

A Clash of Capitalisms: Foreign Shareholders and Corporate Restructuring in 1990s Japan

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This article examines the clash between stakeholder- and shareholder-based business systems resulting from an increase in foreign portfolio investment in the Japanese economy during the 1990s. An analysis of 1,108 firms between 1991 and 2000 shows that as foreign institutional investors, who were more interested in investment returns than in long-term relationships, replaced domestic shareholders, one fundamental pillar of Japan's stakeholder capitalism began to crack. Japanese firms began to adopt downsizing and asset divestiture, practices more characteristic of Anglo-American shareholder economies. The influence of foreigners, however, was weaker in firms more deeply embedded in the local system through close ties to domestic financial institutions and corporate groups. Thus, foreign investors were influential primarily in firms less embedded in the existing stakeholder system. This research contributes to debates on globalization and convergence of business systems, institutional change, and corporate governance systems.

The impact of global markets for capital, products, labor, and information on national economic systems ranks among the most hotly debated issues in the social sciences today (Guillen 2001b). Whereas a long tradition of research has predicted an increasing similarity of organizational forms, business practices, and market structures in the face of advancing tech-

nology and intensifying competitive pressures (Bell 1973; Coffee 2000; Kerr et al. 1964), some scholars have highlighted the improbability of such convergence. They argue that a nation's economic structure is the product of a set of complementary institutions including the state, the financial infrastructure, and the social system, and that, consequently, business systems vary widely across the globe (Guillen 2001a; Hall and Soskice 2001; Hamilton and Biggart 1988; Hollingsworth, Schmitter, and Streeck 1994; Whitley 1992).

One of the sharpest distinctions among business systems is between the market, or shareholder, economies of the Anglo-American countries and the coordinated, or stakeholder, economies typified by Germany and Japan (Albert 1993; Hall and Soskice 2001; Streeck and Yamamura 2001). At the core of this distinction are different systems of corporate finance and corporate ownership. The Anglo-American system is based on dispersed shareholders and equity-based finance. In contrast, stakeholder systems feature debt financing, concentrated shareholders, and tightly interconnected networks among firms, their trading partners, and financial institutions. These different financial systems are closely linked to

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differences in employment policies and firm strategies. The Anglo-American system features liquid labor markets, an external market for skills, and an emphasis on profitability over growth, whereas stakeholder systems are built around internal labor markets, firm-specific skills, and an emphasis on growth over profits.

In the early 1990s, increasing globalization of capital began to undermine the very foundations of the stakeholder systems. Institutional investors, in other words, managers of public and private pension funds, insurance companies, mutual funds, and university and other endowments, especially from the Anglo-American economies, looked beyond their own national borders for investment opportunities (Useem 1998). Between 1990 and 1998, Americans increased their holdings of foreign shares from \$197.3 million to \$1.4 trillion (Steinmetz 1999). During this same period, foreign ownership in Japanese stocks increased from about 5 to 10 percent of the total market value of all publicly listed shares, and continued to increase to almost 20 percent by 2001, according to the Tokyo Stock Exchange (2002). Concurrently, the strong banking systems that supported stakeholder systems declined. Large firms moved from bank debt to capital markets. In Japan, a banking crisis weakened the banks, causing them to sell off large portions of their holdings of firm shares (Hoshi and Kashyap 2001), whereas in Germany, leading banks shifted their strategies from relationship banking toward investment banking and capital markets.

This globalization of investment capital brought shareholder and stakeholder systems of capitalism into direct contact. What was the result of this interaction? The Economist (2001), a strong proponent of shareholder capitalism, proclaimed the end of stakeholder capitalism: "The [German and Japanese] model is itself quietly being dismantled. For as an equity culture has spread in Germany, France, and even in Japan and Italy, these countries have been inexorably evolving in an American direction." Financial economists argued that this trend reflected the greater efficiency of the Anglo-American system. With increasing globalization of financial markets, firms and nations could no longer afford to maintain what they saw as outdated and inferior stakeholder systems (Rajan and Zingales 2003; see Coffee 2000 for an

extensive review of this "strong convergence" perspective).

Other researchers, in contrast, argued that the superiority of the shareholder system was far from clear, and even if it were, change was not so easy. Business systems consist of tightly linked, complementary institutions, and a change in one part of the system does not mean wholesale transformation (Aoki 2001; Hall and Soskice 2001). Shared notions of legitimate behavior and powerful actors who are likely to resist change promote stability (DiMaggio and Powell 1983; Fligstein 2001). Yet, it is difficult to believe that foreign capital has had no influence. With their growing investments abroad, foreign institutional investors have become important actors in stakeholder systems, and firms with foreign shareholders simultaneously confront two systems of business. How have they responded? This article explores this question in a study of 1,108 Japanese firms listed publicly from 1991 and 2000. We examine the effect of foreign ownership on downsizing and asset divestiture, and assess how embeddedness in the existing system, as measured by ownership by Japanese financial institutions and corporate groups, moderated this effect. Although our methodology is primarily quantitative, we supplement the quantitative analyses with some interview data. One of the authors conducted interviews with approximately 50 corporate executives, institutional investors, and government officials in Japan between 2000 and 2002, as part of a larger project on corporate governance reform and change in Japan.

The general outline of our argument is as follows. The interests of shareholders vary across business systems. In stakeholder systems such as Japan, shareholders tend to have other interests above and beyond their equity investment, such as maintaining ongoing business relationships. In shareholder systems, shareholders care primarily about the return on their investment. When these shareholders invest in a stakeholder system, their interests clash with those of existing shareholders, and provided they have the mechanisms to do so, they try to influence firm behavior to their own benefit. The influence of these foreign shareholders, however, depends on a firm's embeddedness in the existing system: the more it is embedded, the more able it will be to resist foreign influence.

Japan is a particularly suitable setting for research on the confrontation between two business systems, both because the Japanese system contrasted so sharply with the Anglo-American system and because the influence of foreign investors increased dramatically during the 1990s. Downsizing and asset divestiture, the focus of this article, represent major points of contention between Japanese and Anglo-American systems. In Japan, the company was considered a community, with long-term employment and increasing opportunities for core employees as a primary objective (Dore 1973). In contrast, downsizing in the United States was seen as a legitimate means for delivering value to shareholders (Budros 1997). Japanese firms valued growth over profitability or share price (Abegglen and Stalk 1985), whereas U.S. firms in the 1980s and 1990s showed increasing willingness to sell and reconfigure assets to improve return to shareholders (Davis, Diekmann, and Tinsley 1994).

In their study of downsizing in a sample of Japanese firms between 1990 and 1997, Ahmadjian and Robinson (2001) found a positive and significant main effect of foreign ownership and downsizing, although the significance level dropped when interactions between size and population downsizing were included (as they were in the models presented in this article). This article goes beyond this previous research by analyzing the conditions under which foreign owners were influential, by examining the effects of interactions between foreign ownership and financial and group membership, and by exploring in greater detail the interests of foreign investors and the means by which they exercised their influence.

Although our research is set in Japan, it has implications for a broader understanding of institutional change. Whereas researchers have emphasized distinctions between business systems and the patterns through which these systems evolved, they have had less to say about the mechanisms by which business systems change. Further development of theory on business systems requires attention to potential mechanisms of change as well as inertial points of continuity. By investigating how global capital affects firm behavior, this article contributes to this agenda.

