbell, *Institutional Change and Globalization* (Princeton, NJ: Princeton University Press, 2004).

[6] T.J. Pempel and K. Tsunekawa, "Corporatism without Labor? The Japanese Anomoy," in *Trends Toward Corporatist Intermediation*, ed. Phillippe Schmitter and Gerhard Lehmbruch (London, UK: Sage Publishing, 1979).

[7] Douglas North, *Institutions, Institutional Change and Economic Performance* (Cambridge University Press, 1990).

[8] Steven K. Vogel, *Japan Remodeled: How Government and Industry are Reforming Japanese Capitalism* (Ithaca, NY: Cornell University Press, 2006).

by which firms coordinate with their employees to mitigate problems such as adverse selection and moral hazard.[9] In their conception, the role of institutions is to support particular means of coordination. In the VoC vantage, institutions are also “rules of the game” that support particular solutions to coordination problems.

However, critically, Hall and Soskice posit that firms drive institutional change—that if firms alter their means of coordination, institutional change will follow. This is a clear proposition that can be tested using the Japanese case, since foreign MNCs clearly introduced a new set of practices. The findings can also contribute to a stream of inquiry regarding institutional change.[10] Did the new practices introduced by foreign MNCs drive changes in the institutions to support those new mechanisms of coordination?

A related point is the motivations of foreign MNCs entering Japan from the mid-1990s. Hall and Soskice hypothesize that MNCs move across national borders to take advantage of “comparative institutional advantages.”[11] The question is whether this was the case for foreign MNCs that entered Japan in the late 1990s to early 2000s—and if not, what were their motivations? This can be determined by examining the conditions of initial entry and business models of foreign MNCs in Japan as they changed over time.

FINDINGS

The main findings of this chapter are as follows. The influx of foreign MNCs into the sectors receiving the most inward FDI resulted largely from regulatory shifts that 1) facilitated MNCs’ entry, 2) reorganized the dynamics of competition that advantaged the introduction of

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[9] The VoC framework differentiates between two types of economies based on the patterns of firm-level coordination. In “Liberal Market Economies,” (LMEs) coordination occurs through hierarchies and competitive market arrangements. In “Coordinated Market Economies,” (CMEs) non-market relationships are the primary means of coordination. Hall and Soskice contend that firms in any country tend to gravitate towards the means of coordination supported by institutions. These institutions are complementary, in that each depends on the existence of others to function. The CME typology is closely based on Germany, but Hall and Soskice note that Japan also fits the typology, with some differences in the industrial relations and corporate network

[10] Wolfgang Streeck and Kathleen Ann Thelen, *Beyond continuity : institutional change in advanced political economies* (Oxford, England ; New York: Oxford University Press, 2005); Robert Boyer, "The Diversity of Institutions Governing the "New Economy"," in *Knowledge: the New Wealth of Nations>* (University of Amsterdam2002).

[11] Hall and Soskice, *Varieties of capitalism the institutional foundations of comparative advantage*. 36-44.

new practices, often MNCs global business models and products. Numerous MNCs took advantage of the new opportunities, and many pushed the envelope on new possibilities enabled by the new regulatory frameworks. The regulatory changes themselves were driven primarily by political dynamics stemming from the aftermath of Japan's bubble bursting in 1990.

On balance, *domestic political dynamics, rather than the actions of MNCs, or the adoption of new practices by domestic firms, drove the institutional changes enabling MNCs to enter and introduce new practices*. Regulatory changes created opportunities for MNCs, which took advantage of them. By doing so, MNCs expanded the normative range of acceptable (and potentially successful) practices.

The motivations of MNCs entering Japan were not necessarily to take advantage of "comparative institutional advantages" distinct to Japan. If anything, they were interested in the new market conditions and opportunities created by regulatory shifts. They were taking advantage of regulatory shifts that enabled them to introduce business models from their global operations.

The pattern of syncretism, sparked by domestic politics-driven regulatory reform, is most dramatic in finance, where foreign firms departed furthest from traditional Japanese firms in organization, business models, and coordination with other actors. It is also clear in other sectors that experienced a major influx of foreign MNCs from the late 1990s. These sectors include telecommunications, pharmaceuticals, and automobiles, briefly reviewed in this chapter.

ROADMAP

This chapter first revisits the strengths and weaknesses of the VoC framework, applying it to Japan in order to identify the relevant institutions to trace over time. The chapter then briefly establishes the context of Japan's inflow of FDI. The chapter traces in some detail the financial sectors of banking and securities with respect to foreign firms and institutional change. It then provides shorter overviews telecommunications, pharmaceuticals, and automobiles with a similar analytical vantage.

I. Comparative capitalisms and the VoC Framework Revisited

A longstanding thrust of scholarship best characterized as "comparative capitalisms" seeks to understand the sources of diversity in how advanced industrial economies organize their capitalist systems, and the drivers of change.[12] MNCs are often noted as one of many drivers of economic globalization, dominated by trade and investment flows, but few analyses take MNCs as the central focus.

1.1 VOC RECONSIDERED

Hall and Soskice's "Varieties of Capitalism" (VoC) framework, published in 2000, has been one of the most influential of the decade. Its strengths are many, including a focus on the micro-foundations of firm-level activities to create macro-level typologies, and its clear hypotheses.

The VoC framework spawned a healthy debate, in which several critiques and alternatives to their approach were raised. Some disagree with their analytical foundations of placing firm-level coordination as the lynchpin for how political economies are organized; they contend that a different set of variables best captures the relevant diversity of capitalist systems. [13] Others disagree with the relatively static view presented in the initial VoC formulation.[14] Some political scientists contend that the role of the state as a potentially autonomous actor is missing, and that interest group politics are ignored.[15] Another view is that political bargains set up the institutions that shape firm-level coordination in the first place.[16] Finally, the degree to which institutions are actually complementary to each other has been called into question.[17]

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[12] For an excellent overview of the literature, see Jackson and Deeg, "From comparing capitalisms to the politics of institutional change."

[13] Bruno Amable, The diversity of modern capitalism, (Oxford ; New York: Oxford University Press, 2003), http://www.oxfordscholarship.com/oso/public/content/economicsfinance/9780199261130/toc.html.

[14] Colin Crouch, *Capitalist diversity and change : recombinant governance and institutional entrepreneurs* (Oxford ; New York: Oxford University Press, 2005).

[15] Jackson and Deeg, "From comparing capitalisms to the politics of institutional change."

[16] John Zysman and Dan Breznitz, "The State in a Double Bind: Staying Wealthy in a Changing Global Economy," *BRIE Working Paper* 188(2010).

A critical advantage of the VoC framework, however, is that it provides two simple, testable hypotheses, the answer to which transcends the framework itself. First, if a group of MNCs bring new forms of coordination to a particular country and become prominent market actors, we should expect institutional adjustment – particularly if the firms are from LMEs moving to CMEs. Second, if MNCs enter a CME to take advantage of the host country's "comparative institutional advantage," that should be observable in their business models upon entry.

1.2 VoC Applied to Japan's Traditional Model: Adding Government as an Actor

In applying the VoC framework to Japan, it becomes immediately clear that the role of the government was highly significant in establishing and sustaining the key national level institutions. The institutions themselves were not the direct result of corporate political lobbying or policy infiltration, although in many cases, business interests were served.

First, taking the variables from the VoC framework, we see that; 1) "Industrial relations" maps onto Japan's structure of enterprise-based unions. 2) "Worker skills" applies to Japan's meritocratic education system focused on raising the mean achievement of students with a focus on effort-based testing. 3) "Corporate governance" was historically based on the main bank-centered governance system in which bank loan centered financing was coupled with banks' implicit guarantee against failure in exchange for exercising management control at times of duress ("contingent governance" as articulated by Aoki[18]). 4) "Inter-firm relations" map onto keiretsu business structures, and 5) "Employees" refers to long-term employment and seniority wages.

The early origins of these institutions date from Japan's initial industrialization in the late 1800s. In the mobilization for war from around 1940, and early on in the postwar period, specific political bargains established and sustained the institutions in the form described as the

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[17] Robert Boyer, "Coherence, Diversity, and the Evolution of Capitalisms - the Institutional Complementarily Hypothesis," *Evolutionary and Institutional Economics Review* 2(2005); Colin Crouch et al., "Dialogue on "Institutional complementarity and political economy"," *Socio-Economic Review* 3(2005).

[18] Masahiko Aoki and Hugh T. Patrick, *The Japanese main bank system : its relevance for developing and transforming economies* (Oxford [England] ; New York: Oxford University Press, 1994).

"Japanese model" of capitalism. 1) Enterprise unions were formed initially by government initiatives that dissolved industry-based unions in the mobilization for war.[19] They were further entrenched by the Allied Occupation government reversing its initial support for labor unions as a force for democratization; it purged unions of suspected communist sympathizers, preventing broad inter-firm unions from developing.[20] Large firms, backed by the Ministry of Labor, limited union development before trans-industry ties were forged.[21] 2) The education system was reshaped by the Occupation government, which shifted the system away from training a small number of elite towards compulsory education through middle school with a meritocratic, multi-tracked system in which students were differentiated by ability.[22] 3) The main bank system grew out of the government's wartime mobilization effort which consolidated the number of commercial banks from over 1400 in 1926 to 61 in 1945, assigned particular banks to industrial groups, and promoted bank consortia for long term investment loans. In the early postwar period, the government promoted a bank-centered financial system with support for long term credit banks and targeted investment projects.[23] 4) The cross-shareholding underlying keiretsu structures were the result of industrial policy by the Ministry of International Trade and Industry (MITI) in the 1960s. It revised the commercial code and provided strong administrative guidance to corporate groups to engage in cross-shareholding as protection against potential foreign takeovers as Japan acceded to international organizations such as the OECD. 5) Long term employment was strongly supported by the government in a social bargain to keep welfare costs low by focusing on stable employment in large enterprises. Long-term employment was also sustained by a series of judicial rulings that made it difficult for firms to fire employees.[24]

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[19] Yukio Noguchi, "The 1940 System: Japan under the Wartime Economy," *American Economic Review* 88, no. 2 (1998).

[20] Peter Duus, *Modern Japan*, 2nd ed. (Boston: Houghton Mifflin, 1998).

[21] Gregory Jackson, "The Origins of nonliberal corporate governance in Germany and Japan," in *The end of diversity? : prospects for German and Japanese capitalism*
ed. Kozo Yamamura and Wolfgang Streeck (Ithaca, NY: Cornell University Press, 2001).

[22] Duus, *Modern Japan*. 266.

[23] Noguchi, "The 1940 System: Japan under the Wartime Economy."; Aoki and Patrick, *The Japanese main bank system : its relevance for developing and transforming economies*.

