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Varieties of Capitalism: Production and Market Relations in the USA and Japan

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During the 1980s, Japan's macroeconomic strength encouraged widespread interest in the competitive advantages associated with its organization-oriented micro-level institutions. However, with Japan's more recent macro-economic difficulties and prolonged stagnation, and in the light of America's relative success, pressure for institutional reform in the direction of the American model is mounting. Liberalization of trade and capital movements has contributed to increasing economic inter-dependence and integration of the world's advanced nations. Customers and investors in Japan and the US alike are demanding that firms be increasingly responsive to changes in technologies and market requirements and that they deliver consistently high quality products and services at low price. At the same time, the increase in foreign equity investment in Japan means that, like their American counterparts, Japanese firms are being urged to prioritise shareholder interests, deliver continuous improvement in short term financial results and be transparent in their reporting. However, despite very similar pressures to those faced by American firms, Japan is evolving incrementally and developing a hybrid system that continues to maintain its emphasis on a resource-based approach to productive system effectiveness and organizational competitiveness.

Focusing on the contrasting cases of Japan and the US, *The Embedded Corporation: Corporate Governance and Employment Relations in Japan and the United States* describes developments in corporate governance and human resource management (HRM), analysing the influence of globalization, shifts in macro-economic performance and declining union strength on employment practices, the strategic role of HRM and the professional status of the HR executive in this context. Traditionally, Japanese firms have been what Jacoby describes as 'organisation oriented' while American firms have been more 'market oriented.' This is reflected in the dominant features of their respective systems of corporate governance and work organization, where despite movement towards the American model, the Japanese system of *stakeholder*-orientated corporate governance and its view of labour as a productive *resource* continues to stand in sharp contrast to the American *shareholder*-based system of corporate governance and view that labour is a factor of production with a *cost* to be minimised. An important finding is that companies in both America and Japan are moving towards the market pole of the organization – market continuum. But differences in the rate of change and reluctance to abandon micro-level institutions and practices that have been considered sources of competitive advantage have contributed to the persistence of significant differences in corporate governance and employment relations across the two countries.

These developments have important implications for national systems of corporate governance and employment relations. Yet explaining them depends upon an understanding of the *productive* function of HRM, which itself requires an analytical framework that is grounded in a theory of production. The starting point for this essay, therefore, is an analysis of 'productive systems,' the strategic role of HRM within them and the requirements for its effectiveness. In this respect, HRM represents the management of the organization of work, the effectiveness of which is importantly determined by its role in production. HRM and corporate governance are dynamically interrelated in the sense that while HRM serves to structure internal productive system relationships, corporate governance brings together and structures relationships among internal and external stakeholders. The essay next examines the logic of production and the challenges firms face in an environmental context such as that in the US, where the logic of markets is prioritized. In Japanese capitalism, by contrast, the logic of production is prioritized and markets serve as the arena in which productive system effectiveness is realised. The case of Ferodyn,[1] a Japanese-American joint venture located in the United States, is used to illustrate both the competitive advantages derived from the Japanese production-oriented approach and the difficulties associated with operating in the American market-oriented system of corporate governance. The essay concludes by arguing that whilst it is difficult to identify the degree to which micro-level institutions contribute to macro-level performance, the Japanese and American systems of corporate governance and employment relations – and within them, the role of the HR department and executive – are likely to continue to diverge because of differences in the role and relative importance they assign to market and production relationships.

Productive Systems: HRM and corporate governance

The importance of a theory of production in explaining the relationship between labour management and corporate governance derives from the fact that the purpose of HRM is the effective deployment of labour in production; and this depends upon an understanding of the logic of production, the essentially complementary relationship between labour and the means of production, and the central importance of cooperation in productive system relationships.[2] The centrality of cooperation in production and the mutuality of stakeholder interests in organisational effectiveness, however, do not imply that all interests are shared. Inevitable and legitimate conflicts of interest arise with regard to distribution of jointly created value, in a system where relationships are characterized by differences in relative power. But mutual dependence in production relationships means that no-one is without power and the failure to effectively resolve conflicts of interest has the potential to undermine performance by setting off a retaliatory withdrawal of cooperation on the part of the relatively disadvantaged group. An important objective of HRM is therefore to organize and manage labour resources in such a way as to secure the maximum level of cooperation in production and thereby achieve the operational and dynamic efficiencies that follow from this; HRM also has a role to play in establishing mechanisms for finding acceptable solutions to differences in stakeholder interests.