BACKGROUND AND THEORY

Our argument rests on the fundamental notion that a national economy is a configuration of actors—the state, corporate elites, labor, capital—whose interests and preferences are shaped by and in turn shape both formal rules and informal norms (Aguilera and Jackson 2003; Fligstein 1990; Hall and Soskice 2001; Streeck and Yamamura 2001). Some scholars have catalogued the rich diversity of systems of capitalism in industrialized economies and examined the processes by which divergent political systems, institutional structures, and idiosyncratic paths of development have led to distinct systems of employment, industrial organization, and corporate governance (Guillen 2001a; Hall and Soskice 2001; Whitley 1992). Others have examined how institutions shape the regulatory framework within which political and economic actors operate (North 1990), how power and politics determine these rules (Roe 1994; Thelen and Steinmo 1992), and how ideology and taken-for-granted notions of legitimacy influence interests and behavior (Fligstein 1990; DiMaggio and Powell 1983; Dobbin 1994).

Researchers on comparative business systems offer two explanations for why, even in the face of increasingly intertwined global markets for products, capital, labor, and ideas, the likelihood that business systems will converge is low. First, they argue that there is no one best way to organize an economy. Instead, different business systems have different comparative advantages. Guillen (2001a), for example, illustrated how particular configurations of actors and institutions combined with distinctive trajectories of development have resulted in different areas of specialization in South Korea, Argentina, and Spain. Hall and Soskice (2001) argued that American shareholder capitalism and the stakeholder economies of Japan and Germany have encouraged different types of innovation.

Researchers further argue that change within a business system is determined by existing institutions, and hence follows a path-dependent course of evolution. Powerful actors, who have shaped institutions to advance their own interests, are likely to resist change (Bebchuk and Roe 1999; Fligstein 2001). Ideologies of capitalism and widely held notions of the legitimate way to organize an economy determine

how actors structure rules, build organizations, and conduct business (Biggart and Guillen 1999; Dobbin 1994). Business systems also are marked by institutional complementarities, and hence, changing any one part of the system without changing others may result in declining performance, if not wholesale disaster (Aoki 2001).

Evidence from the United States, however, indicates that radical change can and does happen, even in the face of entrenched interests, shared ideologies, and normative assumptions and rules. Fligstein (1990) documented how conceptions of control, or conceptions of legitimate and appropriate objectives, interests, and practices of the firm, shifted dramatically several times over the history of U.S. industrialization. He argued that such change is best understood through a "political-cultural" approach, in which new actors, or newly powerful actors, reshape the rules and assumptions on which an economy is based to promote their own interests further. Davis and Thompson (1994) further described how new actors, in the form of institutional investors, spearheaded a social movement that changed the conception of the firm to an entity owned by shareholders and solely devoted to the mantra of "maximizing shareholder value."

We believe that the globalization of financial markets and the increasing propensity of institutional investors to invest in distant economies can similarly be understood as a political process by which new actors with very different interests and incentives enter an economy. To assess the influence of these new actors, however, it is necessary to look not only at their direct effect, but also at how they interacted with the existing system. We argue that the interests of foreign institutional investors were largely defined by the United States, or more broadly, the Anglo-American system of capitalism. Foreign influence was weaker, however, the more deeply a firm was embedded in the Japanese system through ties to financial institutions and business groups. Before we turn to our hypotheses and empirical analyses, we highlight differences between the Japanese and U.S. systems, noting how interests of shareholders were defined, and how these interests were associated with different business practices.

THE JAPANESE SYSTEM

In Japan, a range of stakeholders, including employees, banks, customers, suppliers, and shareholders, influenced firm behavior. In the late 1980s, banks and other financial institutions held about 40 percent of publicly listed shares, whereas corporations held about 25 percent (Tokyo Stock Exchange 2002). Although ownership concentration was not as high as in some other Asian and European countries (La Porta et al. 1998), related firms, often members of the same business group, held significant blocks of a firm's shares. Thus, although law forbade any single bank from holding a stake greater than 5 percent, banks could combine with other financial institutions, including trust banks and life insurance companies, to ensure that shares remained in friendly hands. These shareholders used their stakes to cement long-term relationships and to support ongoing business transactions such as the supply of parts and materials or commercial banking relationships (Gerlach 1992; Gilson and Roe 1993). With shareholders concerned about long-term relationships, firms developed and implemented strategy based on long-term goals, seeking to maximize market share and growth rather than profits or share price (Abegglen and Stalk 1985).

This system of corporate ownership supported the permanent employment system. In postwar Japan, large firms ensured their male employees a career with the same firm (or a closely related subsidiary) until retirement.¹ This system arose as a response to serious labor strife during the early postwar years, in which management exchanged an assurance of long-term employment and steadily rising wages for cooperative labor relations (Gordon 1985; Kume 1998).

Strong norms against downsizing persisted throughout the postwar era (Usui and Colignon 1996). Both management and labor acknowledged that permanent employment was one cornerstone of the rapid and stable growth of the Japanese economy, a belief that found support in the research of academics seeking to explain

¹ There is debate as to whether permanent employment existed in smaller firms (Cole 1979). Permanent employment was definitely a feature of the listed firms in our empirical sample.

the “Japanese miracle” (Aoki 1990; Dore 1973). Senior managers, who usually were promoted from the ranks of employees after a long career at the same firm, were loath to make decisions that would cost jobs. For them, dismissing employees was an emotional issue. When Yamaichi Securities was dissolved in 1997 because of trading improprieties and off-balance-sheet losses, president Nozawa Shohei burst into tears at a press conference. Later he explained: “I couldn’t help but cry when I thought about the future of our 7,600 employees and their families. Suddenly, they lost their jobs” (Yamamoto 1999).

The media and popular opinion also enforced norms against downsizing. The press reserved harsh criticism for firms that tried to cut employment without due cause of declining performance and imminent corporate failure (Ahmadjian and Robinson 2001). In 1993, Pioneer received negative publicity for trying to implement an early retirement program. When Carlos Ghosn, dispatched by Renault to turn around Nissan, announced factory closings, Japan’s prime minister criticized his policies.

Japanese firms also were hesitant to sell off assets. With the historical emphasis on growth, the idea of casting off parts of the company to raise cash and improve return on investment was an unfamiliar and questionable business practice. In 2004, Kanebo abandoned the planned sale of its cosmetics division to Kao because labor and management were concerned that it would result in the loss of jobs and weaken the remaining company. Nissan’s closing of its Zama plant in 1995 was the object of much anguish, not because of job losses to factory employees (who would be transferred elsewhere), but because closing a plant with such a long and proud history was so drastic. An official of a Japanese manufacturer acquired by a foreign company told us that one of the first decisions of the foreigners was to sell company-owned resort properties (used by management for leisure and entertaining). He said that he was surprised by this action because it had never occurred to the Japanese management.

The Japanese stakeholder system enabled these norms against downsizing and divestiture. The main holders of corporate shares—banks, insurance companies, and other corporations—were primarily concerned about a firm’s ability to borrow money and repay

loans, to provide a steady stream of commercial banking and insurance business, and to be a steady supplier of parts or a purchaser of finished products. Notions of profitability were less important, unless extremely low performance threatened a firm’s existence. Accounting regulations also meant that Japanese corporate and financial shareholders did not need to be concerned about the value of their shareholdings. Until the late 1990s, firms reported the shareholdings at purchase value, meaning that there were no adverse consequences to holding shares of a company that was declining in value.

THE U.S. SYSTEM

In contrast to Japan, the United States was a shareholder system in which shareholding was a vehicle for investment rather than a means by which stakeholders cemented ongoing business relationships. By the 1990s, the American system had been indelibly influenced by the rise of institutional investors: pension funds, mutual funds, insurance companies, and other fund managers (Useem 1996). In 1985, institutional investors owned about 43 percent of the shares of the 1,000 largest U.S. companies, whereas individuals owned 57 percent. By 1997, institutions owned 60 percent and individuals owned only 40 percent (Useem 1996). The United Kingdom experienced a similar increase in equity investment by institutions.

