

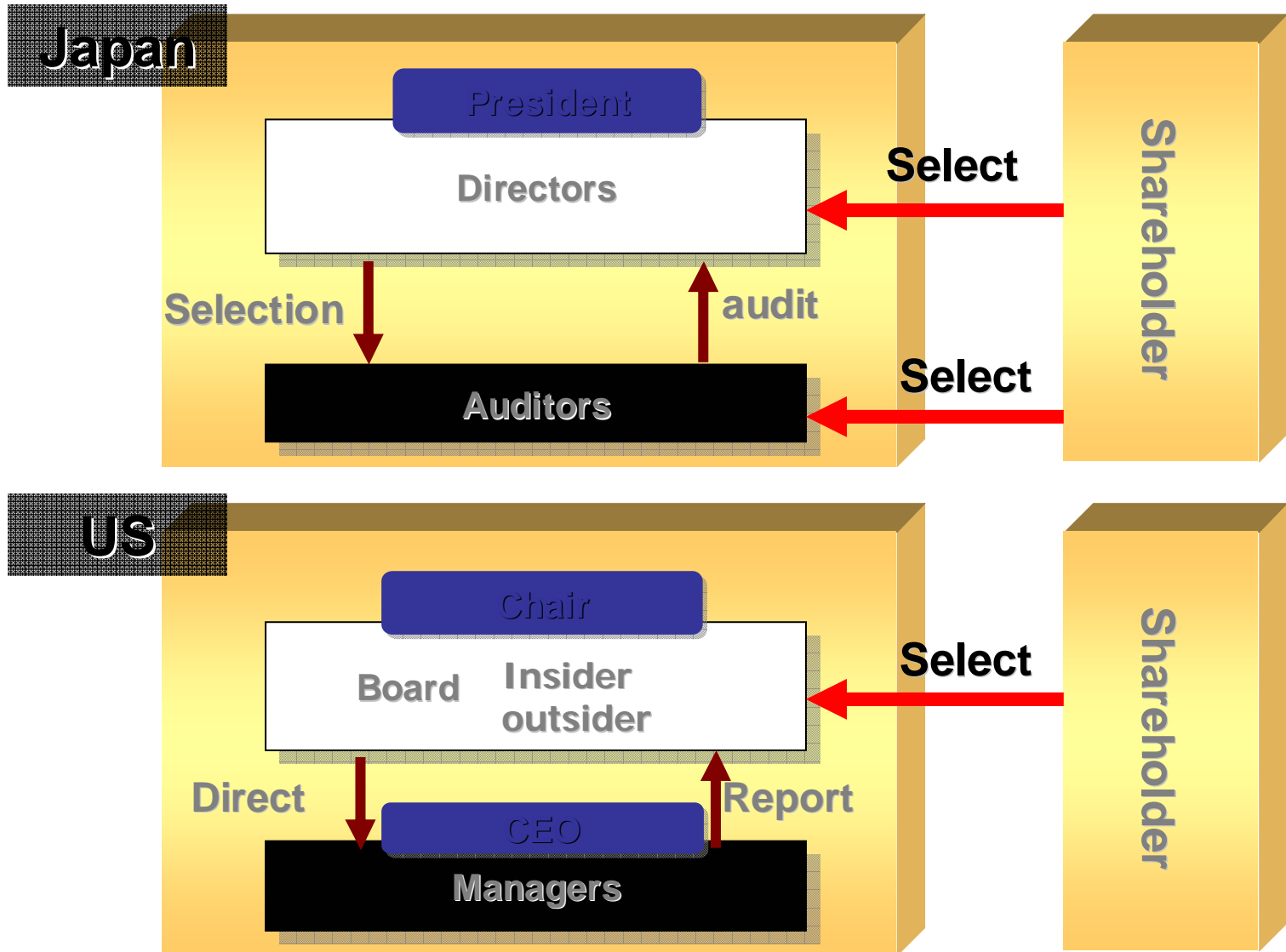
Employment Policy and Corporate Governance: An Empirical Analysis on the Stakeholder Model in Japan

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Two Types of CG Model

- **Classical View**
 - Managers are maximizing company's profit.
 - Possible problems:
 - (1) Agency problem between managers and shareholders
 - (2) Exploitation of minority shareholders
- **Stakeholder View**
 - Joint determination among many stakeholders including employees.
 - Possible problems:
 - (1) might not maximize profits for the sake of stakeholders
 - (2) might cost more for outsiders

Comparisons of CG



Characteristics of Japanese CG

- Infrequent hostile takeovers
- Insider dominated boards
- Long-term employment
- Inactive shareholder's meeting.....