With growing recognition of the increasing returns generated by cooperation in production and greater worker involvement in the planning and execution of work, as well as by worker self-regulation and a more democratic style of management, HRM has become a significant component of organizational strategy. In this, central importance is assigned to *commitment* to the objectives of the organization, which is seen to generate competitive advantages that benefit both the organization and its stakeholder groups (Guest 1987). However, the ability of managers to commit themselves to employees in such a way as to secure the productive objectives of HRM, depends upon the extent to which they are required to prioritise the interests of others than their workforce and other internal stakeholders; and this will be importantly determined by corporate governance (Deakin et. al. 2002). By designating a dominant stakeholder group and prioritizing interests accordingly, corporate governance conditions managerial commitments on the requirements of that group. Corporate governance also has an influence on the dominant view of human resources (employee stakeholders). In American-style publicly traded firms, for example, the shareholder is the dominant stakeholder. Hence, the employment and income security of employees and other internal stakeholders (such as suppliers) is conditional on the achievement of continual improvement in shareholder value, the pursuit of which may be in direct opposition to these longer-term interests. Because shareholders tend to be less committed to the organisation than they are to the value of the shares they hold, their relationship with internal stakeholders is a relatively detached one. In this context, human resources are likely to be viewed as a *cost* to be minimized or a productive resource to be *exploited*. By contrast, in firms where shareholder interests do not dominate or where they are tempered by recognition of longer-term, shared interests in organizational viability, employees are more likely to be considered a productive *resource* and source of competitive advantage. In this respect, therefore, corporate governance has an influence on the degree of reciprocity in commitments, which in turn will determine the effectiveness of HRM in achieving its ultimate *productive* objectives.

Resource-based firms in the U.S. and Japan: The conflicting logic of markets and production

Many studies find that cooperative, team-based workplace techniques generate substantive productivity and quality gains as well as financial results that are equal or superior to those associated with more traditional work systems.[3] However, as Jacoby acknowledges, 'The conundrum is that, despite the productivity advantages of these practices, they remain relatively uncommon in the US' (p. 160). Even those firms that succeed in planning and implementing cooperative work systems have found that sustaining them over the longer term is difficult. To date, studies suggest that diffusion of these practices is slower and less extensive than one would expect, and the medium and long-run survival of even the most promising new workplace techniques is far from guaranteed.[4] The difficulties experienced by resource-based firms in the US bear this out and can be traced to the inherent conflict between the human resource orientation of the work system and the neoliberal-market logic that dominates American law and economic policy, business practice and corporate governance.

This conflict has its origins in the structuring of the American environment by historical developments in the theory and practice of markets and organisation.[5] These are rooted in the liberal economic conceptualisation of individuals as inherently self-interested, and the assumption that behaviour is best mediated by the market in order to ensure both individual and general economic welfare as well as to deliver distributional justice. The significance of market competition is that it is credited with releasing the creative self-interest of individuals while at the same time constraining its misuse. The market is also seen as rewarding success by selecting out organisations by virtue of their success and allowing them to grow to market dominance. Such arguments as these shaped the development of economic theory and legal practice in the US, which subsequently shifted the right to self-determination from individuals to the management of large corporations. This move was warranted by what Berk (1997) described as ‘corporate liberalism’, from which perspective managerial control of large firms is justified by the beneficial effect it is believed to have on economic progress. It is reinforced in employment relations, where managerial prerogative is considered the necessary means for enforcing workers’ compliance with contractual promise. Thus, while liberal economic theory is generally suspicious of cooperation and collective organisation, such as trade unions and employers’ organisations, it justifies market and hierarchical control in business on the grounds that it is the outcome of competitive success and efficient markets. More recently, this logic has been extended to the stock market, which is assumed to operate as an efficient market for corporate control in which shareholders, by means of the hostile takeover, ensure managerial efficiency (Deakin & Slinger 1997).