[24] Curtis J. Milhaupt, J. Mark Ramseyer, and Michael K. Young, *Japanese law in context : readings in society, the economy, and politics*, Harvard East Asian monographs (Cambridge, Mass.: Harvard University Asia Center : Distributed by Harvard University Press, 2001). 384-98.

Table 1: Political Origins of Japan's VoC Characteristics

VoC Variables	Traditional Japanese Model	Political Origin of J-Model Characteristic
Industrial relations	Enterprise unions	Gov't support of enterprise-based unions
Worker skills	New hire generalists	Education system set up by gov't
Corporate Governance	Main Banks	Gov't's strategic resource allocation, "convoy system"
Inter-firm relations	Keiretsu	Gov't encouraged cross-shareholding to protect from foreign takeover.
Employment system	Long term employment, seniority wages	Pension, social security systems focused on employers to lower direct government costs.

There is a clear hand of government, particularly in is overall strategic focus in its "developmental" model of capitalism centered on financial system. The main bank system was a central part of Japan's postwar growth strategy, with the government shaping the allocation of resources in the economy. Banks were shielded from bankruptcy through the "convoy" system of implicit government bailouts and government-orchestrated mergers for troubled banks. Coordination with the government was therefore one of the critical elements of firm-level coordination. The government itself was also an actor, in many cases acting with relative autonomy from the firm-level interests rather than simply reflecting corporate preferences. In a variety of sectors, therefore, strong government-industry coordination was critical to firms' businesses—particularly in highly regulated sectors. Banks hired MOF-*tan,* so called MOF handlers, for example. Administrative guidance was delivered through interpersonal networks, and information exchange went both ways through dense webs of interpersonal networks. We there need to add "government-industry coordination" to the set of VoC variables.[25]

Japanese firm's coordination patterns are the basis of this "model." The characteristics are stronger in some sectors than others, and in some firms than others.

[25] Daniel I. Okimoto, *Between MITI and the Market: Japanese Industrial Policy for High Technology* (Stanford Stanford University Press, 1989); Richard Samuels, *The Business of the Japanese State: Energy Markets in Comparative and Historical Perspective* (Ithaca, NY: Cornell University Press, 1987).

1.3 Japan's Emerging New Model and the "F Firm" Model

Recent scholarship has shown how these traditional institutions began changing substantially from the mid to late 1990s. 1) Enterprise unions declined as union membership in general fell, partly fueled by firms' increasing reliance on contract and temporary workers. 2) Labor markets shifted as the fluidity in mid-career hiring increased, spawning growing markets for headhunters and temp agencies. In particular sectors such as securities-related finance, information technology, and foreign firms in general were among the major employers of mid-career hires. 3) The main bank system weakened as the importance of bank lending decreased for healthy and large firms, though increasing for less competitive and small-medium firms. Regulatory changes facilitated greater diversity of corporate governance structures, such as the introduction of outside directors, executive board systems, and stock options. 4) The nature of keiretsu changed as stable cross-shareholding eroded, large firms reduced their levels of diversification, major mergers occurred between previously distinct groups, and firms adopted greater openness in business partners. 5) Long term employment was eroded as a series of court cases and changes to the Labor Standards Law removed much of the legal and doctrinal underpinning of corporate obligations to maintain employment. Seniority wages shrank as firms increased use of temporary and contract workers, with many firms incorporating some form of performance-based component to their wage structure.[26]

[26] Vogel, *Japan Remodeled: How Government and Industry are Reforming Japanese Capitalism*; Ulrike Schaede, *Choose and focus : Japanese business strategies for the 21st century* (Ithaca: Cornell University Press, 2008); Masahiko Aoki, Gregory Jackson, and Hideaki Miyajima, eds., *Corporate governance in Japan* (Oxford: Oxford University Press, 2007); Harald Conrad, "From Seniority to Performance Principle: The Evolution of Pay Practices in Japanese Firms since the 1990s," *Social Science Japan Journal* 13, no. 1 (2010).

Table 2: **Japan's Emerging New Model, Tracing VoC Characteristics**

VoC Variables	Traditional Japanese Model	Emerging New Japan Model
Industrial relations	Enterprise unions	Overall union decline
Worker skills	New hire generalists	Growing mid-career labor market
Corporate Governance	Main Banks	Less bank dependence by large firms, greater diversity of governance structures
Inter-firm relations	Keiretsu	Traditional Keiretsu weakened, cross-shareholding declined
Employment system	Long term employment, seniority wages	Increased temporary and contract workers, performance component to wages
Government-Industry Relations	Dense formal and informal interpersonal networks	Greater formalization of interactions, decreasing important of informal interpersonal networks

Foreign firms are mostly at the forefront of this new emerging model, adopting practices that depart most clearly from Japan's traditional postwar model. In particular, firms in securities finance, such as the US Wall Street firms such as Goldman Sachs, Merrill Lynch, Lehman Brothers, along with European investment banks such as Deutsche Bank, BNP Paribas and UBS Warburg departed most dramatically from the traditional Japanese corporate organizations and practices.[27] Since they are the most extreme cases, the VoC hypothesis would expect us to find them most responsible for driving institutional change surrounding their mechanisms of coordination.

There is, of course, considerable heterogeneity among the practices of foreign firms. Some adopt structures and strategies closer to their Japanese competitors, while others find that defying traditional organizations are their strategic strength. IBM Japan, for example, famously adopted a very Japanese corporate organization to its great success. Nissan, on the other hand, actively reduced cross-shareholding and keiretsu tied once bought out by Renault, contributing to its dramatic recovery—but it did not engage in mass layoffs.

[27] Mari Yamauchi, "Employment Systems of Financial Institutions in Japan - Its Varieties by Capital, Products and Individual Strategies [Japanese]," *Japan Journal of Human Resource Management* 12, no. 1 (2010); "Convergence and Divergence - Employment Systems at Tokyo Based Investment Banks after the Lehman Shock [Japanese]," *Mita Business Review* 54, no. 2 (2011).

It is worth specifying a stylized “F Firm” model to clarify how it departs from the traditional stylized Japanese firm (J firm) model. The F firm entails: 1) No unions; 2) heavy reliance on mid-career hires; 3) main banks relationships rarely established or utilized; 4) keiretsu not heavily relied upon with little if any cross-shareholding, and; 5) no guarantee of long term employment, with performance-oriented pay. Moreover, the F Firm is far more willing to defy the government’s informal administrative guidance and is less interested in cultivating dense interpersonal networks.

Table 3: “F Firm” Model Compared to Traditional J Firm Model, VoC Variables

VoC Variables	Traditional Japanese Model (Large J firm)	Stereotypical foreign MNC in Japan
Industrial relations	Enterprise unions	No union
Worker skills	New hire generalists	Mid-career hires
Corporate Governance	Main Banks	Shareholder, home headquarters
Inter-firm relations	Keiretsu	Fluid relations
Employment system	Long term employment, seniority wages	Short term, performance based wages
Government-Industry Relations	Informal interpersonal networks cultivated with government officials	Low reliance on ex-bureaucrats, willing to defy government

Let us now turn to each of the sectors. Securities and banking, in which F firms depart most dramatically from traditional Japanese firms, will be examined in the greatest detail.

II. Banking and Securities

In the banking and securities sector, *regulatory changes, driven by domestic politics, drove syncretism* by enabling the introduction of new actors, new business models, and new patterns of coordination. Foreign MNCs took advantage of the new opportunities most, and profited greatly—but they were not the primary drivers of the regulatory change.

The *traditional model* entailed domination by large Japanese financial firms, with MOF compartmentalizing and strongly managing the sector. The Japanese firms were the archetype for Japan’s “J firm” organization and mechanisms of coordination. MOF shaped firms’ business models through formal and informal policy tools as part of the “developmental” state limiting foreign firms to a particular market segment.

The most dramatic *change* was driven by regulatory shifts in the late 1990s – Japan’s financial “Big Bang” policies promulgated under Prime Minister Hashimoto. The reforms were driven by domestic politics stemming from a series of scandals that seriously eroded the reputations and power of the Ministry of Finance, and domestic financial institutions. Reform occurred in the context of Japan’s banking crisis, and the perceived need among political elite to make Japan’s financial system more open, internationally relevant, and competitive.

In the new *syncretic model*, an influx of foreign MNCs introduced new business models, new patterns of inter-firm and government-business coordination. Foreign actors were also responsible for the dramatic restructuring and turnarounds of several Japanese financial institutions. Domestic firms adjusted, but slowly, resulting in the new, old, and hybrid all coexisting in Japan’s financial sector.

Figure 1: Syncretism in Japan’s Banking and Securities Sector

Traditional Model		**Change**		**Syncretic Model**
• Sector dominated by traditional “J firms” • Industry highly regulated by MOF	→	Regulatory changes (Financial Big Bang), driven by domestic politics, not MNCs	→	• Influx of Foreign firms • New business models challenging old • New patterns of gov’t-business, intra-industry coordination • Foreign restructuring of failed banks

2.1 The Traditional Model: Foreign Firms Limited During Heyday of “Developmental State” Heyday (1950 – late 1960s)

During most of Japan’s high growth era from the 1950s to 1970s, MOF compartmentalized the sector and exercised strong strategic control over the allocation of funding in the economy. Foreign banks were confined to a particular market segment, but enjoyed a cartel-like status and did not push hard for change. During this era, the banking sector as a whole was essentially closed to new entrants and new business models.

In the early 1950s, foreign banks were limited to areas including trade financing and foreign currency-related activities, later expanding to impact loans (medium-term foreign currency loans to Japanese firms). MOF used administrative guidance to protect the foreign market segments from Japanese firms' attempts to enter. The number of foreign banks in Japan increased only from 12 to 15 between 1951 and 1967. Though largely excluded from domestic policy processes, the foreign banks enjoyed their profitable market niches and did not actively press for change.[28]

2.2 External Pressure for Foreign Entry – But Not From Foreign Firms Within (mid-70s-1980s):

In the 1970s and 1980s, foreign financial institutions drawn to Japan's rapidly growing economy mobilized their home governments to pressure MOF to allow their entry—with some success.[29] As the number of foreign banks grew from 15 in 1967 to 33 in 1974, increased competition eroded their previous cartel-like profitability, driving foreign firms to enter new market segments such as securities and trust banking. Foreign pressure, both from foreign governments and from foreign firms partnering with Japanese firms to take advantage of regulatory loopholes, led to the Tokyo Stock Exchange (TSE) allowing foreign membership.[30]

MNCs already in Japan, however, did not strongly advocate deregulation. For example, early foreign TSE members, having paid over a billion yen each in direct fees and indirect costs to enjoy fixed commission rates, were opposed to new entry.[31]

[28] Louis W. Pauly, *Regulatory Politics in Japan: The Case of Foreign Banking* (Ithaca, N.Y.: China-Japan Program, Cornell University, 1987). 17-19, 67-68; Kazuo Tatewaki, *Gaikoku ginko to Nihon : zainichi gaigin hyaku-yonjunen no kobo* (Tokyo: Sotensha Shuppan, 2004).