Institutional investors brought a distinct ideology, described by Useem (1996) as “investor capitalism,” and by Fligstein (2001) as the “shareholder value conception of control.” The fundamental notion behind this ideology was that the main objective of the firm was to “maximize shareholder value,” implying that shareholders were the owners of the firm, and that firms existed to deliver a return in investment to shareholders.

The rise of institutional investors coincided with increased influence by financial economists and the agency theory of corporate control. This theory held that shareholders were the ultimate owners of the firm, and that managers, as agents of the shareholders, had to be carefully watched and disciplined (Davis and Thompson 1994; Fligstein 2001). “Maximizing shareholder value” became the mantra taught in business schools and adopted by institutional investors and the business press.

With their relatively high stakes in firms and resources to launch activist campaigns, institutional investors had greater power than individuals to influence firms, and they did so, working to remove CEOs from leading firms such as IBM and GM (Useem 1996).² Managers quickly realized that they had to subscribe to this ideology of shareholder value or lose their jobs (Davis and Thompson 1994). Furthermore, the rise of stock options, with their stated objective of aligning the interests of managers and shareholders and their actual effect of inflating executive compensation to record levels, made “maximizing shareholder value” a very lucrative pursuit for corporate executives.

It is important to note, however, that “maximizing shareholder value” was not merely an ideology, but a reflection of very real incentives of institutional investors and the regulatory framework under which they operated. Pension fund managers in the United States were subject to laws regarding fiduciary duty, and could be sued if they were perceived as not acting in the interests of their beneficiaries. Fund managers unable to “beat the market” and provide superior returns to their shareholders were likely to lose their jobs or experience a severe drop in compensation.

In practice, the notion of “maximizing shareholder value” was translated into a set of practices widely seen as being in the best interests of shareholders. One was the breakup of conglomerates and the pursuit of “focus” (Davis et al. 1994). Another was downsizing. Budros (1997:23) showed that the downsizing rate among the Fortune 100 firms in the United States increased from less than 5 percent in 1979 to more than 40 percent in 1994, and continued to spread even as the U.S. economy recovered from the downturn of the 1980s. The notion that downsizing was the key to increasing shareholder value became so deeply entrenched that downsizing continued to spread even as evidence accumulated that it did not improve performance (Budros 1997). Firms that downsized

often were rewarded by the stock market. For example, when Xerox in 1993 announced a 10 percent downsizing as part of a long-term strategic reorientation, its shares increased by 7 percent (Wharton Center for Leadership and Change Management 2004).

FOREIGN INSTITUTIONAL INVESTORS COME TO JAPAN

In the 1990s, institutional investors increasingly added international stocks to their portfolios to diversify risk and take advantage of growth in foreign markets. Significant amounts of this investment went to Japan. Between 1990 and 2000, foreign ownership of Japanese shares increased from 4.2 to 13.2 percent of all listed shares. These investors were almost all U.S. or European, and of the European investors, British funds were predominant (Shirota 2002). In the second half of the 1990s, American money poured into Japan at an increasing rate as investors redirected their investments from Europe to Japan and Asia (Shirota 2002:47). We examined the top 10 shareholders of each firm in our sample, and found that they were overwhelmingly United States or United Kingdom based. Other foreign investors included offshore funds (Bermuda) and German funds (e.g., from Deutsche Bank, which was increasingly adopting Anglo-American practices). Even these non-U.S. investors had interests consistent with the shareholder system—to diversify their portfolios and maximize investment returns.

Foreign investors in Japan were predominantly institutions adding Japanese shares to their global portfolios (Tiberghien 2002). Foreign direct investment, defined as holding shares in a firm for strategic purposes such as establishing a manufacturing facility or securing distribution channels, was insignificant in comparison. In 2000, foreign direct investment in Japan was 1.1 percent of the gross domestic product (GDP), as compared with 27.9 percent in the United States, 32.4 percent in the United Kingdom, and 22.4 percent in Germany (American Chamber of Commerce in Japan 2003:2).

Foreign investors encountered a troubled Japanese economy. During the 1990s, the average return on equity among Japanese firms lagged behind that of U.S. firms, and by the end of the decade, approached zero. During the

² Although their shareholdings were more concentrated than those of individuals, institutions held relatively small blocks of shares, making ownership in the United States more concentrated than in the past, yet far less concentrated than in economies such as that of Germany.

overheated late 1980s, firms had overinvested in real estate and production capacity, exacerbating already low levels of productivity across many industries. McKinsey and Company estimated that Japan's overall productivity of capital was 60 percent that of the United States, whereas productivity of labor was about 70 percent (McKinsey Global Institute 2000), and it was estimated that Japanese firms had up to 6 million excess employees (Eisenstodt 1995). Yet, although there was a growing consensus among managers that firms had excess employment and assets, norms against downsizing remained strong.

The increase in foreign ownership of Japanese shares was matched by a decrease in ownership by domestic financial institutions. The precipitous drop in stock and land prices in the early 1990s had left Japanese banks with a huge burden of bad debt. Life insurance companies suffered from their high exposure to banks (they were among the major holders of bank shares) and were unable to make enough money through their investments to cover their insurance contracts. Financial institutions began selling their shareholdings to realize unrealized gains and streamlining their stock portfolios in response to changes in accounting regulations (Okabe 2002).³ The percentage of shares in listed companies held by financial institutions decreased from 45.2 percent in 1990 to 37 percent in 2000, whereas the percentage held by business companies decreased from 25.2 to 22.3 percent of listed shares.

Foreign institutional investors saw the problem as a failure by executives to manage corporations in the interests of shareholders. In particular, they criticized the reluctance of Japanese firms to restructure to improve their return on equity. The California public employee pension (CalPERS) fund recommendations for Japan (1998) captured this view: "In order to attract new investors, particularly from overseas, Japanese corporations will need to demonstrate that corporate assets are being managed

in the interests of the company and its owners, not in the interests of a select group of shareholders or stakeholders." According to a report by Bank of Japan economists (Takahashi and Oyama 2000:12), "Increasing influence of foreign investors, who generally set higher required rates of return than do domestic investors, have urged Japanese companies to improve their return on capital (e.g., ROE/EVA) and encouraged them to carry out restructuring such as reinforcing business portfolios and/or liquidating low-profitability assets" (see also Tiberghien 2002).

INFLUENCE OF FOREIGN INVESTORS

Foreign shareholders used both exit and voice to make their interests clear to management. The threat of exit by foreigners was particularly salient. Foreigners had an inordinate influence on share prices because they were much more active in buying and selling shares than Japanese investors, and Japanese investors often followed their moves in and out of stocks (Tiberghien 2002; authors' interviews). Whereas foreigners held about 10 percent of publicly traded shares in 1996, their share of stock transactions was about 30 percent, increasing to nearly 40 percent in 1999 (Tokyo Stock Exchange 2002), and thus, their influence exceeded their actual levels of shareholdings. Foreigners were net buyers of stock each year from 1991 to 1999, except for 1998 (Takahashi 2000). In contrast, Japanese financial institutions were net sellers of shares during this period, whereas corporate shareholdings tended to be stable. Foreigners were known for pulling out of a stock very quickly when they were unhappy. For example, foreign ownership of NTT plummeted from 31.84 percent in March 2003 to 14.2 percent in September of the same year (Shirota 2002:54).