In a parallel development, theories of labour management diverge from the idea of the efficacy of hierarchical control. The first stage in this process was the emergence of scientific management, by which scientific laws of production – if properly applied by management – were believed to both maximise productive efficiency and resolve the mutual antagonism between managers and workers. Scientific management’s failure in this latter respect gave rise to the human relations school. Initially concerned with identifying the physiological and social needs of workers and using this knowledge to improve the performance of Taylorist forms of work organisation, further development in human relations led to the realisation that involving workers in the planning and execution of work as part of group activity improved their socio-psychological well-being and released their creativity. The idea that human relations is a productive factor was a stimulant for the development of HRM. Thus, in the evolution of theory and practice in labour management, the role of management has been redefined from authoritarian initiator, organiser and director of work to democratic ‘facilitator’ of a participatory, cooperative and self-regulating system; at the same time, workers have been re-conceptualised as full partners in co-operative production, rather than *factors of production* to be coerced into compliance with managerial interpretation of their contractual commitment. This shift in the respective roles of management and workers has been accompanied by a re-characterisation of the workplace from ‘pluralistic,’ where interests of the two sides are viewed as separate and potentially conflictual, to ‘unitary,’ where interests are considered to be in common.

Theoretical developments in liberal economics and production management, upon which American business practice and policy have been based, therefore diverge in their conclusions regarding authority and power in productive enterprise. Liberal economics justifies the increasing centralisation of entrepreneurial power and authority on the grounds that it is justified by market success; and challenging it risks slowing economic progress. Management theory, on the other hand, while not challenging the authority of management, argues for an increasing decentralisation of responsibility for production. This gives rise to a fundamental conflict between the logic of markets as an efficient mechanism for allocating resources, promoting entrepreneurship and distributing income and the logic of production management as a process for effectively combining and exploiting productive forces. In American capitalism, this contradiction has been assumed away by supposition that the market is an efficient co-ordinating mechanism and by the notion that management can even-handedly work in the interest all of the organisation's stakeholders. However, its impact can be seen in the enormous challenges faced by American resource-based firms.

In contrast to the American emphasis on competition in free markets, and despite the marketisation of certain aspects of corporate governance and employment relations, the central focus of the Japanese variety of capitalism continues to be production. In Japanese firms, the emphasis is on co-operation and the decentralization of responsibility and control in production. Collective action supercedes individual action. Contracts tend to be relational rather than arms length and continuity instead of discontinuity characterizes productive relationships. Micro-level institutions provide support for such things as information flows, knowledge transfer and collective learning processes by which new product and process technologies are developed and diffused. They also serve to establish the rules, norms, standards of business behaviour and trust that are required for building long-term relationships. As evident in Jacoby's research, even in the more market-oriented of the Japanese firms he studied, this emphasis on the requirements of production was apparent. For example, rates of turnover were low, core employees were provided lifetime employment, substantial expenditures were made in firm specific training, employees' welfare was considered a responsibility of the firm, and in the event of layoffs, companies provided retraining in an effort to limit the negative consequences for those affected. In these firms, the HR department played a central role, was stakeholder orientated and maintained a high level of status within the executive ranks (pp. 54-7; 76-7).

Regardless of the degree of cooperation on the supply side, however, Japanese firms are highly competitive in product markets; and market success plays an important role in the dynamics of the national productive system. This is evident in the strength of Japan's industrial sector, which despite general macro-economic stagnation, has contributed to the country's persistent and substantial trade surplus. But these are not the idealised markets of American liberal ideology that function to co-ordinate production and to evolve superior productive forms. Rather, these markets are outlets for productive activity where competitiveness depends upon setting the pace in the effective co-ordination of production and innovative activity, and in creating as well as responding to customer demand. Markets and production relations are therefore complementary and iterate in a dynamic process that generates pressure for responsiveness and change in both markets and firms. Because the logic of production is not subordinated to that of free markets, the Japanese system delivers consistently high quality and productivity in tandem with high road employment relations, thereby serving the long-term interests of all of the system's stakeholder groups. In this context, the central importance of HRM in facilitating the dual achievement of production and market requirements serves to elevate and reinforce both the position of HRM within the firm's strategic approach and the professional status of the HR executive.