Like Germany, some regard this as an employee oriented stakeholder model (Blair and Roe 1999)

Used to be interpreted along the “conditional governance” model (Aoki (1994))

Figure 1
Employees and Return On Assets of Listed Companies
in Japanese Manufacturing
1990:2001

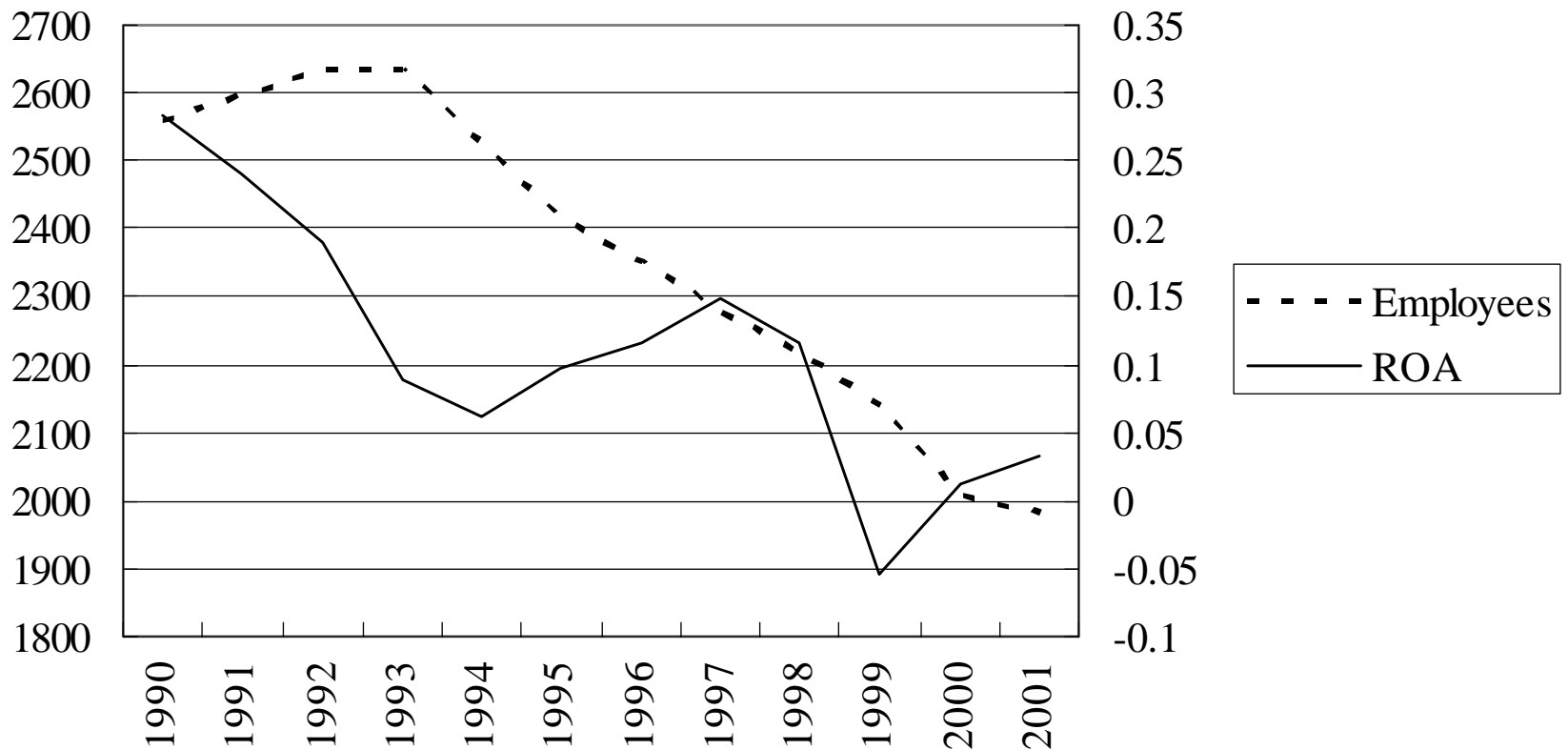
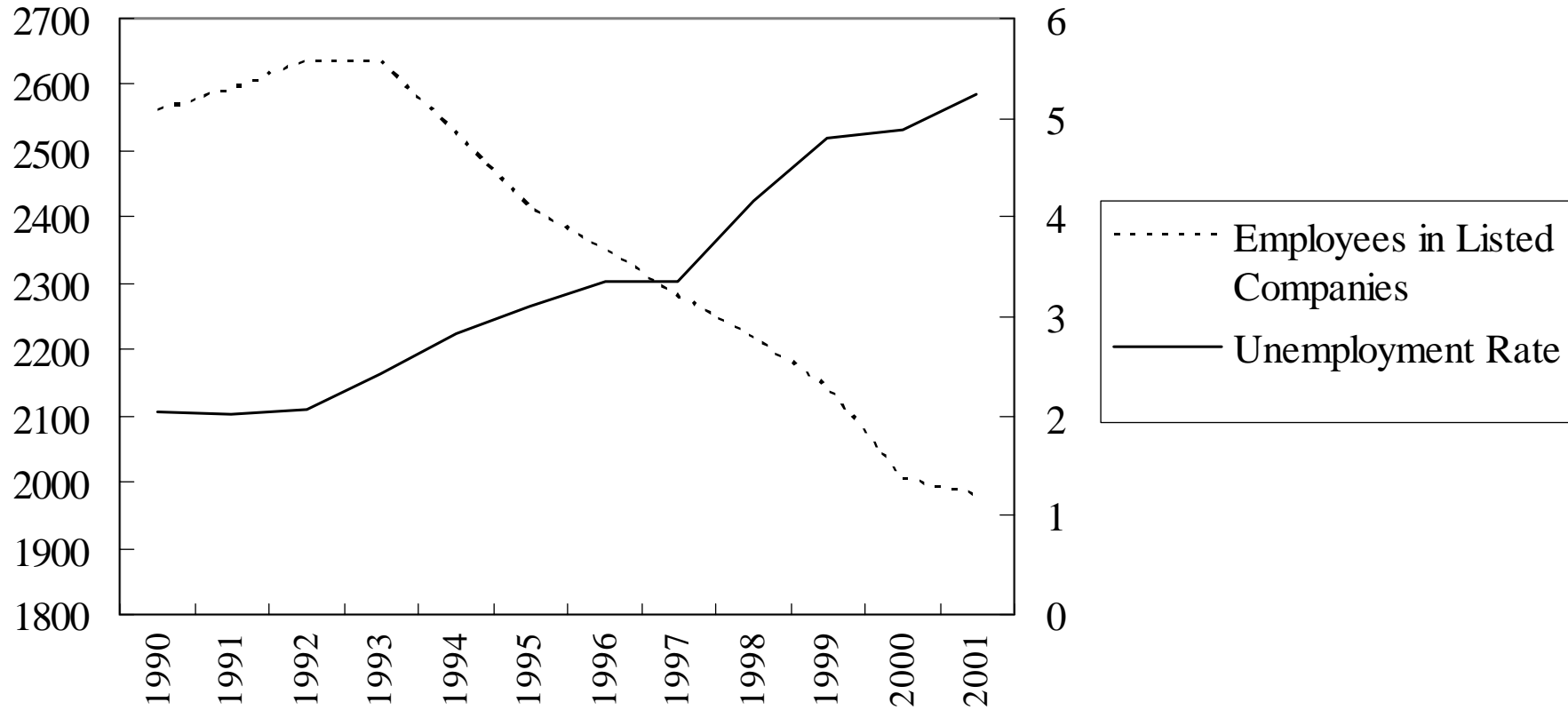