[29] For details, see Pauly, *Regulatory Politics in Japan: The Case of Foreign Banking*.

[30] Henry Laurence, *Money rules : the new politics of finance in Britain and Japan* (Ithaca, N.Y. ; London: Cornell University Press, 2001). 129-30.

[31] ibid., 132.

The impact of foreign financial institutions was limited. Japan had 82 foreign banks by 1990, but almost none had widespread retail or business operations. Until 1999, foreign banks were unable to join the industry association as full members. The number of foreign securities firms grew from 1 in 1972 to 52 in 1990, but they accounted for less than 10% of Japan's share trading volume. In trust banking, foreign firms were precluded from the positions of executive director and ordinary committee member in the Trust Company Association of Japan, and were not allowed to vote even with full membership.[32]

2.3 Change: Financial Big Bang Reforms Enabling Foreign Influx, New Market Dynamics (mid 1990s -)

The financial Big Bang reforms dramatically altered Japan's financial industry. They enabled new entry, deregulated business models by abolishing fixed commission rates, and removed the segmentation between market areas. Combined with the government moving to abandon the "convey" system as the non-performing loans crisis hit banks, foreign financial firms were major beneficiaries of the reforms.

The financial "Big Bang" reforms consisted of a variety of measures to deregulate and de-compartmentalize Japan's financial sector over several years. It was essentially an omnibus bill, consisting of almost 1000 pages, revising 24 financial and tax laws. Passed in March 1998, it took effect in December of that year. (For details, see Kushida and Shimizu of this volume).[33]

In contrast to Great Britain's financial "big bang" reforms of the 1980s, Japan's Big Bang reforms were not pushed by incumbent firms, domestic or foreign. While it was British brokerages lobbying the government to deregulate financial markets for them to compete against US firms, Japan's reforms were not direct results of lobbying by Japanese banks, securities firms, and insurers, along with foreign financial institutions.[34]

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[32] Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes", 67.
[33] For a comprehensive political analysis, see Tetsuro Toya, *The political economy of the Japanese financial big bang : institutional change in finance and public policymaking* (Oxford, England ; New York: Oxford University Press, 2006).

[34] Laurence, *Money rules : the new politics of finance in Britain and Japan*.

Lower entry barriers, such as registration rather than license for securities firms, and the de-compartmentalization of industry segments, enabled a surge of new foreign entrants. For example, brokerages including Charles Schwab, Signa International, American Express, Bank One, and others rushed into the market immediately following the 1998 deregulation.[35]

The government's abandonment of the "convoy" system also facilitated foreign expansion. MOF allowed Yamaichi Securities, one of Japan's "big four" brokerages, to collapse in 1997. Aiming at Japanese household assets, Merrill Lynch purchased 33 retail branches and hired about 2000 of the approximately 7500 Yamaichi employees.[36] In 1999, Salomon SmithBarney created a joint venture with troubled Nikko Securities, creating Nikko SalomonSmithBarney, which became quite successful, capturing 59% of the market in equity underwriting in 2000.[37]

2.4 Syncretism: New, Old, and Hybrid Business Models and Organizations

In the securities sector, the deregulation of brokerage commission fees advantaged foreign firms, who could deploy their global business models, while Japanese firms were forced to adjust. Japanese securities brokerages had been focused on attaining volume, since brokerage commission fee rates were fixed by regulatory statute. US and European firms had developed new products and services following deregulation of the US and UK since the 1980s.

Brokerage commission fees in Japan were deregulated gradually from 1994, culminating in complete deregulation in 1998 as part of the Big Bang reforms. Within three months of the 1994 deregulation on trades larger than 1 billion yen, commission fees dropped

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[35] TDB, *TDB Report: Gyoukai Doukou 1999-2 [TDB Report: Industry Developments 1999-2]* (Tokyo, Japan: Teikoku Data Bank, 1999). 19.

[36] In 2002, however, Merrill, unable to make the enterprise profitable, closed all but two branches, losing an estimated 900 million dollars over four years. Lawrence White, "Asia: Is Japan still a tough nut to crack?," *Euromoney* 2007.

[37] Thomson Financial Securities Data, cited by Ani Hadjian, "Nikko Salomon Logs a Stellar First Half In Japan, Which Leaves Rivals Frothing: Hat trick in equity, debt and M&A has the talons out in Tokyo," *Investment Dealers Digest*, June 26 2000.

by a half within three months as brokerages competed on price.[38] A month after the 1996 deregulation on trades exceeding 50 million yen, Daiwa Securities, the second largest Japanese firms, saw commission revenue drop by a fourth. A 2001 poll of the largest 200 brokerages found an average decline in commission fee revenues of 20% since 1999, and over 70% since 1994.[39]

Foreign financial firms excelled in introducing products and expertise to Japan's new securities markets. For example, in convertible bonds, foreign firms quickly topped the list of trades and issuances. Their program trading algorithms were widely deemed superior, with greater flexibility and speed. Their advanced computer systems were capable of conducting large basket trades (trades involving a portfolio of multiple shares and bonds), leading even Japanese brokerages to place orders with the foreign firms.[40] Foreign research analysts also offered data and evaluations to institutional investors, a services not traditionally provided by Japanese brokerages.[41]

Foreign financial firms leveraged their global footprints to aid Japanese firms raise equity finance abroad. Critically, they also had longstanding relationships with foreign institutional investors that flowed into Japanese equity markets. In March 1997, 11.9% of the total shares (by market value) of all listed companies in Japan were held by foreigners, but by 2005, this had climbed to 23.3. In terms of volume traded, foreigners accounted for 19.9% of stock transactions in 1996, and 39.3% in 2005.[42]

As foreign financial firms' profits soared, Japanese brokerages struggled. In 1996, the Japan Securities Dealers' Association's Japanese members' operating profits dropped 40% from the previous year; foreign securities firms' grew a whopping 21 fold.[43] In 2000, the total

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[38] Shinhua Liu, "Commission Deregulation and Performance of Securities Firms: Further Evidence from Japan," *Journal of Economics and Business* 60, no. 4 (2008).

[39]"Brokerage Commissions Still Declining," *The Nikkei Weekly*, March 26 2001.

[40] Basket trades were often used in the late 1990s to quietly unwind cross-shareholding. If it became clear that a major shareholder was unwinding, speculation could drive down share prices, reducing the value of shares that the firm was attempting to unwind.

[41] Interview with investment banker who wished to be anonymous. Tokyo, Japan.

[42] TSE, TSE Factbook 2008, (Tokyo Stock Exchange, 2008), http://www.tse.or.jp/english/market/data/factbook/index.html.

operating income for the 238 domestic firms dropped 23%, reflecting a 45% drop in commission revenues, while that of the 50 foreign firms rose 33%, with revenue increasing by 44%.[44] (Despite the subprime bubble that led to a full-scale crisis among global firms in 2008, the Japanese market had limited exposure to these products. Foreign financial firms do not disclose their revenue breakdown, but employees contend that most was from operations in the Japanese market.)

Foreign trust banks, which had struggled after Japan's asset bubble burst in 1991, experienced a major surge.[45] After 1998, Japan's financial Big Bang reforms enabled foreign trust banks to offer dollar-denominated overseas investment trusts. Combined with Japan's low interest rates and banking crisis, this led to an inflow of Japanese savings; between 1998 and 1999, despite overall shrinkage of Japanese corporate pension funds entrusted to major Japanese trust banks, the nine foreign trust banks recorded a 30% combined increase in corporate pension fund assets.[46] In the first half of fiscal 1998, the total assets held by foreign trusts increased by approximately 40%.[47] A particularly successful dollar-denominated investment trust developed by LTCB Warburg took in 50 billion yen in its first week.[48] By late 2004, a survey showed that foreign institutions took 26.5% of all shares of funds managed by investment trusts, investment advisers, and pension funds, totaling 147 trillion yen, an increase of 80% since 1997.[49]

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[43] TDB, *TDB Report: Gyoukai Doukou 1998-1 [TDB Report: Industry Developments 1998-1]* (Tokyo, Japan: Teikoku Data Bank, 1998). 370.

[44] *TDB Report: Gyoukai Doukou 2002-1 [TDB Report: Industry Developments 2002-1]* (Tokyo, Japan: Teikoku Data Bank, 2002). 22. In 1999, small and medium firms, an estimated 80% of which were reliant mostly upon commission revenues, began going out of business. *TDB Report: Gyoukai Doukou 1999-2 [TDB Report: Industry Developments 1999-2]*. 18.

[45] For details, see Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes", 94-95.

[46] Makoto Sato, "Realignments sweep trust-bank sector: Government push to speed disposal of bad loans adds to impetus for change," *The Nikkei Weekly*, January 25 1999.

[47] TDB, *TDB Report: Gyoukai Doukou 1999-2 [TDB Report: Industry Developments 1999-2]*. 31.

[48] "Foreign innovations lure investors: Financial institutions tailor higher yielding instruments to Japanese individuals' aversion to high risk," *The Nikkei Weekly*, August 31 1998.

2.4.1 New Inter-firm Coordination: Foreign Firms' Rise as "Suppliers"

Deregulation also fueled new relationships between foreign and major Japanese financial firms. In 1999, the Ministry of Health and Welfare removed most restrictions on the asset mobilization for welfare pension funds. Each fund could select its own investment advisory firm, and the range of investment products and destinations was considerably broadened. Funds seeking higher returns rushed to find higher yielding investments overseas, fueling demand from Japanese financial institutions seeking the expertise of foreign trust banks and investment advisors.

Japanese banks, trust banks, insurers, and even securities firms were among those that sought partnerships with foreign firms. For example, Sumitomo Bank and Daiichi Kangyo Bank created tie-ups with Templeton and JP Morgan, respectively. Sumitomo Trust Bank partnered with Chase Manhattan. Japan's largest life insurer, Japan Life, entered into a tie-up with Deutchebank, Yasuda Life with PaineWebber, and Yasuda Fire and Marine with Signa International. New joint ventures were created as well, including Prudential-Mitsui Trust Investments, Nomura BlackRock Asset Management, Meiji Dresdner Asset Management, and others.

2.4.2 New Patterns of Government-Business Relations: Foreign Firms Driving Disruptive Challenges

Foreign financial firms—particularly in the fast-moving securities sector—spearheaded new patterns of government-business relations by challenging the government in new ways.