The competitive advantages associated with Japan's production-oriented approach are not confined to its domestic export sector, however. Despite the inherent hostility of the American variety of capitalism to a resource-based approach, evidence of the productive advantages associated Japanese capitalism can also be found in the market success of Japanese 'transplants' located in the United States. One such example is Ferodyn, a Japanese-American joint venture.

***Japanese resource-based firms in the U.S.: The case of Ferodyn*[6]**
The Ferodyn joint venture was established as a separate and autonomous entity within a traditional American steel corporation. It was built in the rural American Midwest, 100 miles away from its American parent, to produce exceptionally high quality finished steel coils for customers in the automobile, appliance and office furniture industries. Within the plant and between the plant and corporation, reporting relationships were direct: Ferodyn's HR Director reported to the plant President, who was a corporate executive, reporting directly to the corporation's President and CEO. Ferodyn's technology and work system were modeled on the Japanese system where teamwork, shared responsibility and broadly defined jobs characterized the organization of work; job ladders were flat, promotion was based on training, knowledge and skill and the expectation is that all employees would become fully qualified. To promote employee commitment, bargaining unit employees were guaranteed employment security and pay was high by local and industry standards.

After reaching steady-state operating levels, the Ferodyn productive system was highly effective, reinforcing plant-level strategies and behaviours. It set world records for efficiency and product quality; and employee performance bonuses were high. Employee turnover and grievances were virtually non-existent and employees overwhelmingly agreed that it was a good place to work. The Ferodyn work system also attracted the attention teams of researchers who identified it as an outstanding example of a high performance work system.

However, despite these outward appearances, Ferodyn was vulnerable to changes in its internal and external environment. Although jointly-owned by an American and Japanese parent, Ferodyn was a subsidiary of the American parent, subject to corporate decisions that might not be in the plant's best interest; and the effectiveness of top management in protecting the plant from corporate and union pressures proved to be short-lived because of its dependence on personalities. When these individuals retired, the plant was left without strong leadership protection and support, reducing Ferodyn's relative position and security within the corporation and making it susceptible to changing managerial and union attitudes regarding its work system. As a result, with these retirements and the changes that followed, the plant became embedded in the corporation's more traditional managerial ethos and structure, which was less accommodating of the Japanese resource-based approach upon which it was founded.

Ferodyn was also vulnerable to decisions made by its American parent regarding the structure of corporate ownership. Although clearly profitable, and one of the largest American steel producers at the time, market pressures were steadily eroding not only steel prices but also the value of steel companies' stock. As a result, and under pressure from institutional investors, in a quickly negotiated buy-out, Ferodyn's American parent sold itself (and its share in the joint venture) to a global steel holding company whose low cost strategy is incompatible with the requirements of a production-oriented work system and of the customer mix that Ferodyn was created to serve. Following the take-over, one third of Ferodyn's managerial workforce was removed without warning and control was centralized within the corporation. Employee authority in many areas of production-related decision-making was eliminated, regular training ceased; scheduled maintenance was suspended and the flow of information stopped. In addition, key plant management personnel who had been leaders under the earlier regime were removed, either voluntarily or through forced retirement. Together, these actions have severely damaged the institutional framework upon which Ferodyn's co-operative work system was built; the work system is rapidly deteriorating into a more traditional form and performance is suffering.

The Ferodyn case provides a powerful illustration of the feasibility of successfully replicating a Japanese production-oriented system in the American market-oriented environment and of the product market advantages that can be generated. However, American joint-ownership by a publicly-traded steel corporation subjected it to stock market pressures which were in opposition to Ferodyn's system of production. Were it not made subject to the requirements of the American market-based system of corporate governance, Ferodyn is likely to be a much stronger plant today.[7]

Conclusions

To an important degree, HRM operates as a system of internal governance of the stakeholders involved in production. Systems of corporate governance bring these relationships together with those of the firm's other stakeholder groups in such a way as to either prioritise the interests of particular groups or provide mechanisms that serve to balance competing interests. Because of the central importance of *cooperation* in production for *competitiveness* in markets, in a system where relationships in both production and markets are characterized by mutual and conflicting interests and differences in relative power, the ability to create ways by which legitimate differences in stakeholder interests can be resolved is a source of competitive advantage. This capability will determine not only the effectiveness of HRM and a resource-based approach in meeting the objectives of the organization and the requirements of production but also the capacity of the organization for responding to the demands of the markets in which it operates. In this important respect, the Japanese are both production-oriented *and* market-oriented because the effectiveness of their production-orientation is reflected in the market success of Japanese companies, whether they be domestic exporters or transplants.