Figure 2
Unemployment Rate and Employees



Year (number of firms)		Board Size	Ownership Share: The Special Few	Ownership Share: Financial institutions	Ownership share: Foreign investors	Bank Appointed Director	Proportion of board members that are insiders	Number of Employees	ROA (Operating Income)	ROA (Pre-tax Income) before Taxes
1991 (1060)	Mean	17.85	0.4712	0.3429	0.0374	0.4906	0.7003	2595.0020	0.0529	0.2329
	Median	16	0.4539	0.3375	0.0188	0	0.7405	953.5	0.0492	0.2429
	S.D.	6.90	0.1341	0.1563	0.0601	0.5001	0.2188	6309.7830	0.0375	0.7229
	Max.	55	0.8747	0.7834	0.7391	1	1	79801	0.3419	1.8429
	Min.	6	0.0173	0.0040	0.0000	0	0	28	-0.1992	-17.6429
1996 (1152)	Mean	17.75	0.4681	0.3188	0.0588	0.5000	0.6645	2351.3010	0.0309	0.1129
	Median	16	0.4484	0.3174	0.0311	0.5000	0.7	886	0.0304	0.1329
	S.D.	6.8	0.1354	0.1472	0.0761	0.5002	0.2186	5785.4810	0.0375	0.4929
	Max.	60	0.8764	0.7067	0.6641	1	1	75590	0.1952	3.4929
	Min.	4	0.1628	0.0032	0.0000	0	0	20	-0.1851	-10.9829
1997 (1175)	Mean	17.7	0.4679	0.3163	0.0598	0.4877	0.6678	2277.3510	0.0368	0.1429
	Median	16	0.4495	0.3115	0.0314	0	0.7143	846	0.0342	0.1529
	S.D.	6.8	0.1376	0.1503	0.0790	0.5001	0.2177	5631.1000	0.0367	0.3629
	Max.	61	0.9179	0.7022	0.6868	1	1	72193	0.1814	2.4429
	Min.	6	0.0361	0.0031	0.0000	0	0	22	-0.2092	-4.0229
2001 (1121)	Mean	14.7	0.4662	0.2726	0.0647	0.4808	0.6326	1981.4810	0.0366	0.0329
	Median	14	0.4440	0.2474	0.0203	0	0.6667	746	0.0327	0.1029
	S.D.	5.3	0.1478	0.1530	0.0953	0.4999	0.2254	4883.8270	0.0410	0.7229
	Max.	63	0.9519	0.7012	0.7667	1	1	66005	0.2567	15.7129
	Min.	6	0.0294	0.0015	0.0000	0	0	15	-0.1920	-5.7229

Japanese Companies in the 1990s

- Commercial codes: Introduction of US style CG
 - Decline in Profitability
 - Reduction of # of Employees
 - Diversification in
 - (A) Ownership (Financial Foreign)
 - (B) board structure (Outsider ratio)
- Profit Maximizing Model & traditional stakeholder model coexist

Previous Studies : CG in Japan

No agreements on the role of outside directors

- Kaplan & Minton (1994)
Appointing of outsiders substantially raises the probability of turnover of incumbent top executives. (Fortune1981: 119 firms).
- Kang & Shivdasani (1995) (Moody 270 firms)
Abe (1997) (Kaisha Rireki Souran 1112 firms)
Outsiders have no effects on the sensitivity of turnover to firm performance.

Previous Studies : LA in Japan (1)

Most of studies: employment adjustment speed

$$\ln E_t = \tau_0 + \tau_1 \ln Q_t + \tau_2 \ln E_{t-1}$$

Abe(1999),Urasaka & Noda (2001),Suruga (1997).....

Defects:

1. Observe only net change in employment.
2. No distinction among reducing measures.
3. Assume the same functional form.

Previous Studies : LA in Japan (2)

- Kang & Shivdasani (1997)

Higher portion of mainbank in ownership,
higher probability to layoff

- Suruga (2002)

Probit analysis on the voluntary retirements.

Defects: no measure for the necessity of reducing labor costs, i.e. excess employment (K&S: firms whose sales declined more than 50%)

Aim of our paper

How the change in CG (board composition, ownership structure) affect labor restructuring?

- Integrated data on (a) measures to reduce labor costs, (b) measure of excess employment, (c) board composition and (d) financial data.
- Measures: reduction in (1) bonus, (2) wages, (3) managers' salaries, (4) executive payments, (5) working hours, (6) new hiring & Expansions in (7) lay-offs, (8) earlier or voluntary retirements.

