Understanding a change in corporate governance as an institution: the case of Japan

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The objectives of my paper

- How to understand institutional change (in corporate governance) from an institution-as-equilibrium-outcome view point, using recent change in Japan as an example?
  - M. Aoki, *Toward a Comparative Institutional Analysis,* MIT Press, 2001.
  - How is the concept of an corporate governance institution as an equilibrium related to that of corporate values as symbolic systems?

Contingent Governance

- Control power shifts contingent on the "value-state" (gross vale-added) of the firm between the insiders (team-members) and a relational monitor.
  - Excellent, normal, depressed, critical states.
- The second best solution which
  - Resolves the team-production problem of adverse incentive of budget-breaking by the third party
  - Partially controls insiders' moral hazard.
  - Preserve team-specific assets in case of poor value-state due to external adversity.

Contrasting premises between property rights theory and CG.

- Property rights (incomplete contract) theory (critical assumption: exclusive complementarity between human assets directed to hierarchical control and residual rights of control over physical assets)
- Contingent governance theory: complementarity to organizational architecture with firm-specific information-sharing. No competitive labor markets. Focus on human assets.

Incentives of (delegated) relational monitor

- Ex ante: positive expected returns (corporate failure is costly: difference from the Alchian-Demsetz-Holmstrom solution)
- Ex post: incentive not to bail out at depressed state unless future rents are assured.
  - Imperfect competition;
  - government protection = soft budgeting (error of the second type)

The traditional J-system and its transformation

- Permanent employment system, inside directors
  - Somewhat reduced. Managerial autonomy increasing.
  - Optional legal governance structures
- Cross stockholdings
  - Demised, stock market pressure, take-over threats
- The main bank system
  - Reduced, private equity funds, reorganization specialists
- The convoy system
  - Arms' length regulations
- Bureau-pluralism
  - Being demised. Dynamic complementarities

Alternative emergent premise

- Complementarity between managerial business model and human assets. Physical assets = general purpose machines? (cf. Rajan and Zingales)
- Managerial business model: market strategy, organizational architectural design, value-distribution and incentive schemes, corporate values)

External monitoring of internal linkage (EMIL)

- Complexity and values-diversity. Stock price as summary statistics?
- How can signals be utilized?
  - Outsiders' board as trustees, take-over raiders, banks and private equity funds ……?
- There can be business models which would enhance the stockholders' value at the expense of employees continuation values.
  - Roles of political and legal factors (formal rules of the game among stakeholders matter)?

Corporate governance and corporate values

- Corporate governance structure as an equilibrium outcome (common knowledge) and corporate values as symbolic systems.
- An equivalence of the concept of common knowledge based on Aumann type partition on strategic spaces and that as symbolic representation (proposition) based on Kripke's approach is suggestive.
  - M.Aoki "Endogenizing institutions and their change", www.stanford.edu/~aoki/papers.
- A viable corporate governance structure may be represented by corresponding corporate values.