Whereas share price had not been a main focus of attention for Japanese managers in earlier years of the postwar period, by the 1990s it was gaining attention. Senior managers were aware of their company's share price, although they may not have looked at it daily (Learmount 2002). Firms whose share price dipped too low (100 yen was a sign of serious trouble) were criticized in the business press. Managers considered their share price a source of pride, and wanted to make sure it surpassed that of their

³ Because shareholding was reported at purchase value, many Japanese banks could realize significant gains by selling stock. Changes in accounting regulations in the late 1990s to require the reporting of shareholdings at market value led banks and firms to reevaluate and streamline their stock holdings further.

competitors. Share price was linked also to the ability to raise capital as firms, beginning in the 1980s, increasingly turned to equity-linked finance such as convertible bonds and bonds with warrants (Hoshi and Kashyap 2001:240). Although equity-linked finance had slowed down in the 1990s, a declining dependence on bank loans meant that companies were seeking other forms of finance linked to capital markets rather than close banking relationships.

Managers also were concerned about takeovers. Although hostile takeovers were still rare, there was nevertheless a concern that Japanese firms would soon find themselves on the receiving end of a hostile bid. During the 1990s, mergers and acquisitions (M&A) increased considerably (JETRO 1998), and policymakers signaled that they would no longer stand in the way of foreign acquisition of Japanese firms. According to a report by the Japan Investment Council (1996), a Cabinet-level study group, "the Japan Investment Council welcomes M&A in Japan, and declares that it will spare no effort in helping foreign companies with M&A." Such statements caused rising concern among Japanese firms. The head of investor relations at a major Japanese firm told one of the authors that fear of hostile takeover led it on a program of restructuring and reform in its organizational structure and corporate governance. Toyota increased its equity stakes in affiliated suppliers to keep their shares out of the hands of foreigners who might sell out to the highest bidder in the event of a takeover bid (Shirouzu 1999).

Foreigners also exercised influence through voice. Senior Japanese managers met with foreign funds and learned of their concerns firsthand. A former manager in a foreign investment firm noted that Japanese managers had become more aware of what foreigners wanted: "When they see foreign ownership on their share register moving from 5 percent to 10 percent to 20 percent, they feel a strong psychological pressure to pay attention to corporate governance." Japanese executives that we interviewed were acutely aware of the proportion of their shares held by foreigners, and were increasingly making decisions with foreigners in mind. They suggested that executives of firms with high levels of foreign ownership (and weaker ties to financial institutions and business groups) felt

a far greater sense of urgency when it came to making restructuring decisions.

Executives and fund managers interviewed made it clear that, in contrast to foreign investors, Japanese pension funds, trust banks, insurance companies, and other institutional investors remained silent. Some attributed this to a cultural hesitance of Japanese analysts and fund managers to criticize a company president, and a status hierarchy in which company presidents were more likely to listen to (Caucasian) foreigners than to Japanese. Others argued that Japanese fund managers were not knowledgeable enough to evaluate and comment on a firm's performance. One government official suggested that domestic fund managers simply "had other things to do" because they were too busy dealing with problems of the banking crisis (failing insurance companies, underfunded pensions, and integration difficulties in a spate of bank and insurance company mergers) to be active investors.

Japanese institutional investors also were less likely to exercise exit or voice because they had very different interests than foreigners and very different relationships with the companies whose shares they held. Trust banks, usually close affiliates of commercial banks, were unlikely to do anything to undermine the banks' interests. Pension funds were hesitant to make demands on suppliers or customers. For example, the pension fund of an auto manufacturer would not want to be seen demanding layoffs from a steel company with which it had a long-term transaction relationship. Life insurance companies, among the largest shareholders in the Japanese economy, tended to make money by selling insurance to employees of corporations in which they had ownership stakes. Banks were also unlikely to promote restructuring actively. A senior executive of a major bank during this period described this attitude: "Bankers usually try hard to avoid any drastic divestiture on the part of the clients at the expense of the bank's own profit because banks should be socially responsible beings." Foreign investors, less embedded in the Japanese economy, and already possessing a reputation of being cold and calculating in business relationships, had less to lose in demanding restructuring.

EMBEDDEDNESS IN THE EXISTING SYSTEM

Foreign investors encountered an intact, albeit troubled, business system. Although financial institutions were selling shares, their stake in corporations remained high. In 2000, banks still held 37 percent of publicly traded shares (Tokyo Stock Exchange 2002). They tended to sell shares of companies with which they had distant relationships, while maintaining stakes in firms with which they had close business dealings (Learmount 2002). Although the media touted the decline of business groups, the actual situation was less clear: some groups weakened, but others did not (Lincoln and Gerlach 2004).

There are a number of reasons why firms more deeply embedded in the Japanese system could resist the influence of foreign shareholders. Firms whose shares were held by financial institutions and fellow members of business groups had a cushion of stable shareholders who would not sell their shares, and who could be enticed to purchase more shares if necessary, thus ensuring protection against takeovers and precipitous drops in share price. These local investors also were likely to vote against proposals by foreigners. This tendency was seen in 2002, when M&A Consulting, a Japanese activist investment fund, purchased an 11.9 percent stake in a medium-sized clothing manufacturer, Tokyo Style, and demanded that it pay investors a 500-yen dividend, buy back its shares, and appoint two independent directors. The proposal was defeated, as friendly banks and affiliated companies such as Nippon Life and the department store Isetan came to Tokyo Style's aid (Singer 2002), voting against an immediate return on their investments in favor of maintaining long-term relationships. Nippon Life saw Tokyo Style primarily as a customer for its pension products (Nikkei Weekly 2002), and Isetan was focused on maintaining relationships with an important vendor.

Firms deeply embedded in the existing system also felt less pressure to make abrupt cuts in employees or assets because they were assured of funding despite poor performance (Hoshi and Kashyap 2001). The advantage of close relationships with Japanese institutions can be seen in the contrasting fates of retailers Sogo and Daiei. In 2000, Sogo was forced to declare bankruptcy when its leading bank, Shinsei (owned by a U.S. private equity firm),

refused to forgive its loans. In contrast, Daiei, owned by Japanese financial institutions and other domestic companies, received a series of large bailouts, until its lead bank, UFJ, was itself on the verge of bankruptcy.

Business groups also buffered firms from needing to take dramatic steps to restructure, with high performers tending to subsidize low performers (Lincoln, Gerlach, and Ahmadjian 1996). Affiliation with business groups may explain the very different degrees of success at restructuring in the auto industry. In 1999, Renault purchased a controlling stake in Nissan, which lacked close affiliation with a business group, whereas Daimler Chrysler purchased a controlling stake in Mitsubishi, a member of the Mitsubishi group. The Nissan restructuring was rapid and successful, whereas Mitsubishi's efforts ended in disaster, with legal action over cover-ups of defects and continuing financial problems. Observers suggested that Mitsubishi's tight ties with the Mitsubishi group made it less intent on restructuring, and indeed, after Daimler Chrysler decided to sell off its stake, Mitsubishi group members were there to pick up the pieces. The Phoenix Fund, run by an ex-employee of Tokyo Mitsubishi Bank, and widely acknowledged to be an arm of the bank, purchased Daimler's stake, and the combined holdings of Tokyo Mitsubishi Bank and the Phoenix Fund made the Mitsubishi group the *de facto* owner.

HYPOTHESES

Our argument, in summary, is that the increase in foreign institutional investors in Japan led to a "clash of capitalisms." Foreign investors entered Japan with an ideology of U.S. investor capitalism, in which maximizing shareholder value was the ultimate goal of the firm, and downsizing and divestiture of assets were appropriate and necessary means to that end. They were bound to their own investors, who were concerned about quarterly returns on their portfolios, and were willing and able to invest their money where those returns were greatest. On the other hand, local shareholders, still bound in stakeholder capitalism, saw their shareholding stakes as a means to cement long-term relationships. We predict that the degree to which foreign investors were able to influence Japanese firms depended on the interaction between the two systems: when ownership by financial

institutions was high, or a firm was a member of a business group, Japanese firms were better able to resist the influence of foreigners.