Data (1)

Annual Survey on Corporate Behavior in 2001 (Kigyou Kodo ni Kansuru Anketo Chousa)

- Annual survey (January) complied by CAO.
- Samples: All listed companies.
- Response Rate: 50.8% for the 2001 Survey (Manufacturing 719, non-manufacturing 483).
- The survey contains information on
 - (1) Degree of excess employment and
 - (2) Downsizing Measures
 - (3) Expectation of GDP, industry growth.

Data (3)

- Toyo Keizai : “Directors Data”
- NEEDS : “Firm Shareholding Data”, company financial statements

Board Structure:

Insiders: board members promoted among employees vs. Outsiders: Others

Ownership Structures :

Foreign or Financial Ownership,
Special few (Degree of concentration)

Basic Statistics (all)

	Mean	Median	S.D.	Max.	Min.
Proportion of insiders among board members	0.6726	0.7143	0.2038	1	0
No. of employees	2393.07	1002	5187	54017	33
Board size	15.1552	14	5.2557	36	6
Percentage of shares owned by the Special	0.4448	0	0.1407	1	0
Percentage of shares owned by financial	0.3043	0.2817	0.1559	0.7012	0.0037
Percentage of shares owned by foreigners	0.0737	0.0281	0.1007	0.6120	0.0000
Bank-appointed director	0.5020	1	0.5005	1	0
Total assets (Natural	18.0979	18	1.3106	22	15
Expected rate of industry growth (.01%)	5.6714	5	32.7074	150	-200
Excess employment	6.9980	7	1.0627	12	4
ROA (Operating	0.0379	0.0343	0.0397	0.1794	-0.1716

N=496

Degree of Excess Employment

	Variables	No. of obs	Percent	Cum.
Excessive by more than 50%	12	2	40	0.4
Excessive by 50%	11	0	0	1.21
Excessive by 40%	10	4	0.81	1.21
Excessive by 30%	9	27	5.44	6.65
Excessive by 20%	8	121	24.4	31.05
Excessive by 10%	7	163	32.86	63.91
No excess employment	6	164	33.06	96.98
Short by 10%	5	11	2.22	99.19
Short by 20%	4	4	0.81	100

(Note) There were no firms that responded that employment was short by more than 30

Basic Statistics (firm with EE)

	Mean	Median	S.D.	Max	Min
Proportion of insiders among board members	0.6703	0.7059	0.2010	1	0.0909
No. of employees	2405.96	1065	4943	54017	100
Board size	15.0252	14	5.1188	35	7
Percentage of shares owned by the Special	0.4389	0.4090	0.1381	0.7990	0.0383
Percentage of shares owned by financial	0.3096	0.2927	0.1562	0.6771	0.0217
Percentage of shares owned by foreigners	0.0724	0.0285	0.0981	0.5719	0.0001
Bank-appointed director	0.5110	1	0.5007	1	0
Total assets (Natural	18.1289	17.9827	1.2845	22.1460	14.7613
Expected rate of industry growth (.01%)	-1.3675	0	35.4833	142	-200
Excess employment	7.6215	7	0.7806	12	7
ROA (Operating	0.0315	0.0289	0.0344	0.1400	-0.1716

N=317

Specification

Prob (Measures to reduce labor costs(i))

= f(firm characteristics, board [banker, shareholder, size, insider], firm performance, excess employment)

8 Categories of Measures (multiple answers)

Decrease in 1. Bonus, 2. Wage, 3. Managers' Salaries, 4. Executive Payments, 5. Working Hours, 6. New Hiring