One pattern was to defy informal political pressure. In the summer of 2000, Goldman Sachs was summoned to the National Diet to testify about a specific issue surrounding the bankruptcy of a major department store chain, Sogo. As advisor to the government in selling Sogo's main bank to an American investment fund (more later), Goldman had allegedly not advised the government of the risk of the foreign-managed bank to return soured debt to the government, though Goldman contended the FSA had asked to insert a clause allowing this. The

[49] Cerulli Associates calculations based on data from the Investment Trusts Association, the JSDA, the Japan Securities Investment Advisers Associations, and other sources.

issue was politically sensitive, since the government appeared to have subsidized a foreign investment bank to profit from allowing a major employer to fail. Upon consulting its lawyers, Goldman found that the Diet had no authority to compel testimony, so it refused.[50]

Another pattern was to take advantage of areas of regulatory ambiguity. In 2005, Lehman Brothers enabled Livedoor, an aggressive Japanese Internet start-up firm, to engage in a hostile M&A of a venerable broadcasting corporation by utilizing after-hours acquisitions on an off-exchange system operated by the Tokyo Stock Exchange.[51] Although Livedoor's bid eventually failed, Lehman's controversial role became a topic of political discussion regarding how far Japan's economic system ought to be reformed with "Anglo-American" elements.

A third pattern was to defy informal bureaucratic guidance. When MOF attempted to create a strengthened securities investor protection fund in 1998 to protect investors against bankruptcies such as Yamaichi, foreign firms refused to join. Discovering that, while fund membership was mandatory, nowhere in the regulatory structure did it stipulate that only one fund could exist, foreign firms created their own parallel fund. This left Japan with two parallel securities investor protection funds –the Japan Investor Protection Fund with 241 members comprised of Japanese financial institutions, and the Securities Investor Protection Fund, with 51 foreign institutions—until 2002 when they were merged.[52]

Finally, foreign firms precipitated the collapse of longstanding Japanese industry organization simply by exiting. The Tokyo Stock Exchange (TSE) Participants' Association, essentially a political donation fund, was once significant in linking the securities industry and politicians.[53] As their market presence grew, foreign firms were required to pay a greater proportion of the organization's fees, but were unsatisfied with the level of voice they were

[50] Gillian Tett, *Saving the sun : a Wall Street gamble to rescue Japan from its trillion-dollar meltdown* (New York: HarperBusiness, 2003). 212-16.

[51] This theoretically circumvented the securities rules requirement that acquisition of greater than a third of a public company be conducted through tender offers open to all shareholders. Curtis J. Milhaupt, "In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan," *Columbia Law Review* 105(2005): 2179.

[52] For details, see Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes".

[53] In 2000, it contributed 100 million yen, 95 million in 2001, and 75 million each in 2002 and 2003 in addition to 10 million yen worth of party ticket purchases. These amounts ranked just below the contribution levels by major industry associations – the Japan Automobile Manufacturers' Association and the Japan Iron and Steel Federation. Kushida 2010.

given. In late 2003, Morgan Stanley, discovering that membership not mandatory, withdrew, followed by other major foreign brokerages. This created an exodus of Japanese firms as well, plunging the association into financial distress and dissolution the following summer.[54] A coordinated withdrawal from a voluntary organization, while always a possibility, had never been acted upon in this way, or in this magnitude.

2.5 Bank Restructuring and Reform by Foreign Investment Funds

As Japan's banking crisis hit in the late 1990s and the government abandoned the convoy system, several ailing or failed Japanese banks were sold to foreign investment funds. Under new management, these banks substantially transformed their business models and organizational structures. Two former long term credit banks and two regional banks were sold, and although foreign investment funds initially raised some political and societal concern, they were later largely regarded as saviors, injecting capital and management expertise to spark reform.

The Long Term Credit Bank (LTCB), which had supported Japan's postwar recovery and growth, became insolvent in 1998 despite restructuring, downsizing, an attempted tie-up and buyout deal with Swiss Bank Corporation and Sumitomo Bank, and a government injection of 170 billion yen earlier that year.[55] It was nationalized in October that year.

The government, keen to avoid the traditional convoy approach, (which would have entailed a takeover by historically close Dai-Ichi Kangyo Bank or Industrial Bank of Japan) sold LTBC to Ripplewood Holdings in March 2000 for approximately 121 billion yen.

Renamed Shinsei, the new bank began operations in June 2000, departed sharply from prevailing banking practices. Under a new president whose previous careers included a foreign oil company and Citibank, Shinsei moved away from traditional retail banking. The traditional centralized, hierarchical corporate structure was flattened and decentralized. New employees and teams were hired from outside—many of them from foreign financial institutions operating

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[54] "Seijikenkin, kakusha goto ni, madoguchi ipponka wo shoukenkai minaoshi -- gaku wo kaiji no kaishamo," *Nihon Keizai Shimbun*, March 20 2004.

[55] Vogel, *Japan Remodeled: How Government and Industry are Reforming Japanese Capitalism*. 179-81.

in Japan such as Citigroup, Lehman Brothers, and Bear Stearns. The Fujitsu IT system was overhauled by a team of Indian IT experts brought in from the outside, who adopted a new modular server architecture. The new president demanded better quantitative risk assessment and monthly revenue data, which LTCB had neither quantified rigorously nor collected frequently.[56] It implemented a two-tiered compensation scheme. "Permanent staff" enjoyed higher job security but lower pay, while "market staff," mostly mid-career hires and foreigners, received higher pay in return for lower job security. Women were allowed to apply for and given managerial posts, a departure from previous norms.[57]

Nippon Credit Bank (NCB) was also nationalized in 1998 following scandals and a failed government bailout.[58] Initially sold to a consortium of Japanese firms in 2000 and renamed Aozora Bank, it was resold in 2002 to Cerberus, a politically well-connected US investment fund. The sale to Cerberus had political support, with Prime Minister Koizumi's trusted economic reformer Heizo Takenaka, in charge of financial, economic, and fiscal policy, actively encouraging foreign participation in Japan's banking sector reforms; in his view, foreign firms were valuable allies in reforming Japan's financial system.[59]

Reforms at Aozora, mostly enacted before Cerberus took over, were less dramatic than those undertaken by Shinsei or Tokyo Star. Aozora's restructuring relied on ties with its owners and established partners: in overhauling and operating its IT system, Aozora contracted Hitachi, with which it had a longstanding relationship; Aozora launched an online consultancy on M&A run jointly with Softbank Orix, and Tokio Marine & Fire. Aozora also formed ties with California-based Silicon Valley Bank, specializing in startup firms.

Two failed regional banks, Tokyo Sowa Bank and Kofuku Bank, were sold to US private equity fund Lone Star and a partnership led by WL Ross & Co, respectively. In January 2001, Lone Star won the bid against Shinsei Bank, Orix, and the Cerberus Group, renaming the bank Tokyo Star Bank, and restructuring it extensively. Installing a young American as president, it jettisoned previous operating manuals, replaced the IT system using primarily

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[56] Tett, *Saving the sun : a Wall Street gamble to rescue Japan from its trillion-dollar meltdown*. 197-204.
[57] Vogel, *Japan Remodeled: How Government and Industry are Reforming Japanese Capitalism*. 182-83. For more, see Kushida (2010).

[58] For details, see Kushida (2010).

[59] Personal interview, June 2011.

Indian engineers located in Tokyo and Bangalore, and shifted workflows. Branches were reorganized to provide a consumer-friendly space, and some new products, such as deposit-linked mortgages, were introduced.[60] Tokyo Star Bank took mid-career hires for foreign currency deposits and investment trust operations, in which it lacked expertise, and introduced outside personnel in marketing and public relations departments. It also introduced performance-base salaries.[61]

Kofuku Bank, a second-tier Osaka-based regional bank, became insolvent in 1999, and subsequently coming under government management. A partnership led by WL Ross & Co purchased the bank in 2000, renaming it Kansai Sawayaka Bank, and Transitioning it away from the standard relational banking practices. With the help of the Boston Consulting Group, Kansai Sawayaka focused on retail loans to small-medium businesses in the Kansai area. It partnered with a consumer loan company and became the first mainstream bank in the region to offer unsecured loans at higher interest rates (5-14%) – a niche previously reserved for the consumer finance market segment.[62] It reduced the number of branches and implemented new employee incentives such as stock ownership and stock options.[63]

The turnaround in performance of these banks was significant for most of the 2000s until the 2008 global financial crisis hit. In most cases, the foreign owners exited at a substantial profit. Shinsei went public, Tokyo Star was acquired by a Japanese investment fund, Kansai Sawayaka Bank was sold to a larger regional bank, and Aozora became profitable.

2. 6 SUMMARY

In sum, foreign firms in Japan's banking and securities sectors did not drive the regulatory changes that reshaped the dynamics of competition. They introduced new products, services, practices, organizational structures, and mechanisms of coordination with the

[60] Tim Clark and Carl Kay, *Saying yes to Japan : How outsiders are reviving a trillion dollar services market* (New York: Vertical, 2005). 44-46.

[61] "Foreign funds changing regional banks," *The Nikkei Weekly*, September 2 2002.

[62] "Kansai Sawayakai Bank focused on unsecured loan business," *The Nikkei Weekly*, April 15 2002.

[63] ACCJ, "Kansai Sawayaka Bank (KS Bank): FDI to the Rescue," www.accj.or.jp/doclib/fdi/1069040587.pdf.

government, but did so as a result of regulatory changes that enabled them to do so. They entered Japan not to take advantage of Japan's pre-existing comparative institutional advantage, but to take advantage of new potential advantages enabled by the reforms, to which Japanese competitors were slow to adjust. The most significant regulatory changes were driven by domestic politics.

III. Telecommunications

In telecommunications, the pattern of syncretism and change is similar to that of finance, though somewhat less dramatic. *Regulatory changes, driven by domestic factors, drove syncretism* by enabling new actors to introduce new business models and mechanisms of coordination.

The *traditional model* through much of the postwar era entailed government-owned monopoly carriers with a closed set of Japanese equipment suppliers. After liberalization in the mid-1980s, foreign MNCs were limited to particular, relatively peripheral, sector areas.

Change came in the form of regulatory changes during the mid to late 1990s that enabled foreign firms into essentially all areas of the sector, and new business models. It was driven primarily by a shift within the Ministry of Post and Telecommunications (MPT)'s regulatory priorities as Japan's telecommunications sector fell behind in international competition.

The new *syncretic model* entailed a dramatically higher foreign presence in core areas of the sector, new business models, and new government-business coordination. Foreign firms were not the most significant drivers of change, however, as new Japanese entrants also took advantage of the new regulatory possibilities—and the change came *after* regulatory shifts enabled new entry.