The current interest on the part of American firms in strategic HRM and a resource-based approach suggests recognition of the productive potential of HRM and of the contribution that employees and HRM can make to organizational effectiveness. However, the free market orientation of the American national productive system, particularly in the area of corporate governance, makes it very difficult to sustain these approaches because of the conflicting requirements of production and free markets and of the prioritization of markets in this context. At the same time, the macro-economic strength of the U.S. and the market power of American business are fueling interest in further marketisation of corporate governance and employment relations. Whilst it is difficult to determine the extent to which aggregate performance is derived from micro-level institutions and dynamics, in both the U.S. and Japan, independent of production, there are macro-economic conditions that have contributed to differences in relative performance. In the U.S., for example, the enormous level of household and government debt serves as a stimulus for effective demand; while in Japan, the high rate of savings does quite the opposite. Nevertheless, despite the Japan's current macro-economic difficulties, the market strength of its production-oriented industrial system is manifest in Japan's substantial, uninterrupted trade surplus, which compares favourably with America's persistent deficit.[8]

In both the U.S. and Japan, hybrid systems of corporate governance and employment relations are evolving as evident in the marketisation of certain parts of the Japanese system and the resource-based approach taken by some firms in the American system. Yet both systems are moving towards the market pole of the organization – market continuum at a rate that is serving to increase rather than reduce the distance between these two varieties of capitalism. In the American case, the dominance of the belief in free markets impedes the effective use of HRM to galvanise production. By contrast, despite marketisation of certain aspects of its systems of corporate governance and employment relations, Japan is retaining much of what is required for productive system effectiveness; and the sharpening of market forces may in fact be operating as a stimulant to its long-term competitive advantage.

The irony is that the American market-oriented system is based on belief in the market as the optimal coordinating mechanism for production; yet the superior market performance of the production-oriented Japanese transplants reveals the crucial role played by a production-orientation in determining market effectiveness. What this suggests is that the 'market-orientation,' characteristic of the American variety of capitalism is something quite different from an emphasis on what is required for successful *market performance*. In this regard, comparative analysis of the American market-based and Japanese institution-based varieties of capitalism offers valuable insight into alternative approaches to organizing and managing production and market relationships and their impact on performance of both the corporate and the national productive system.

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Notes

[1] Ferodyn is a fictitious name.

[2] For a discussion of the concept of productive systems see Wilkinson (2002 and 1983), Birecree, Konzelmann and Wilkinson (1997).

[3] See, for example, Appelbaum and Batt 1994; Ichniowski, Kochan, Levine, Olson and Straus 1996; Huselid 1995; Baker 1999.

[4] See, for example, Kochan and Rubinstein 2000, Konzelmann 2003, Konzelmann, Forrant and Wilkinson 2004.

[5] The ideas embodied in this section are further elaborated in an extremely valuable work by Wilkinson 2002; and Forrant and Wilkinson 2004.

[6] For a further development of this case, see Konzelmann, Forrant and Wilkinson 2004 and Konzelmann 2003.

[7] The comparative success of fully-owned Japanese automobile transplants in the U.S., and their effectiveness in replicating the quality of the Japanese production-oriented system within their American supply-chain, suggests that it is possible to emulate the effectiveness of this system in the U.S., but only so long as the requirements of production are not subordinated to those of markets, like the stock market, that are both unrelated to and destructive of the system of production.

[8] Since 1985, Japan's trade surplus on goods has fluctuated between $69 and $131 billion, measuring $106 billion in 2003; this compares with a US trade deficit of between $111 and $549 billion, measuring $549 billion in 2003.