Expansion in 7. Lay-offs, 8. Earlier or Voluntary Retirement

Multivariate Probit Model: SUR version of probit

Results:Multivariate probit

	Bonus reduction		Wage reduction		Reduction in managers' salaries		Reduction in executive payments		Reduction in working hours		Reduction in new hiring		Layoffs		Early or voluntary retirements
er ratio	-0.31338		-0.30038		-0.3089		-0.71354		0.44411		1.17353	**	-1.13823	*	-1.6008
	(-0.66)		(-0.63)		(-0.65)		(-1.56)		(0.72)		(2.57)		(-1.89)		(-3.36)
(Operating income)	-10.36911	***	-12.17497	***	-6.89271	***	-8.3843	***	6.03599	**	1.12666		0.24198		-3.29144
	(-4.30)		(-4.69)		(-3.1)		(-3.67)		(2.00)		(0.50)		(0.09)		(-1.44)
ected rate of industry growth	0.00454	*	0.00075		0.00675	***	0.00301		0.00035		-0.0013		0.00591	**	-0.00237
	(1.90)		(0.33)		(3.13)		(1.33)		(0.14)		(-0.60)		(2.38)		(-1.08)
f employees	-0.16127		-0.18379		-0.09969		-0.32007	**	-0.14682		0.01277		0.13709		0.34858
	(-0.96)		(-1.12)		(-0.62)		(-1.99)		(-0.69)		(0.08)		(0.67)		(2.13)
assets	0.05832		0.17372		0.05243		0.37308	**	0.17598		0.06499		-0.10494		-0.07683
	(0.36)		(1.11)		(0.35)		(2.40)		(0.86)		(0.41)		(-0.54)		(-0.49)
-appointed director	-0.00135		-0.04857		-0.04036		-0.08117		0.12433		-0.07241		-0.18074		-0.25406
	(-0.01)		(-0.31)		(-0.26)		(-0.55)		(0.63)		(-0.49)		(-0.96)		(-1.67)
ership by the "Special Few"	-0.65477		-0.52415		0.53999		-0.44837		1.878	**	0.37542		-1.09042		-1.79501
	(-0.95)		(-0.76)		(0.80)		(-0.69)		(2.05)		(0.55)		(-1.25)		(-2.58)
s employment index	0.16336		0.23404	**	0.10038		0.20977	**	-0.26255	**	-0.13482		-0.27625	**	-0.22971
	(1.54)		(2.24)		(1.02)		(2.08)		(2.11)		(1.35)		(-2.46)		(-2.22)
gn ownership	-0.52961		-0.76713		-0.34484		-1.36602		2.40423		0.72769		-0.29522		-1.03256
	(-0.55)		(-0.78)		(-0.37)		(-1.47)		(-1.54)		(0.76)		(-0.28)		(-1.05)
ership by financial institutions	0.00338		-1.18472		0.24602		-0.10828		0.14953		-0.56377		1.72974	**	-0.13707
	(0.00)		(-1.57)		(0.34)		(-0.15)		(0.16)		(-0.80)		(2.02)		(-0.19)
tant	2.22643		0.19108		0.03113		-2.00415		-3.27126		-1.06947		2.06144		2.23092
	(1.07)		(0.09)		(0.02)		(-1.00)		(-1.23)		(-0.53)		(0.84)		(1.10)
s involved	204		105		108		186		36		194		46		156

Findings

- Firms with a higher share of outsiders are more likely to lay off staff or resort of voluntary early retirement, while boards consisted of insiders are more inclined to reduce new hiring.
- Consistent with the stakeholder view:
Insiders are more concerned with protecting the interests of employees than with profit-maximization as assumed by neoclassical theory.

Endogeneity issues

Kaplan & Minton (1994), Morck & Nakamura (1999): Appointments of outside directors are endogenous and correlated with companies' performance.

lagged variable (5 years) as IV.

Similar results (Table 4).

The negative effect on bonus reduction: Firms with a higher share of insiders does not reduce bonus and keep the remuneration level at the cost of shareholders.

Conclusion and implication (1)

1. First study to examine how changes in board composition and ownership structure affected their labor restructuring to obtain implications of the transformation in corporate governance.
2. Unique integrated firm-level data
 - (1) degree of excess employment,
 - (2) board composition, the ownership structure,
 - (3) labor cost reduction measures
 - (4) financial statement data.

Conclusion and implication (2)

3. Our findings: outsiders are more committed to layoffs, and to implementing voluntary or early retirement, while insiders are more inclined to decrease new hiring.

Outsiders contribute to the downsizing of employment, whereas insiders are more inclined to protect incumbent employees.

4. These findings are consistent with the stakeholder view rather than the neoclassical view of a firm as a profit-maximizer.