Figure 2: Syncretism in Japan's Telecommunications Sector

Traditional Model		**Change**		**Syncretic Model**
• Sector dominated by traditional "J firms" (NTT, KDD, NCCs) • Monopoly, then • MPT managed • competition	→	Regulatory changes, driven by internal MPT shift, not MNCs	→	• Influx of Foreign firms • New business models • New patterns of coordination • New level of market-based industry • actor dynamics

3.1 THE TRADITIONAL: FOREIGN FIRMS LIMITED BEFORE AND AFTER LIBERALIZATION (1985 - MID-1990S)

Telecommunications infrastructure and services in Japan were in the hands of a state-owned monopoly, similar to most other countries, until liberalization in 1985. Nippon Telegraph and Telephone (NTT) operated domestic telephony while Kokusai Denshin Denwa (KDD) monopolized international telephony. They procured equipment from a stable set of suppliers known as the "NTT family," consisting of NEC, Hitachi, Fujitsu, and Oki, along with numerous smaller firms, all of whom competed for procurement orders. As a key part of Japan's developmental strategy, the focus of telecommunications was to build the technological competency of Japanese electronics firms, with NTT subsidizing the R&D efforts of the manufacturers.[64] The market was essentially closed to outsiders, domestic and foreign.

In the late 1970s, the US firm Motorola mobilized the US government to sell pagers to NTT. Its strategy, which succeeded by the early 1980s, was to join the closed group of "NTT family" firms rather than pushing for open procurement procedures.[65]

In 1985, a complex domestic political process resulted in the ended of NTT and KDD's monopolies, along with a regulatory structure that compartmentalized and limited competition. Foreign firms were limited to particular industry segments, prohibited from owning extensive infrastructure. The first global carriers in Japan such as AT&T, British Cable & Wireless, and France Telecom, served foreign MNCs operating in Japan, providing international and data services. In the areas of satellite and cellular services, after political battles involving home country diplomatic pressure, foreign participation was allowed, but limited to minority stakes in operators and providing equipment.[66]

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[64] See Marie Anchordoguy, "Nippon Telegraph and Telephone Company (NTT) and the Building of a Telecommunications Industry in Japan," *Business History Review*, no. 75, Autumn (2001).

[65] Laura D'Andrea Tyson, *Who's bashing whom? : trade conflicts in high-technology industries* (Washington, DC: Institute for International Economics, 1992). 66-67.

[66] For details, see Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes".

3.2 CHANGE: TELECOMMUNICATIONS "REGIME SHIFT" REFORMS: ENABLING THE FOREIGN INFLUX, REORGANIZING MARKET STRUCTURES

Japan's telecommunications regulatory structure underwent a major shift in the mid to late 1990s. MPT de-compartmentalized, largely deregulating pricing, and enabled foreign investment into infrastructure.[67] The shift largely reflected changing views within the ministry on the merits of freer competition – in part a reaction to the advent of the Internet and the Japanese firms' rapid decline in international equipment markets. Neither external pressure nor corporate lobbying were the main drivers.

Japan's deregulation of foreign network ownership occurred in 1998 after entering the World Trade Organization (WTO) Telecommunications Agreement. This, too, was driven primarily by domestic factors rather than lobbying by foreign firms. MPT officials, concerned that NTT, though privatized, dominated the sector and stifled competition, welcomed foreign entrants to facilitate competition. Moreover, MPT wanted access for Japanese firms abroad, since governments such as the US insisted on reciprocal access.[68]

Foreign MNCs immediately rushed into Japan in a variety of areas. Some focused on international services, such as US Carrier Worldcom, followed by Global One and Pacific Gateway Exchange entering in 1998, laying trans-Pacific fiber optic networks. In 1999, British Cable & Wireless won an unprecedented bidding war over IDC, a Japanese international carrier, against NTT. Other foreign firms became Internet Service Providers (ISPs). American firm PSINet purchased Japanese ISPs Rimnet and Tokyo Internet, becoming the second largest competitor to NTT for business users. Foreign firms also invested in domestic telecommunications services; in 1999, British Telecom and AT&T purchased shares of Japan Telecom, one NTT's largest competitors. By mid-2002, 25 foreign carriers had registered as infrastructure-owning carriers.

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[67] For details, see "Japan's Telecommunications Regime Shift: Understanding Japan's Potential Resurgence " in *How Revolutionary was the Digital Revolution? National Responses, Market Transitions, and Global Technology in the Digital Era*, ed. Abraham Newman, and John Zysman (Stanford, CA: Stanford University Press, 2006).

[68] Yuko Suda, *Tsushin gurobaru-ka no seijigaku : "gaiatsu" to Nihon no denki tsushin seisaku [The politics of globalization in telecommunications : "external pressure" on Japanese policies]*, Shohan ed. (Tokyo, Japan: Yushindo Kobunsha, 2005).

In a related area, cable television, deregulation of foreign ownership in 1995 enabled J:Com, a foreign-managed cable company to expand its business, becoming the largest cable company in Japan. In 1997 and 1999, it expanded to telephony and Internet services, respectively.[69]

In communications equipment, Silicon Valley-based Cisco Systems, which dominated global Internet infrastructure markets, captured 70 to 80% of Japan's market for Internet routers as the market grew from 55 billion yen in 1995 to 202 billion yen in 2002.[70]

3.3 New Business Models, New Mechanisms of Coordination, New Market Dynamism:

3.3.1 Vodaphone's Japan Adventure

The entry of British carrier Vodafone into Japan spearheaded a major industry shift. Vodafone entered in 2001 through the largest M&A deal in Japan's history until then by purchasing Japan Telecom, which owned J-Phone, one of Japan's three nationwide cellular carriers. Unlike the troubled banks in the previous section, J-Phone was enjoying several years of rapid growth, having pioneered color displays and camera-embedded handsets that could email pictures. Vodafone's strategy was therefore not a turn-around, but rather to take advantage of J-Phone's mobile Internet platform know-how and introduce it in European markets. It did so with its *VodafoneLive!* offering to becoming the largest European cellular Internet service provider at the time.

Vodafone's largest new business model was to attempt linking Japan's domestic manufacturers, who were stuck in the domestic market competing for procurement orders from carriers for handsets incompatible with global markets, with global markets. It introduced global model handsets from Japanese manufacturers worldwide – but unfortunately, in Japan's

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[69] Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes", 135.

[70] Tatsuo Tanaka and Reiko Murakami, "Network Externalities in the Japanese Market of Routers," *Competition Policy Research Center Discussion Paper, Fair Trade Commission of Japan*, no. 1-E (2003), http://www.jftc.go.jp/cprc/DP/CPDP-1-E.pdf.

advanced but proprietary domestic market, they represented a step backward. Consumers fled, and Vodafone ended up exiting Japan in 2006.

3.3.2 Dynamism in Japan's Telecommunications Industry

In entering and exiting, however, Vodafone provided new functions for the Japanese telecommunications market by facilitating dynamic changes of ownership for the first time. First, after initially purchasing Japan Telecom, Vodafone reorganized the company under a holding company, and sold off the landline business to Ripplewood, the US investment fund. Ripplewood then sold Japan Telecom to Softbank, an aggressive upstart firm which had brought Nasdaq into Japan as a joint venture, and purchased the failed Nippon Credit Bank (renamed Aozora). Ripplewood's profits were estimated at about 90 billion yen, and Japan Telecom's original are unlikely to have sold their shares directly to Softbank, often viewed by large established firms with suspicion.[71] When Vodafone exited Japan, Softbank purchased its cellular operations through the largest leveraged buyout Japan had seen until then. Softbank therefore became one of the three major Japanese cellular carriers through market mechanisms unavailable a few years earlier.[72]

In a similar move on a smaller scale, investment fund Carlyle purchased 60% of another Japanese wireless carrier, DDI pocket, in mid-2004.[73] After initial growth based on data services, the company, renamed Willcom, was outcompeted by other wireless carriers, ending up in bankruptcy in early 2010. Carlyle lost approximately $330 million,[74] but Softbank purchased the bankrupt company and refocused it on low cost voice communications, leading to another increase in subscribers. Softbank also gained access to precious wireless spectrum, which it can potentially use for other services.

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[71] For further details, see Kenji E. Kushida, "Leading Without Followers: How Politics and Market Dynamics Trapped Innovations in Japan's Domestic "Galapagos" Telecommunications Sector," *Journal of Industry, Competition and Trade* 11, no. 3 (2011).

[72] Vodafone's exit was not entirely a failure, since it raised a similar amount to what it had paid to enter and invest in its Japanese operations. Ibid.

[73] For details, see "Wireless Bound and Unbound: The Politics Shaping Cellular Markets in Japan and South Korea," *Journal of Information Technology and Politics* 5, no. 2 (2008).

[74] Alison Tudor, "Bankruptcy by Willcom stings Carlyle," *Wall Street Journal*, February 19 2010.

3.3.3 New Patterns of Government-Business Coordination: Suing the Government but Not Driven by Foreign Firms

Spearheading new patterns of government-business coordination, NTT's competitors and some foreign firms banded together to sue the ministry in charge of telecommunications – the first such lawsuit in the industry. Spearheaded by KDDI, the major competitor to NTT, the 2003 lawsuit was a signal designed to show the government the industry's willingness to use the judicial branch as an arena of policymaking.

Five telecommunications carriers, including KDDI, Japan Telecom, Poweredcom, Cable & Wireless IDC, and Fusion Communications, (of which Japan Telecom and Cable and Wireless IDC had foreign presidents) sued the Minister of MIC over the issue of interconnection fees charged by NTT for access to its network. The government had approved an increase of interconnection rates for the first time, and although the lawsuit was dismissed two years later, the industry participants considered it a success. MIC considered the possibility of lawsuits, constraining it from discretionary policymaking, and more importantly, it could avoid political intervention of the sort it was historically subject to by citing the possibility of such lawsuits.[75]

3.4 SUMMARY

Thus, in telecommunications, the traditional model of Japanese carriers and a closed set of equipment manufacturers shifted dramatically after regulatory changes of the mid-1990s. These regulatory changes were driven primarily by domestic regulatory preference changes. Foreign firms, previously kept out of infrastructure businesses, became major players. They contributed to new dynamics of competition in which firms could be bought and sold, with Vodafone's entry and exit resulting in a Japanese new entrant becoming the third largest telecommunications firm. Syncretism resulted, in which NTT retained a dominant market presence with a traditional organization, while its competitors, domestic and foreign, engaged in a variety of strategies though various organizational structures, forging new patterns of government-industry coordination.

[75] Personal Interviews, former MIC officials, KDDI executive. 2008, 2011, Tokyo and Stanford.