We test this argument in an analysis of two practices: downsizing and asset divestiture. Both forms of restructuring were considered effective strategies for "maximizing shareholder value" in the U.S. system of shareholder capitalism. In the stakeholder system of Japan, in contrast, these practices were disapproved because they threatened the livelihood of key stakeholders, especially employees. Our argument revolves particularly around the interaction between foreign ownership and measures of embeddedness in the existing system, namely ownership by domestic financial institutions and membership in business groups. We predict that the effect of foreign ownership will be felt most strongly in firms that are not members of business groups, and firms that have lower levels of financial ownership. Our analyses test the following hypotheses:

Hypothesis 1: The greater the percentage of a firm's shares held by foreign investors, the more likely it is to downsize or divest assets.

Hypothesis 2: The greater the percentage of a firm's shares held by domestic financial institutions, the weaker the relationship between foreign ownership and downsizing or asset divestiture.

Hypothesis 3: The relationship between foreign ownership and downsizing or asset divestiture is weaker in members of business groups.

DATA AND METHODS

The data set consisted of observations on 1,108 nonfinancial companies publicly listed on the first section of the Tokyo Stock Exchange, spanning the years 1991 to 2000. We included only firms publicly listed in all years of this period, omitting nine firms listed in 1990, but subsequently exited from the sample. Because only a very small percentage of the firms in the sample exited during this period, selection bias was unlikely to be a problem. We also eliminated 13 firms in which a single foreign corporation had a controlling stake (no firms had controlling stakes by foreign institutional investors). In firms controlled by foreigners, the foreign owner has the last word, and the interaction between

financial and foreign shareholders is likely to be irrelevant. We further eliminated 142 firms in which another Japanese corporation had a controlling stake because these are not independent firms. (We estimated our models on the full sample as well, and found that excluding these firms had virtually no effect on the outcomes of interest.)

DEPENDENT VARIABLES

We obtained data for all variables from the Nikkei NEEDS database. This provided financial data from securities filings for listed Japanese firms. We analyzed two measures of downsizing. The first was a dichotomous variable equal to 1 when a firm decreased its number of permanent employees by 5 percent or more between year t and year $t-1$. Five percent represents a substantial cut in the labor force, large enough to be more than a random fluctuation or gradual adjustment in employment level. In additional analyses, we measured downsizing as decreases of 10 percent or more. We chose a discrete rather than a continuous measure of employment reduction because the discrete measure captures large changes in employment.

We measured asset divestiture in a similar way: as decreases in total tangible fixed assets greater than 5 and 10 percent between year $t-1$ and year t .

INDEPENDENT VARIABLES

Foreign ownership is the percentage of total shares outstanding held by non-Japanese investors. The data source did not specify whether a foreign investor was an individual, an institution, or a nonfinancial corporation.

Financial ownership is the percentage of shares outstanding held by Japanese banks, trust banks, and insurance companies. Although we could not distinguish between each type of financial institution, they had very similar interests. Trust banks and insurance companies tend to be closely related to banks. Trust banks are owned by banks, and insurance companies are owners of banks and firms.

Group membership took the value of 1 when a firm was a member of the presidents' council of the Sumitomo, Mitsubishi, Mitsui, Fuyo, Sanwa, or DKB groups (Gerlach 1992).

CONTROL VARIABLES

We measured performance in three ways. Return on assets, or profits before taxes divided by total assets (*keijyō rieki* in Japanese), has been used to measure corporate performance in numerous analyses of Japanese firm performance (Kaplan 1994; Lincoln et al. 1996; Nakatani 1984). Because Japanese managers also valued growth as an important corporate objective and performance metric (Abegglen and Stalk 1985), we included annual change in sales between year $t-1$ and year t . Because repeated negative profitability is a particularly strong signal of poor performance to Japanese managers, we also included a dummy variable that equaled 2 when a firm experienced two consecutive periods of negative profits (and 1 when it experienced 1 year of negative profits in the previous 2 years).

We included dummy variables for each of 18 two-digit industries. We also included the log of age in 1990 and the log of total assets. In analyses of divestiture, we controlled for capital intensity, tangible fixed assets divided by employees. We controlled for export intensity, with exports divided by sales.

In their study of downsizing among Japanese firms, Ahmadjian and Robinson (2001) found that to avoid negative publicity, firms sought “safety in numbers,” and larger, more prestigious firms waited until other firms downsized first. To control for this we added population downsizing (the cumulative number of downsizing events in the population from 1991 to $t-1$) and interactions between this variable and age, size, and wages, as measured by labor costs divided by the total number of employees. We followed a similar procedure for our analysis of divestiture.

ANALYTICAL APPROACH

We used discrete-time event history methodology (Allison 1984; Yamaguchi 1991), using a random-effects probit model to estimate the hazard of a downsizing or of divestiture events in a given year for a pooled sample of each firm observed during each of the 10 years. The discrete-time model is appropriate when information on the exact timing of an event is not available and multiple organizations report the same event as occurring at the same time (i.e., in the same year). In most cases, discrete and

continuous time models produce similar results (Allison 1984).

Because downsizing and divestiture were repeated events, and because different propensities to downsize (or divest) may be attributable to unmeasured firm-specific factors, statistical tests of resulting coefficient estimates could be inaccurate. Therefore, it is important to control for unobserved heterogeneity between firms. Following the recommendation of Allison (1984), we included the cumulative number of times each firm downsized (divested) from 1991 to $t-1$ as a variable representing cumulative firm experience in 5 percent downsizing (divestiture). We estimated the models using a random-effects procedure (xtprobit in STATA). We were unable to use a fixed-effects model: a large percentage of the firms in the sample never had a downsizing (divestiture) event, and these firms would be omitted in a fixed-effects analysis. Probit analyses with robust standard errors (White 1980) were virtually identical to the random-effects probit model (available from the authors). The robust estimator obtains consistent standard errors even when the correlation structure assumed by a probit model is violated, allowing us to relax the assumption that observations of the same firm were uncorrelated across time.

FINDINGS

Figure 1 shows rates of downsizing over time, and Figure 2 shows rates of asset divestiture (see Table 1 on our *ASR* Online Supplement for descriptive statistics for all variables). Whereas the mean of foreign ownership across all periods and across all firms is relatively low, the range is very broad. In our sample, 2,391 of 11,088 observations showed foreign ownership exceeding 10 percent. By 2000, foreign portfolio investors held more than 30 percent of the shares in at least 50 Tokyo Stock Exchange First Section firms (data available from the authors). Zero-order correlations are available in Table 2 of our *ASR* Online Supplement. These show no zero-order correlation between foreign or financial ownership and the four dependent variables (5 and 10 percent downsizing and 5 and 10 percent divestiture). As the multivariate analyses show, the effect of foreign ownership on downsizing and divestiture is conditional on financial ownership.