IV. Pharmaceuticals

In the pharmaceutical sector as well, *regulatory changes, driven by domestic politics, drove syncretism*, by shifting business models, government-industry coordination, intra-industry coordination, and by enabling foreign MNCs, which had a long historical presence in upstream activities, into the full range of activities in the industry.

The *traditional model* for most of the postwar period limited foreign firms to upstream activities—providing raw materials and licensing compounds.

Change was driven by regulatory shifts, some of it incrementally since the 1980s, but far more pronounced during the 1990s. The regulatory shifts during the 1990s were in response to political dynamics created by a series of scandals involving government ties to pharmaceutical firms and industry practices.[76] The regulatory shifts changed the dynamics of competition in the domestic market to foreign firms' favor.

The *syncretic model* became clear as foreign firms moved into the downstream activities of sales, marketing, distribution, and manufacturing. They brought globally developed products and employed professional workforces, many of the mid-career hires, becoming the largest pharmaceutical firms operating in Japan. They displaced major and medium-sized Japanese firms, most of whom depended on licenses or off-patent products, and who had to reconfigure their salesforces to comply with new regulations. Thus, new, old, and hybrid coexisted after the regulatory changes.

[76] This section draws heavily from Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Processes".

Figure 3: Syncretism in Japan’s Pharmaceuticals Sector

Traditional Model		**Change**		**Syncretic Model**
• Sector dominated by traditional “J firms” • F Firms restricted to upstream activity	→	Regulatory changes, driven by 1990s response to scandals, not MNCs	→	• Influx of Foreign firms • New business practices • New patterns of coordination • (corporate-doctor, clinical testing)

Foreign firms were interested in the Japanese market primarily for its size—second only to the US. The market size was larger than simple population or economic proportions vis-à-vis the US since the regulatory structure created strong incentives for doctors to prescribe relatively large quantities of pharmaceutical products. Direct institutional features and industry-level coordination were not primary considerations.

4.1 Historical Restrictions Limiting Foreign Participation to Upstream Activities

From the inception of Japan’s modern pharmaceutical sector, foreign firms were limited to upstream activities, providing new materials and licensing products to Japanese manufacturers.

In both the prewar and immediate postwar periods, acute shortages of foreign products upon which the nation depended led the government to orchestrate the entry of a large number of small-medium firms that imported bulk ingredients from foreign producers, combined them locally, and sold the resulting products in the domestic market. By the 1950s, they numbered over a thousand, with few possessing their own R&D capabilities.[77]

Japan’s pharmaceutical market was attractive for MNCs, growing rapidly from half a trillion yen in sales in 1965 to one trillion yen in 1970, quadrupling by 1980.[78] However, a

[77] Makoto Noguchi, *Yoku Wakaru Iyakuhin Gyokai [Understanding the Pharmaceutical Industry]* (Tokyo, Japan: Nihon Jitsugyo Shuppansha, 2003). 14-15.

variety of *regulatory restrictions* limited MNCs to upstream activities. From the 1950s through most of the 1960s, the Japanese government strategically leveraged regulations such as the Foreign Exchange Control Law to force MNCs to form (often multiple) joint ventures or licensing agreements for distribution and sales.[79] Foreign investment into Japanese pharmaceutical firms were prohibited until a 50% limit was set in 1967, raised to 100% in 1975. Until the 1980s, foreign MNCs were restricted from critical activities such as applying for clinical testing and manufacturing.

Industry dynamics also hindered foreign MNCs' operations in Japan. First, sales activities were highly labor intensive and time consuming. The healthcare delivery system of hospitals and clinics was highly fragmented, and pharmaceutical firms competed for procurement orders from doctors, who both prescribed and dispensed pharmaceuticals. Second, wholesale distribution networks were complex and fragmented. This mattered in providing volume discounts, since Japan's National Health Insurance (NHI) system set the prices for doctor's fees and retail prices of pharmaceuticals; wholesalers therefore sold discounted products to doctors, who could earn a "doctors' margin." Third, and arguably most critically, Japan's pre-clinical and clinical trials required proprietary procedures and data generated in Japan – a product of the Ministry of Health and Welfare (MHW)'s reaction to a major worldwide scandal in the 1960s (thalidomide creating birth defects) due to insufficient testing. MHW allocated clinical trials to prominent university professors, with which applicant firms had no direct formal contact. For further explanation or information concerning rejected applications, informal interpersonal networks were critical, pushing MNCs towards partnerships with Japanese firms.[80]

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[78] Robert Neimeth, "Japan's Pharmaceutical Industry: Postwar Evolution," in *The Changing economics of medical technology*, ed. Annetine Gelijns and Ethan A. Halm (Washington, D.C.: National Academy Press, 1991), 161.

[79] Pfizer entered by creating a joint venture with Tanabe in 1953, and with Daito in 1955. Ciba (now part of Novartis), which had been exporting to Japan from 1870 through the early 1900s through Takeda, entered in 1952.[79] Other entrants in the 1950s included Schering, Lederle, and Roussel, followed in the 1960s by Sandoz, Bristol Myers, Hoechst, and Merck.

[80] Nagami Kishi, *Gaishi kei Seiyaku Kigyou Gekidou no Jidai [The era of upheaval, Foreign Pharmaceutical Firms]* (Tokyo: Nihon Noritsu Kyoukai Manejimento Senta, 1996). 136-41.

4.2 Regulatory Changes Enabling the Surge of Foreign MNCs, Shifting Industry Dynamics

Regulatory shifts in the 1990s, reactions to scandals and some foreign pressure, led to greater formalization in the coordination between actors.

In the early 1990s, partly resulting from the US-Japan bilateral Structural Impediments Initiative talks, and directly following a Japan Fair Trade Commission ruling in 1992, pharmaceutical firms were prohibited from negotiating prices with doctors. Instead, wholesalers became exclusive price negotiators with doctors, dramatically reducing pharmaceutical firms' labor intensity in sales practices.[81] From around 1999, wholesaler networks became far simpler due to major consolidation as they faced increased price pressure, both as the negotiators of prices with doctors and hospitals, and after MHW's reimbursement price reductions of the 1990s.[82]

A major scandal in 1996 from informal government-business ties decreased the legitimacy of informal interpersonal networks. The scandal involved pharmaceutical firms with retired MHW bureaucrats in upper management using HIV-tainted blood for transfusions, despite the availability of treatment processes and internal MHW study group warnings.

Informal doctor-pharmaceutical firm ties were also professionalized. In 1997 the Japan Pharmaceutical Manufacturers' Industry Association (JPMA) implemented a standardized testing and accreditation system for sales forces, known as Medical Representatives (MRs). Following this, many university and general hospitals prohibited non-accredited salespeople from soliciting staff doctors. This benefitted MNCs, who did not have to invest in large general salesforces but could provide rapid specialist responses to doctors' queries.

Japan's clinical trials procedures shifted towards international standards from the 1980s, accelerating in the 1990s. A 1983 revision of the Pharmaceutical Affairs Law allowed foreign firms to apply for clinical testing directly. MOSS talks resulted in foreign pharmaceutical firms'

[81] Noguchi, *Yoku Wakaru Iyakuhin Gyokai [Understanding the Pharmaceutical Industry]*. 84-88.

[82] By 2007, the membership of the Japan Pharmaceutical Wholesalers Association shrank from 486 in 1985 to 129, and the 129 members were largely comprised of four major wholesalers and their subsidiaries. Ralph Paprzycki and Kyoji Fukao, *Foreign direct investment in Japan : multinationals' role in growth and globalization* (New York, NY: Cambridge University Press, 2008). 181.

ability to exit from existing partnerships with Japanese firms, facilitating their move downstream.[83]

Japan's involvement in the International Conference on Harmonization (ICH), founded in 1990 to standardize clinical testing, led considerably relaxed local data requirements.[84] Most notably, a 1998 reform enabled limited use of overseas clinical test results, spawning a market for outsourced overseas clinical testing.[85] A 2004 Pharmaceutical Law revision simplified clinical approval processes, further relaxing data requirements. Global-scale pharmaceutical MNCs benefitted the most.

From the 1980s, MHW began aggressively cutting pharmaceutical reimbursement prices, a result of Japan's broader healthcare politics. Put simply, the government wanted to cut healthcare expenditures but the doctor's association was too powerful to cut doctor's fees, leading the government to reduce reimbursement prices for pharmaceuticals.[86] With base prices at 100 in 1980, they fell to 53 in 1989.[87] MHW continued to lower prices, with decreases of 10% every year in 1996, 1997, and 1998, with another 7% in 1999, 6% in 2002, and 4% in 2004.[88] From 1996, as MHW reduced prices, it also began to significantly shift the relative

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[83] Aki Yoshikawa, "The Other Drug War: U.S.-Japan Trade in Pharmaceutical," *California Management Review* 31, no. 2 (1989): 83.

[84] ICH brought together the industry associations and regulatory agencies of pharmaceutical manufacturers from Europe, the US, and Japan. Members include the EU, the European Federation of Pharmaceutical Industries and Associations (EFPIA), the US Food and Drug Administration (FDA), the Pharmaceutical Research and Manufacturers of America (PhRMA), Japan's Ministry of Health, Labor, and Welfare (MHLW), and the Japan Pharmaceutical Manufacturers Association (JPMA).

[85] Contract Research Organizations (CROs) after the 2005 Pharmaceutical Law revision. Sales of the industry totaled 15.6 billion yen in 2000, employing approximately 1700 people, growing four-fold to 61 billion yen sales in 2004 with almost 5700 employees, and reaching 113 billion yen by 2009 with almost ten thousand employees. (See Table 27). With the proportion of foreign firms employing CROs almost constant at approximately 30%, the rapid growth of this industry represents a major reduction in the internal organizational investments necessary for foreign firms to engage in the clinical testing procedures.

[86] For details, see Kushida 2010, John Creighton Campbell and Naoki Ikegami, *The art of balance in health policy : maintaining Japan's low-cost, egalitarian system* (Cambridge ; New York: Cambridge University Press, 1998). 108-11.

[87] Neimeth, "Japan's Pharmaceutical Industry: Postwar Evolution," 161.

[88] TDB, *TDB Report: Gyoukai Doukou 2000-2 [TDB Report: Industry Developments 2000-2]* (Tokyo, Japan: Teikoku Data Bank, 2000). 209; *TDB Report: Gyoukai Doukou 2003-1 [TDB Report: Industry Developments 2003-1]* (Tokyo, Japan: Teikoku Data Bank, 2003). 223; *TDB Report: Gyoukai Doukou 2005-1 [TDB Report: Industry Developments 2005-1]* (Tokyo, Japan: Teikoku Data Bank, 2005). 225.

weight, reducing the prices of older products, and “knock-offs.” more rapidly. This favored MNCs who tended to have newer products, and hurt small-medium Japanese pharmaceutical firms with few R&D resources which had been protected by high reimbursement prices even after their patents had expired.[89] Although foreign MNCs had been advocated for these regulatory changes for decades, the timing was determined by domestic politics.