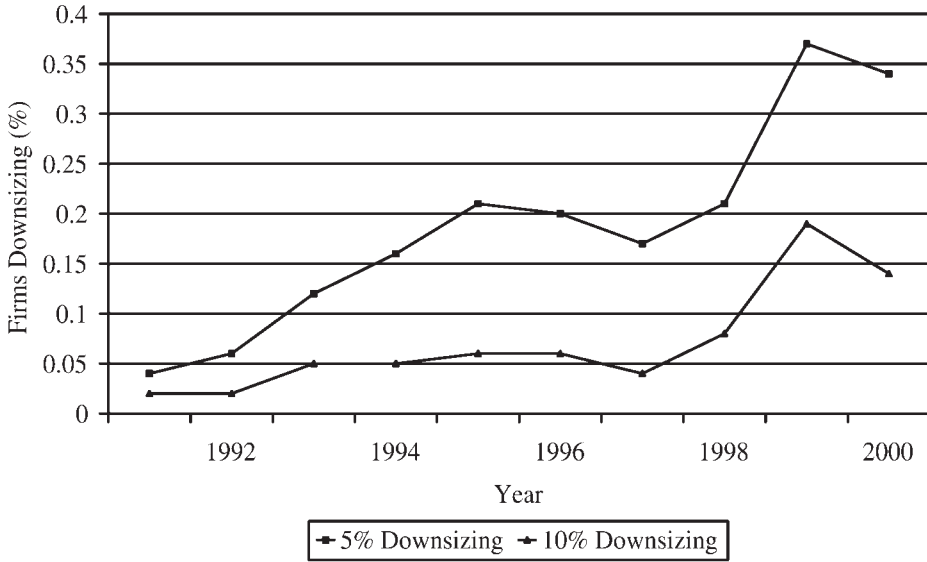


Figure 1. Percentage of Firms Downsizing in a Given Year, 1991–2000

Table 1 reports discrete event time series analyses for downsizings of 5 percent or more. Model 1 includes firm characteristics, industry dummies, previous firm experience in downsizing, and population downsizing interacted with various firm characteristics. It indicates that

downsizing became increasingly prevalent over time and was strongly related to return on assets, sales growth, and negative profits in previous years. Larger, older, and higher wage firms were less likely to downsize at first, but their propensity to downsize increased over time.

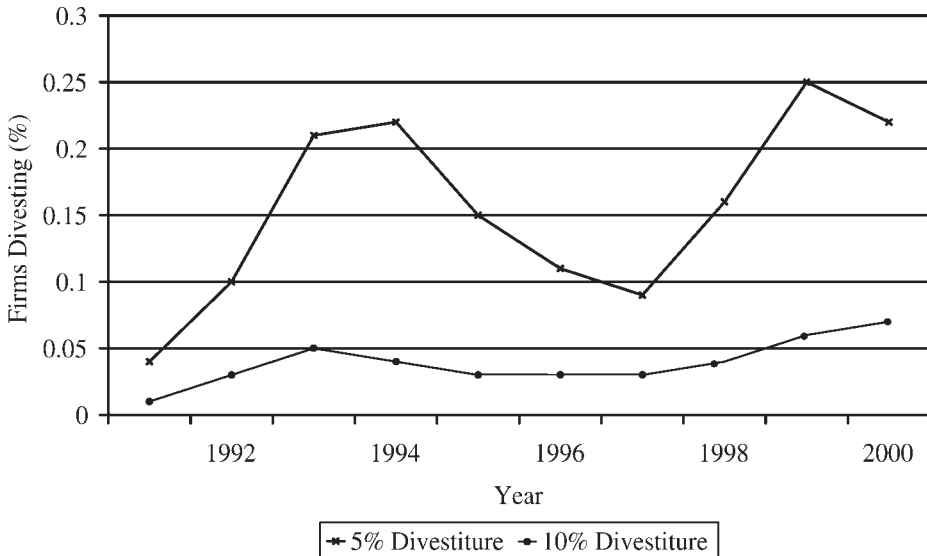


Figure 2. Percentage of Firms Divesting Tangible Fixed Assets in a Given Year, 1991–2000

Table 1. Downsizings of Five Percent or More in 1,108 Firms, 1991 to 2000

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
Year	.130*** (.029)	.135*** (.029)	.140*** (.030)	.137*** (.031)	.140*** (.030)
Return on assets (t-1)	-6.397*** (.519)	-6.281*** (.536)	-6.118*** (.540)	-6.339*** (1.437)	-6.181*** (.541)
% Change in sales (t-1)	-.758*** (.105)	-.759*** (.106)	-.767*** (.106)	-.758*** (.198)	-.764*** (.106)
Negative profits in year t-1 and year t-2	.307*** (.036)	.308*** (.037)	.307*** (.037)	.306*** (.062)	.306*** (.037)
Log assets (t-1)	-.030 (.022)	-.030 (.024)	-.030 (.024)	-.035 (.027)	-.034 (.024)
Firm age in 1990	-.218* (.090)	-.183* (.093)	-.208* (.094)	-.194* (.110)	-.212* (.094)
Wage (deviation from industry mean) (t-1)	-.030 (.016)	-.027 (.017)	-.029 (.017)	-.027 (.018)	-.028 (.017)
Exports/sales (t-1)	.030 (.127)	.060 (.128)	.081 (.129)	.042 (.135)	.067 (.129)
Cumulative firm experience in 5% downsizings, 1991 to t-1	.360*** (.028)	.354*** (.029)	.358*** (.029)	.354*** (.030)	.357*** (.029)
Cumulative firm experience in 5% downsizings, squared	-.040*** (.006)	-.039*** (.006)	-.040*** (.006)	-.040*** (.006)	-.040*** (.006)
Population downsizing (cumulative total from 1991)	-.002*** (.0004)	-.002** (.0004)	-.002*** (.0004)	-.002*** (.0004)	-.002*** (.0003)
Log assets * population downsizing	.0001** (.00002)	.0001** (.00002)	.0001*** (.00002)	.0001*** (.00002)	.0001*** (.00002)
Age * Population downsizing	.0003*** (.0001)	.0003*** (.0001)	.0003*** (.0001)	.0003*** (.0001)	.0003*** (.0001)
Wage * Population downsizing	3.94e-06 (.00001)	3.86e-06 (.00001)	4.62e-06 (.00001)	3.84e-06 (.00001)	4.48e-06 (.00001)
% Shares held by foreigners (t-1)		-.157 (.260)	1.561** (.562)	.050 (.303)	1.470** (.564)
% Shares held by financial institutions (t-1)		-.258 (.136)	.044 (.161)	-.268* (.148)	-.005 (.164)
1 = Member of big six group		.130* (.054)	.137* (.054)	.296*** (.079)	.252** (.084)
% Foreign ownership * % Financial ownership			-5.320*** (1.524)		-4.588** (1.576)
% Foreign ownership * Member of big six group				-1.956** (.734)	-1.371 (.778)
Constant	-.357 (.420)	-.441 (.448)	-.456 (.449)	-.349 (.539)	-.390 (.450)
Log likelihood	-4326.58	-4321.76	-4315.49	-4318.25	-4313.91

Note: Random effects probit coefficients with standard errors shown in parentheses; 18 dummy variables for industry significant, not reported.

* $p < .05$; ** $p < .01$; *** $p < .001$ (two-tailed tests).

The interaction between wages and population downsizing was not significant, although it was in the predicted direction.

Model 2 includes the percentages of shares held by foreigners and financial institutions and group membership. In this model, the main effects of foreign and financial ownership on

downsizing were not significant. The estimate of big six membership was positive and significant.

In Model 3, the interaction between foreign and financial ownership was negative and significant, supporting Hypothesis 2. In the presence of this interaction the main effect of foreign

ownership became positive and significant, consistent with Hypothesis 1. The absence of a significant main effect of foreign ownership in models wherein the interaction between foreign and financial ownership was not included indicates that the influence of foreigners was conditional on the degree of financial ownership. At mean levels of financial ownership (about 37 percent), foreigners were unable to exert influence. This further supports our argument that firms with higher levels of ownership by domestic financial institutions were able to resist the influence of foreigners.⁴

The interaction between group membership and foreign ownership, shown in Model 4, was negative and significant, supporting Hypothesis 3. Model 5 includes both interaction terms. The significance of the interaction between group and foreign ownership declined, but remained at the 5 percent level in a one-tailed test, which is appropriate because the hypothesis is directional. The positive and significant main effect of group is puzzling, because it suggests that whereas groups suppressed foreign influence, they promoted downsizing. However, closer consideration shows that this may not be so surprising. Big six groups have long used their close ties to redistribute profits to protect poor-performing members (Lincoln et al. 1996), and groups may use these ties and cooperative relationships to facilitate downsizing. A group member may be more likely to restructure if it knows that it can send its excess employees to another group member, or that it can sell underutilized assets to group members.