4.2.1 The Surge of Foreign MNCs: Moving Downstream

By the late 1990s, the dynamics of competition within Japan’s domestic pharmaceutical sector – pricing, sales and distribution, and clinical testing – had shifted significantly, facilitating the expansion of multinationals into the downstream activities of sales and distribution.

Global mergers occurred through the 1990s, widening the gap in scale between Japanese firms and global MNCs. By 2001, the global sales and R&D capabilities of the largest multinationals, such as Pfizer, Glaxo SmithKline, and Merck, dwarfed that of major Japanese firms – to say nothing of medium-sized Japanese firms.

Foreign MNCs surged into the Japanese market through several means. First, they exited historical partnerships, a movement that accelerated in the late 1990s. For example, in 1985, Ciba-Geigy, which had been contracting sales to Takeda and Fujisawa, began selling independently. Also in the 1980s, Bayer separated from Takeda, Sund from Sankyo, and SmithKline Beecham from Fujisawa. By the early 2000s, most foreign firms had shifted to selling their own products themselves.[90] The dissolution of partnerships was highly detrimental to medium sized firms. For example, in 1998, after Pharmacia dissolved its partnership with Sumitomo Seiyaku, the latter’s sales dropped by a quarter the following year.[91]

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[89] For example, Eizai and Daiichi Tanabe relied on older products for almost 40% of their sales, Chugai for 30%. For mid-sized firms Mochida, Kyorin, and Kissei, reliance on older products was above 70%. By the mid-2000s, the prices for generics and other knock-offs were reduced to 15 to 70 percent of the original product, averaging about 50%. Paprzycki and Fukao, *Foreign direct investment in Japan : multinationals' role in growth and globalization*. 177.

[90] Noguchi, *Yoku Wakaru Iyakuhin Gyokai [Understanding the Pharmaceutical Industry]*. 46-47.

[91] "Gaishikei ga tainichi kousei wo kakeru iyakuhin bijinesu gekihen no shougeki [The shock to pharmaceutical businesses caused by foreign firms on the offensive in Japan]," *Shukan Daiamondo* 2002.

Second, MNCs expanded their salesforces through mid-career and new hires. For example, between 2000 and 2001, Pfizer hired over 600 people, followed by another 600 in 2002. Many of these new employees were mid-career hires from Japanese pharmaceutical firms.[92] In a stark contrast to the entire history of the industry until the late 1990s, by 2000, foreign firms sported the largest presence of salespeople in the industry. In 2000, the size of sales forces representing Pfizer, Merck, Glaxo SmithKline, Novartis, and Astra Zenaka equaled or exceeded that of the largest Japanese firms, Takeda, Sankyo, and Yamanouchi. (See Table 29)

Table 1. Number of Salespeople ("MR"s), Top Foreign and Japanese Pharmaceutical Firms

Top Foreign Firms	**MRs**	**Top Japanese Firms**	**MRs**
Pfizer	1700	Takeda	1350
Banyu (Merck)	1476	Sankyo	1240
Glaxo SmithKline	1300	Yamanouchi	1300
Novartis	1300		
Astra Zeneca	1300		
Beringer Ingelheim	600		
Pharmacia	700		

Adapted from "Gaishikei Ga Tainichi Kousei Wo Kakeru Iyakuhin Bijinesu Gekihen No Shougeki [the Shock to Pharmaceutical Businesses Caused by Foreign Firms on the Offensive in Japan]." *Shukan Daiamondo*, 2002, 52-54. Citing Japan Pharmaceuticals Manufacturing Association.

Third, foreign MNCs acquired numerous medium-sized firms to gain domestic salesforces and wholesale distributions networks. The earliest such move was Merck's purchase of Banyu in 1983, but the wave of major buyouts begin in 1998, such as Beolinger Ingelheim's purchase of SS Pharmaceutical and Roche's purchase of Chugai. These were not bailouts, since the Japanese firms sported reasonably strong sales and wholesale networks, but

92 "Nippon Kouryaku Faizaa Hahiru: MR tsugitsugi hikinuki, uriagedaka mokuhyou kokunai toppu [Pfizer rushes to capture Japan, hires away MRs, aims for top sales in the domestic market]," *Nikkei Sangyo Shimbun*, June 11 2002.

were relatively weak in R&D. In several cases, such as relatively strong Banyu and Chugai, MNCs did not replace top management, instead granting relative autonomy. (See Table 31)

Table 2. M&A Activity in Pharmaceuticals

	Multinational Firm	Japanese M&A Target
1983	Merck	Banyu
1998	BASF (Germany)	Hokuriku Seiyaku
	Akzo Nobel (Netherlands)	Kanebo's Pharma divison
2000	UCB (Belgium)	Fujirebio
	Boelinger Ingelheim (Germany)	SS Pharmaceutical
2001	Schering (Germany)	Mitsui Pharmaceutical
	Abbott Laboratories (US)	BASF/Hokuriku Seiyaku
2002	Roche	Chugai

SUMMARY

In pharmaceuticals, the traditional model of limited foreign MNCs to upstream activities eroded over time, but accelerated in the 1990s, driven by domestic political and bureaucratic scandals. Many of the regulatory shifts, such as globalizing clinical testing procedures, were results advocated by foreign MNCs for years, but the timing was shaped by domestic political factors.

The new, syncretic model was shaped by foreign MNCs expanding their operations in Japan through various means to become among the largest players, coexisting with traditional Japanese large and small-medium pharmaceutical firms who still depended on traditional business models, lacking R&D capabilities.

V. Automobiles

In the automobiles sector, regulatory changes enabled foreign entry since the 1980s, but market crises among Japanese manufacturers in the late 1990s facilitated a major influx of foreign MNCs.

The *traditional model* consisted of MITI's infant industry protection measures that restricted inward FDI and imports, promoting domestic firms. Regulatory *changes* reduced formal barriers to entry to foreign firms, leading to some early tie-ups.

The *syncretic model* developed as troubled Japanese firms entered into major tieups with foreign firms, receiving capital infusions and ceding management control. Some of the new foreign management significantly restructured existing organizations and business models.

Figure 4: Syncretism in Japan's Automobile Sector

Traditional Model		**Change**		**Syncretic Model**
• Sector dominated by traditional "J firms" • Strategic closure • followed by J-firm competitiveness	→	Market opportunities for foreign firms through J Firm performance crisis (Not regulatory changes driven by MNCs)	→	• Influx of Foreign firms • New business practices • New patterns of coordination

THE TRADITIONAL MODEL: STRATEGICALLY CLOSED INDUSTRY

The heyday of MITI's industrial policy towards the Japanese automobile industry began in the late 1940s, lasting until around 1970. Japan's prewar automobile industry had been dominated by Ford and GM, and in the immediate postwar period, the Japanese government had rescued domestic firms teetering on collapse.[93]

[93] Despite some internal dispute, MITI carried the day, and the government offered direct support through the BOJ and bank loans from the Japan Development Bank (JDB) and the Industrial Bank of Japan (IBJ). Nissan, Toyota, and Isuzu survived only with this support. Michael A. Cusumano, *The Japanese automobile industry : technology and management at Nissan and Toyota* (Cambridge, Mass.: Council on East Asian Studies, Harvard University Press, 1985). 19.

MITI's segmented the market, protected it from foreign imports and FDI, and nurtured Japanese firms.[94] MITI did, however, facilitate tie-ups between Japanese and foreign firms for technology transfers.[95]

5.1 Regulatory Reforms Enabling Foreign Entry, but J Firms Outcompete

Trade pressure from the US government in the 1960s, mobilized by the US "Big Three" auto firms, reduced the Japanese government's explicit protections on the domestic market. In 1970, foreign equity investment ceilings were lifted, and foreign firms rushed into capital tieups with Japanese firms. In 1970, Chrysler was involved in creating Mitsubishi Motors as a joint venture with Mitsubishi Heavy Industries, contributing 15%. In 1971, GM purchased 34.1% of Isuzu, which was facing financial collapse. In 1979, Ford acquired 24.5% of Mazda after the latter was rescued by its main bank, Sumitomo Bank, and return to profitability in 1976.

However, the Big Three failed to gain substantial market shares in Japan. They pointed to non-tariff barriers – which existed to some degree. At the same time, however, Japanese pointed out that while large American cars were popular as status symbols, many of the American small-medium cars suffered quality problems through the 1980s, and lacked many of the mass-market features optimized for Japanese parking and driving conditions (folding side mirrors, for example).

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[94] MITI segmented the market through automobile manufacturing licenses, foreign exchange allocations, and set import taxes to restrict imports. MITI privileged the "Big 5" domestic auto companies including Nissan, Toyota, and Isuzu, Hino Motors, and Mitsubishi Heavy Industries. A second set of manufacturers specializing in small cars and three-wheeled vehicles – Toyo Kogyo (later to become Mazda), Daihatsu, Fuji Heavy Industries (later to become Subaru), Suzuki, and Mitsubishi – received less support. Akira Kawahara, *The origin of competitive strength : fifty years of the auto industry in Japan and the U.S* (Tokyo ; New York: Springer, 1998). 9-10; ibid.

[95] Tie-ups included: Nissan with the British firm Austin in 1952, and in the following year, Isuzu with Rootes, another British firm, Hino with Renault, and Mitsubishi with Willy-Overland, an American firm. All four tie-up contracts prohibited the Japanese partner from exporting their cars. Three of the four contracts ended in 1960 (1958 for Mitsubishi), though some were extended; the tieup lasted 7 years for Nissan, 12 years for Isuzu after an extension, 11 years for Hino after an extension, and 10 years for Mitsubishi after an extension. Toyota was the only Big 5 manufacturers that chose to avoid a partnership.

5.2 THE SYNCRETIC MODEL: J FIRM MANAGEMENT CRISES DRIVE FOREIGN ENTRY OPPORTUNITIES, RESTRUCTURING

Market developments took a dramatic turn in the mid to late 1990s, leading to a major foreign influx. As economic stagnation slowed automobile market growth and the high yen hurt profitability of exports, several firms faced financial crises. Foreign auto firms entered Japan to a degree unthinkable a decade earlier to turn around major Japanese auto firms. Three major tie-ups, between Renault and Nissan, Ford and Mazda, and DaimlerChrysler and Mitsubishi Motors, led to different degrees of restructuring mechanisms of coordination.

5.2.1 Renault and Nissan: The Paradigmatic Revival

Nissan's turnaround under the management control of Renault was dramatic, following Renault's 1999 purchase of a 37% stake in Nissan for approximately $5.4 billion.