We conducted similar analyses for downsizings of 10 percent or more (see Table 3 on our *ASR* Online Supplement). The results are similar to those for 5 percent downsizings.

⁴ The main effect of foreign ownership in Ahmadjian and Robinson (2001) was positive and marginally significant without the interaction between foreign and financial ownership. The difference between the analyses may be due to differences in the samples. The current article analyzes all nonbanking firms on the first section of the Tokyo Stock Exchange, whereas the 2001 article examined mostly manufacturing firms on any Japanese stock exchange over a shorter period. In the current article, a higher average level of financial ownership may be suppressing the main effect of foreign ownership in the absence of the interaction term.

Table 2 presents analyses for divestitures of 5 percent. As in the case of downsizing, the propensity to divest assets increased over time. Firms divested assets in response to poor performance. Larger firms were less likely to divest at first, but the propensity to divest increased with population divestiture rates. Supporting Hypotheses 1 and 2, the interaction between foreign and financial ownership was negative and significant, and in the presence of this interaction, the main effect of foreign ownership was positive and significant. Contrary to Hypothesis 3, group membership did not decrease the relationship between foreign ownership and divestiture.

The results for the effect that foreign and financial ownership had on 10 percent divestiture were similar to those for 5 percent divestiture (see Table 4 on our *ASR* Online Supplement). The interaction between foreign ownership and group, however, was not significant, although it had the predicted sign.

Figure 3 graphs the probability of downsizing at different levels of financial and foreign ownership, holding other variables at their means. In a firm with no financial ownership, an increase in foreign ownership from 0 to 60 percent increases the probability of downsizing from 15 to 45 percent. In a firm with 22 percent financial ownership (one standard deviation below the mean), a similar increase in foreign ownership increases the probability of downsizing from 15 to about 20 percent. At 34 percent financial ownership, a level at which a single shareholder gains de facto control through veto power over board decisions, increased foreign ownership has no effect on downsizing. Figure 4 shows a similar pattern for asset divestiture.

ALTERNATIVE EXPLANATIONS

There are several alternative explanations for the relationship between foreign ownership and restructuring. According to one explanation, firms that restructured subsequently attracted foreign investment. To explore this possibility, we compared the increase in foreign ownership from year *t* to year *t*+2 for the entire sample and the subsample of firms that had downsized in the previous period (results available from the authors). There was no significant difference in the increase in foreign ownership between the

Table 2. Divestitures of Five Percent of 1,108 firms, 1991 to 2000

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
Year	.430*** (.050)	.430*** (.050)	.434*** (.050)	.430*** (.050)	.434*** (.050)
Return on assets (t-1)	-4.558*** (.486)	-4.545*** (.502)	-4.385*** (.505)	-4.548*** (.502)	-4.363*** (.506)
% Change in sales (t-1)	-.688*** (.104)	-.688*** (.105)	-.691*** (.105)	-.688*** (.105)	-.692*** (.105)
Negative profits in year t-1 and year t-2	.219*** (.036)	.219*** (.037)	.220*** (.037)	.219*** (.037)	.220*** (.037)
Log assets (t-1)	-.104*** (.024)	-.100*** (.026)	-.101*** (.026)	-.101*** (.026)	-.099*** (.026)
Firm age in 1990	-.134 (.096)	-.127 (.100)	-.160 (.100)	-.127 (.100)	-.160 (.100)
Capital intensity (t-1)	-.0006* (.0003)	-.0006* (.0003)	-.0006* (.0003)	-.0006* (.0003)	-.0006 (.0003)
Exports/sales (t-1)	.184 (.120)	.184 (.122)	.207 (.122)	.183 (.122)	.212 (.122)
Cumulative firm experience in 5% divestitures, 1991 to t-1	.350*** (.031)	.350*** (.031)	.351*** (.031)	.349*** (.031)	.352*** (.031)
Cumulative firm experience in 5% divestitures, squared	-.039*** (.007)	-.039*** (.007)	-.039*** (.007)	-.039*** (.007)	-.039*** (.007)
Population divestitures (cumulative total from 1991)	-.003*** (.0004)	-.003*** (.0004)	-.003*** (.0004)	-.003*** (.0004)	-.003*** (.0005)
Log assets * population divestitures	.0001*** (.00002)	.0001*** (.00002)	.0001*** (.00002)	.0001*** (.00002)	.0001*** (.00002)
Age * population divestitures	-.00002 (.0001)	-.00002 (.0001)	.00001 (.0001)	-.00002 (.0001)	.00001 (.0001)
% Shares held by foreigners (t-1)		-.023 (.263)	1.836** (.564)	-.011 (.272)	1.878** (.567)
% Shares held by financial institutions (t-1)		-.031 (.136)	.286 (.161)	-.032 (.136)	.305 (.163)
1 = member of big six group		-.021 (.058)	-.014 (.058)	-.009 (.088)	-.067 (.089)
% Foreign ownership * % Financial ownership			-5.700*** (1.522)		-6.010*** (1.573)
% Foreign ownership * Member of big six group				-.138 (.780)	.642 (.808)
Constant	-.453 (.441)	-.516 (.470)	-.487 (.471)	-.509 (.472)	-.517 (.473)
Log likelihood	-4165.57	-4165.47	-4158.32	-4165.46	-4158.01

Note: Random effects probit coefficients with standard errors shown in parentheses; 18 dummy variables for industry significant, not reported.

* $p < .05$; ** $p < .01$; *** $p < .001$ (two-tailed tests).

two samples. We also found no significant relationship between downsizing and change in foreign ownership in the subsequent year.

A common causal factor (e.g., the propensity of foreigners to purchase shares in troubled firms likely to downsize anyway) may also explain the relationship between foreign ownership and restructuring. To test this, we compared the increase in foreign ownership over the subsequent 2 years for a subset of firms having

less than a zero return on assets with the whole sample, and found that foreign ownership did not increase among troubled firms. Kang and Shivdasani (1997) found that financially distressed firms with close ties to financial institutions were more likely to downsize.

We conducted additional analyses that included an interaction between financial ownership and return on assets in the previous year (available from the authors). The estimate of the inter-

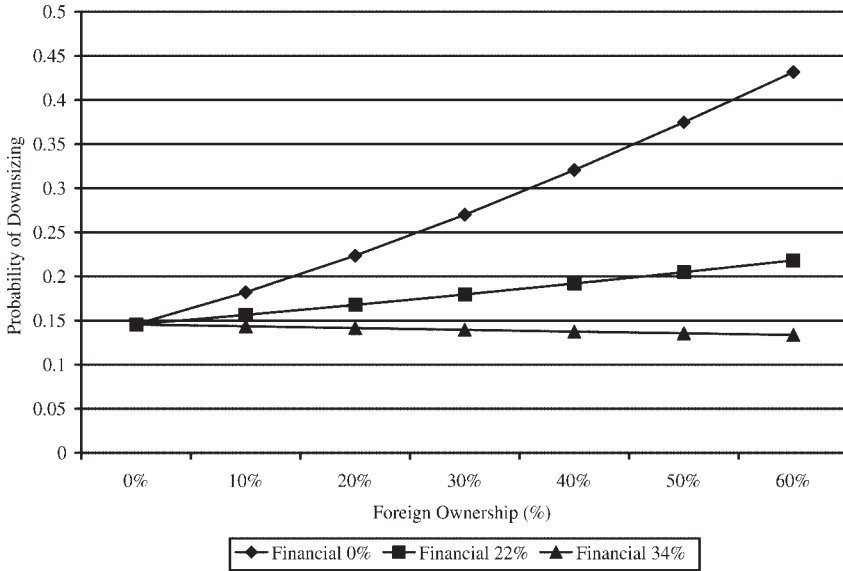


Figure 3. Financial and Foreign Influence on Five Percent Downsizing

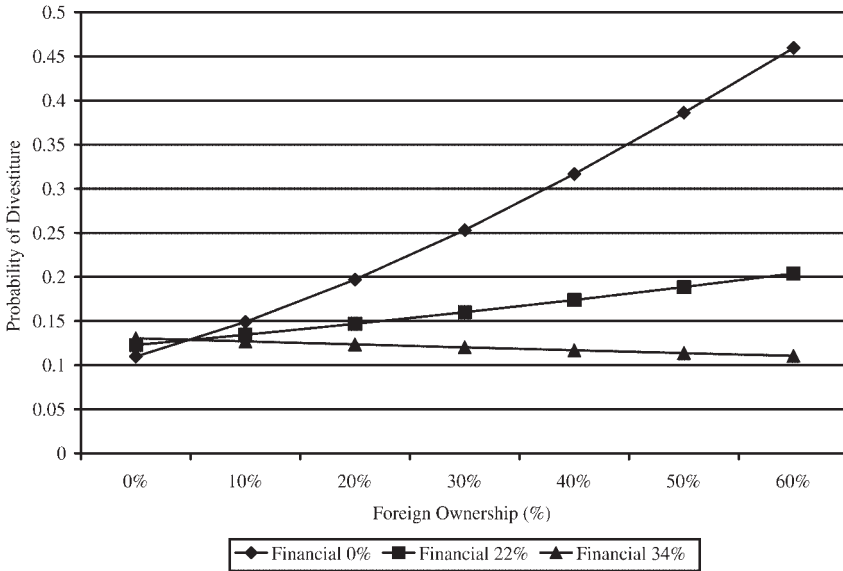


Figure 4. Financial and Foreign Influence on Five Percent Asset Divestiture

action effect was positive and significant, indicating that for very troubled firms, financial institutions encouraged downsizing. However, even in the presence of this interaction, the interaction between financial and foreign ownership remained negative and significant.

We measured downsizing and divestiture as discrete events—of 5 and 10 percent changes in

employment and tangible fixed assets. Although the 5 and 10 percent changes were closest to our definition of downsizing as a discrete and relatively large change, we also analyzed continuous measures of change as a robustness check. Tables 5 and 6 in our *ASR* Online Supplement show analyses of percentage change in employees and tangible fixed assets. Because these

were fixed-effect models, we could not include group membership, which is time invariant. The results are consistent with the discrete-time event history analyses. (Note that the coefficients are the reverse of those for downsizing. A negative association between foreign ownership and downsizing means that foreign ownership decreases employment growth, consistent with downsizing.)

DISCUSSION

In the 1990s, divergent business systems came into direct contact and conflict as foreign institutional investors—mutual funds, pension funds, and other investment funds—invested in distant markets. Influenced by this contact, Japanese firms adopted practices more consistent with the U.S. shareholder-based system: downsizing and divestiture of assets. The influence of foreigners, however, depended on the degree to which a firm was embedded in the Japanese system through its ties to financial institutions or business groups.

Whereas many writers have been skeptical as to how much business systems will converge under pressures of global competition and markets for products, labor, capital, and ideas, our findings suggest that some practices associated with U.S. shareholder capitalism have diffused to Japan. Although we are not ready to assert that Japan will become exactly like the United States, we see evidence that foreign ownership has led Japanese firms to adopt practices inconsistent with the Japanese stakeholder system.

Our empirical analyses make it clear, however, that although foreign investors were influential, existing institutions mattered. Foreign shareholders were associated with increased restructuring in firms that were not deeply embedded in the Japanese stakeholder system. Firms with high levels of financial ownership or close ties to other Japanese businesses could rely on ongoing support from friendly banks for a more gradual restructuring, or none at all. These firms did not have to worry that a sudden sell-off of their shares by foreign investors would leave them vulnerable to takeover. They knew that their friendly shareholders would vote alongside management in their annual general meetings.

Some researchers on the globalization of financial markets have argued that the superior efficiency of the shareholder model of capitalism will crowd out stakeholder models (see, for example, Rajan and Zingales 2003). Our research, however, indicates that the rising influence of foreign investors resulted from a political process. Foreign actors, with very different interests and incentives, replaced local shareholders who were more tightly bound to the stakeholder system. This occurred as Japanese financial institutions, and, to a lesser extent, corporations, sold their shareholdings as a result of financial crisis. Foreigners had influence where the stakeholder system was already weakened—among firms that had never been tightly embedded in the existing system and among firms whose ties to banks and business groups had dissolved. The Japanese stakeholder system was not overwhelmed by a superior shareholder system: in the clash between shareholder and stakeholder systems, the stakeholder system held its own. Rather, the shareholder system established a foothold in Japan where the Japanese stakeholder system had already weakened.

FUTURE PROSPECTS FOR CHANGE

Our objective was not only to address theoretical questions about interactions between business systems, but also to answer an empirical one: is Japan abandoning its business system and adopting American ways of shareholder capitalism? Will pressures for change remain limited to firms less embedded in the stakeholder system, or will the clash of the two systems eventually give way to a victory by one or the other?

One scenario is that local investors and managers will learn from foreign investors and adopt foreign ways (Haunschild and Miner 1997). Downsizing and divestiture may spread as a fad, as firms hop on a bandwagon of a popular business practice in the face of uncertainty (Abrahamson and Rosenkopf 1993). Restructuring among foreign-owned firms may remove the perceived illegitimacy of these practices and encourage their spread to larger, older, and more prestigious firms (Ahmadjian and Robinson 2001). For example, Nissan's restructuring under chief operating officer (and later CEO) Carlos Ghosn made restructuring more

palatable for Japanese companies, not only because Nissan subsequently recovered from its near-death state, but also because Ghosn and Nissan received so much publicity that subsequent restructurings became less newsworthy.

Another possibility is that financial institutions and business groups will continue to check foreign influence, leading to an increased bifurcation between firms exposed to foreign capital that adopt Anglo-American practices and those that remain tied to the Japanese system and maintain business as usual (Jackson 2002). There is already some evidence of this trajectory. Toyota, one of Japan's highest performing firms, has maintained the permanent employment system and strong ties with its suppliers, whereas Nissan has transformed itself along more Anglo-American lines. Whether two distinct systems emerge or the shareholder model prevails will depend on how much the "de-embedding" of Japanese firms through unwinding of shareholdings continues. At this point, it is not clear whether financial institutions and groups will continue to unwind their cross-shareholdings until the stakeholder system dissolves completely, or whether they will eventually stop at some lower but still substantial level.

Our approach was to document foreign investor influence on firm behavior in a large sample of firms over a long period. This means that we have left important questions to be answered later. It would be interesting to identify different types of foreign portfolio investors and their influence. Although we were able to remove the strategic investments of foreign corporations from the sample, we could not distinguish between large index funds, hedge funds, and other actively managed funds. The distinction between actively managed and index funds is likely to be important because we would expect that firms with high ownership by actively managed funds are more likely to respond to foreign investors than those owned by index funds (which buy stakes in a portfolio of shares that represent the entire market instead of picking and choosing individual firms). This information is probably obtainable only through detailed interviews.

Although our research focused on Japan, we believe our findings are applicable across national borders. More research is needed to compare the influence of foreign investors

across economies, and to examine the conditions under which foreigners are likely to be influential. Although it is unlikely that U.S. investor capitalism will completely replace the Japanese or other systems, the increasing globalization of capital ensures that future developments will reflect encounters between divergent systems.

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