By the late 1990s, Nissan teetered on the edge of bankruptcy due to factors including aggressive product and dealer expansion in the US, miscalculations of dealer valuation in the US, poor differentiation among its products, high debt, and damage inflicted by depreciation of the yen. It incurred losses for six of the seven years until 1998.[96] Its main banks, Fuji Bank and Industrial Bank of Japan, themselves facing mountains of non-performing loans, rejected potential bailouts. Following unsuccessful talks with DaimlerChrysler and Ford, Nissan negotiated with Renault, which was willing inject massive capital injection in return for complete management control. Renault sent Carlos Ghosn, a Brazilian born Frenchman of Lebanese descent, who became Nissan's president in 2000 and CEO in 2001.

Ghosn restructured Nissan extensively. Supplier chains were reorganized with suppliers reduced from 1145 in 2000 to 595 in 2002. Nissan closed a major manufacturing plant, working with unions to offer early retirement or transfers to other plants. The entire Nissan group workforce was reduced by approximately 15,000 people, and the company poached a chief designer from Isuzu –an unprecedented move in the Japanese auto industry. Nissan also

[96] Daniel Arturo Heller, "An Inquiry into the Role of Interfirm Relationships in Recent Organizational Change Initiatives in Japanese Automobile Firms," *Shinshu Daigaku Keizaigaku Ron Shuu [Shinshuu University Economic Review]*, no. 49 (2003).

sold assets such as real estate to repay its debts. By sharing product development elements like vehicle platforms with Renault and combining purchasing operations, Nissan reduced its procurement costs by 20%. In overseas operations, Renault and Nissan shared plants. In 2002, Nissan reached its performance targets a year early, becoming profitable and eliminate ing interest-bearing debts. Overall, Ghosn enacted dramatic but successful reforms without resorting to mass layoffs.

5.2.2 Ford and Mazda: A Major Turnaround Under the Radar

In 1996, Ford expanded its tie-up with Mazda, strengthening its management control. By the mid-1990s, Mazda faced a crisis due to factors including dealer overexpansion and a lack of hit products. Mazda logged operating losses for three consecutive years from 1993 to 1996. Sumitomo Bank, its main bank which had brought Mazda and Ford together in the past, once again called upon Ford, inviting it to examine Mazda's books in late 1993.[97] Ford doubled its executives in Mazda's board, increased its stake to 33% (for an estimated $480 million) in 1996, appointing a Ford executive as Mazda's CEO—the first Japanese auto firm to do so. Several other Ford executives and groups of midlevel engineers and managers were also dispatched.

Restructuring at Mazda, though extensive, was less dramatic than at Nissan. Mazda's production plans were frozen and examined by Ford-dispatched management, subsidiaries were reduced by half between 1999 and 2000 (34 to 17), and cost cutting measures such as expense reductions and exchange rate exposure hedges were pursued. Mazda rebranded itself, internal divisions were reorganized, and a major voluntary retirement program led to a reduction of over 2000 personnel. The reform had the dramatic slogan "change or die," and English was adopted as the primary internal language for top-level meetings. In 2002, numerous new products were released, returning the firm to profitability.[98] In the meantime, Ford learned aspects of supplier management, particularly in quality and delivery from Mazda.[99]

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[97] "The Rebirth of Mazda Under Ford's Shadow," in *The second automobile revolution : trajectories of the world carmakers in the 21st century*
ed. Michel Freyssenet (Basingstoke: Palgrave Macmillan, 2009).

5.2.3 DaimlerChrysler and Mitsubishi Motors: Difficulty and Failure

Not all foreign management takeovers of Japanese auto firms were successful, however. DaimlerChrysler (the result of a de facto acquisition of Chrysler by Daimler in 1998) purchased a controlling 33.4% stake of Mitsbishi Motors, also in crisis in 2000.

In stark contrast with Renault's management team, the DaimlerChrysler executives failed to stage a dramatic turnaround of Mitsubishi Motors. It incurred losses in 2003, and in the following year a major scandal erupted upon the revelation that Mitsubishi Motors management had been covering up serious defects for over a decade. Refusing Mitsubishi's request for a new capital injection, DaimlerChrysler divested itself in 2005. As part of the exit deal, it acquired 85% of Mitsubishi's truck division, spinning it out as Mitsubishi Fuso Truck and Bus.[100]

5.2.4 New Patterns of Inter-firm Coordination: A Market for Japanese Auto Firms

The entry of MNCs facilitated the reorganization of the sector, entailing a marketization of firms – in the sense that they can be bought, split apart, and sold – more than ever before. As Nissan divested itself of its keiretsu relationships, it sold Nissan Diesel, a trucking company, to Volvo. In 2007, the latter made the truck company into a wholly owned subsidiary, paying just over $1 billion.

The sudden exit of GM from its investments in Japanese firms created shockwaves in the sector, especially among firms into which the company had invested. GM's exit

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[98] "An Inquiry into the Role of Interfirm Relationships in Recent Organizational Change Initiatives in Japanese Automobile Firms."; "The Rebirth of Mazda Under Ford's Shadow."

[99] James R. Lincoln and Michael L. Gerlach, *Japan's network economy : a structure, persistence, and change*, Structural analysis in the social sciences (Cambridge (England) ; New York, N.Y.: Cambridge University Press, 2004). 337.

[100] Holm-Detlev Kohler, "From the Marriage in Heaven to the Divorce on Earth: the DaimlerChrysler Trajectory since the Merger," in *The second automobile revolution : trajectories of the world carmakers in the 21st century*, ed. Michel Freyssenet (Basingstoke: Palgrave Macmillan, 2009).

demonstrated how factors relatively unrelated to the Japanese market could precipitate major exogenous shifts in MNCs' strategies in Japan. In the mid to late 2000s, facing higher gas prices and a collapse in demand for its core revenue-driving large vehicles, GM confronted a financial crisis. As its need to raise operating capital became acute, in 2005, The following year, GM sold its entire 49% stake in Isuzu – a stake it had held since 1999 when it raised it level of ownership. Also in 2006, , selling of the remaining shares in 2008.

GM's sudden exit from its Japanese investments and partnership in 2005 and 2006, as it faced its own crisis, led to a realignment of capital holdings and relationships among Japanese auto firms. Toyota purchased a large proportion of GM's stake in Fuji Heavy Industries, GM suddenly sold off all of its shares of Fuji Heavy Industries (Subaru), much to the surprise and shock of the latter. Toyota cultivated deep production ties with Subaru. Toyota also became a major shareholder of Isuzu after GM sold its 49% stake in 2005, integrating many of its operations with Toyota's Hino truck division. After GM lowered its 20% stake in Suzuki to 3% in 2006 (selling off the rest in 2008), Suzuki entered into a partnership with Volkswagen, receiving a 20% investment in early 2010.

5.3 Summary

In automobiles, unlike the other sectors, regulatory shifts alone did not precipitate an immediately influx of foreign firms. Only in the 1990s, when firms face serious financial crisis, did foreign firms enter dramatically. While strong firms, mainly Toyota, retained its traditional J-firm organization as a competitive strengths, those taken over by foreign firms – particularly Nissan – restructured extensively and introduced new practices and organizational structures, taking a syncretic form.

Conclusion

An analysis of the sectors that received the largest influxes of foreign direct investment shows clearly that foreign *MNCs were drivers of syncretism in Japan's political economy*. While this chapter is necessarily a truncated view of a more detailed study, it still clearly shows that many MNCs introduced new norms, practices, and organizations into a variety of sectors.

These sectors experienced an influx of the new, some residual old, and hybridization as many of the older players adjusted.

Major regulatory shifts provided the opportunities for new business models and organizational structures. Yet, in contrast to the VoC hypotheses generated by Hall and Soskice, *foreign MNCs, though benefitting most from the reforms, were not the primary drivers.* In most cases, the influx followed the regulatory shifts, and foreign MNCs already with presences in Japan did not push hard for change. Regulatory change was driven by domestic political dynamics, most specific to each sector.

In addition, in contrast to the VoC hypothesis about the movement of MNCs, *foreign MNCs did not enter Japan to take advantage of Japan's traditional "comparative institutional advantages."* Instead, in most cases it was the new regulatory structures that enabled a new set of competitive dynamics, which were attractive to MNCs. In several sectors such as finance and pharmaceutical, the foreign MNCs could introduce global products and services into the Japanese market in ways that they could not before, giving them competitive advantages in Japan. Their success contributed to the syncretic model, as many Japanese competitors were forced to adjust at adapt to some degree, resulting in a far more diverse picture than ever before.

Table 1. Inward Direct Investment (MOF data) (100 million yen)

FY	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Food	4	3	77	0	0	-	-	-	-	-	0	-	0	69	-	-
Textile	-	2	-	-	-	1	22	-	-	-	-	-	-	-	-	0
Rubber&Leather	-	1	0	-	-	-	1	-	-	8	-	-	-	-	-	-
Chemical	9	52	203	64	37	42	61	23	91	22	472	361	317	2,560	46	30
Metal	3	30	1	1	5	0	0	229	3	-	10	-	-	91	3	-
Machinery	103	116	63	107	69	45	12	1	356	369	109	353	66	435	494	28
Petroleum	7	45	29	51	52	139	10	24	26	4	4	2	9	15	101	38
Glass&Ceramics	1	7	1	-	-	-	0	-	-	-	-	-	-	-	-	-
others	7	19	81	33	2	9	0	3	8	29	6	10	44	22	21	0
Manufacturing Total	134	275	455	256	165	236	107	280	483	431	601	726	436	3,192	666	96
Telecommunication	3	1	4	0	2	3	4	4	-	32	61	7,025	11	523	374	2,208
Construction	1	8	18	-	1	-	-	-	-	-	-	0	-	0	5	5
Trading	157	73	93	116	189	43	105	508	86	65	77	753	78	632	65	31
Finance&Insurance	12	19	1	25	-	10	0	40	102	870	614	2,356	1,371	254	2,216	2,018
Service	32	122	290	28	27	26	16	81	78	318	226	541	631	837	152	198
Transportation	2	9	0	3	0	0	0	0	-	0	-	7	-	2	-	2
Real Estate	31	2	2	1	5	0	0	86	6	1	35	3	108	0	117	35
others	8	7	4	0	4	1	1	0	86	12	0	0	2	-	0	3
Non-Manufacturing Total	246	241	411	173	228	83	126	720	360	1,298	1,013	10,687	2,202	2,248	2,929	4,501
TOTAL	380	515	865	429	393	320	233	1,000	843	1,729	1,615	11,413	2,638	5,439	3,596	4,597

Source: Ministry of Finance

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