Research Report on Corporate Governance, Social Responsibility and Human Resources Strategies

Summary

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Note 1: The circle indicates the leader of the research team.

Note 2: Overlapping parts were coauthored.

(Research Objectives and Methods)

This report attempts to specify relations between corporate governance and human resources strategies at companies from multiple viewpoints. Corporate governance is narrowly defined as disciplining of corporate managers. According to a textbook definition, corporate managers are agents that manage companies in a manner to maximize benefits for shareholders as principals. At large companies where separation between management and capital has been making progress, however, managers may take actions that do not necessarily maximize benefits for shareholders. This is the so-called moral hazard problem. What are incentives and methods for corporate managers to be disciplined while avoiding the problem? Solutions to this question represent corporate governance.

However, such textbook theory had been considered not necessarily applicable to Japanese companies. Japanese companies, including large ones, had depended primarily on indirect financing for raising funds and featured cross shareholdings with banks and trading partners. Most major shareholders had been banks and trading partners. Featuring one of the Japanese management characteristics, it had allowed Japanese companies to base their business operations on long-term viewpoints, bringing about their long-term relations with banks and trading partners and their tacit long-term employment agreements with workers. However, business operations based on such long-term viewpoints had not necessarily been expected to contribute to improving short-term profits for shareholders.

Since the 1980s, however, gradual financial market deregulation has encouraged large Japanese companies to raise funds directly from financial markets. Banks' nonperforming loan problem after the burst of economic bubbles has forced them to unwind cross shareholdings with their corporate customers. Japanese companies can no longer ignore short-term profits for shareholders. As foreign investors including investment funds have acquired massive amounts of Japanese equity shares since the second half of the 1990s, some Japanese companies are dominantly owned by foreign shareholders. Japanese companies are now generally required to grow more conscious of shareholders' opinions or requests regarding business management.

Furthermore, recent corporate scandals in Japan have led Japanese companies' corporate governance to attract attention again. Scandals in 2006 included automakers' concealment of product defects subject to recalling, a gas appliance sales firm's irregular modifications to appliances and an Internet firm's accounting fraud. For whom and for what purpose are companies managed? The question is asked anew in Japan.

In this respect, a growing view is that companies should give priority to their corporate social responsibility. The CSR concept is that corporate managers should maximize profits for their companies while coordinating interests of not only their shareholders but also all of their other stakeholders.

Thus, the problem of how to discipline corporate managers is now linked to a widening range of issues including CSR as well as narrowly and widely defined corporate governance. The scope of stakeholders involved in disciplining of corporate managers has also expanded. The dynamic changes in the problem of how to discipline corporate managers might have exerted some impact on corporate management.

In a bid to grasp the dynamic changes in corporate governance and their impact on corporate management, the Japan Institute for Labour Policy and Training conducted a survey on "Corporate Governance/CSR and Human Resources Strategies" in October 2005. In the survey targeting 2,531 listed companies, corporate planning officers were asked to answer questions on such matters as business management stances, general meetings of shareholders and CSR, and human resources and labor management officers were asked on relevant matters. Questionnaires were sent and collected via mail between October 6 and 21, 2005. Valid respondents numbered 450 companies, accounting for 17.8% of the questionnaire target companies.

In our survey scheme, we chose all listed companies as a survey target and connected responding companies' responses with their financial data (from the Nikkei NEEDS) to analyze the impact of corporate finance and governance on human resources strategies.

This research report looks into relations between corporate governance and human resources strategies, based on the survey results. The analysis covers the following five points: The first is how a company's human resources strategy is affected by stakeholders viewed as important by the company. The second is how human resources strategy is affected by corporate governance especially by attributes of managers. The third is how employees' participation in corporate management is affected by attributes of managers. The fourth is how corporate governance affects corporate restructuring. The fifth is how corporate governance and CSR affect the utilization of women workers.

(Details of Research Report)

The report is divided into three parts -- Part I for an outline of the report, Part II for an outline of the survey, and Part III (analysis) for specifics. The specifics in Part III follow:

Corporate Finance and Human Resources Policies -- Chapter 1

○ <Relations between Corporate Financial Structures and Important Stakeholders>

Chapter 1 considers how companies' financial structures and their important stakeholders affect their human resources strategies. One finding given in this chapter is that stakeholders viewed by companies as important may differ depending on these companies' financial structures. For example, a company that heavily depends on borrowings has continued and will continue to view trading partners as important and banks as very influential. A company featuring a higher foreign ownership ratio views institutional investors as important and very influential.

○ **<Effects of Corporate Financial Structures on Human Resources Strategies>**

How do companies' financial structures affect human resources strategies? Analysis indicates that companies that are owned heavily by banks feature influential employees. At such companies, the average length of employees' services is longer and management usually takes the responsibility for education and training of employees. Moreover, companies that are owned heavily by foreigners tend to view individual employees as responsible for their own education and training in the future. Financial structures, including characteristics of shareholders, affect human resources strategies directly or indirectly through influences of stakeholders.

Corporate Governance Structures and Human Resources -- Chapter 2

○ **<Effects of Top Corporate Managers' Attributes on Human Resources Strategies>**

Chapter 2 analyzes how attributes of top corporate managers and shareholders affect human resources strategies. According to an analysis on how attributes of top corporate managers affect human resources strategies, companies that are owned by top managers tend to be rather positive about education and training of employees, to link performances to rewards and to make evaluation of performances more transparent. Companies that are managed by former bureaucrats or the like are not so positive about education or training of employees. Their human resources or labor management strategies fail to be consistent and their welfare systems tend to be insufficient. In this way, characteristics of top corporate managers can greatly affect human resources strategies. While some companies develop human resources strategies to increase their corporate values, others don't. There is possibly a so-called agency problem, here. (The problem means that the agent fails to act as required by the principal due to a conflict of interest between economic units (for example, between shareholders and managers) under incomplete information.)

○ **<Effects of Shareholders' Attributes on Human Resources Strategies>**

The analysis also indicates effects of shareholders' attributes on human resources strategies. Institutionally complementary relations have been observed between bank-held equity stakes and human resources strategies at companies. At the same time, foreign corporations that have increased their equity stakes in Japanese companies have complementary relations with these Japanese companies' human resources strategies. Bank-held equity stakes have complementary relations with traditional employment practices. Foreign investors in Japanese firms have such relations with performance-based wage and promotion systems.

Japanese companies' traditional seniority-based wage and lifetime employment systems have changed greatly since the second half of the 1990s. A frequently cited factor behind the change is an increase in older employees that keep labor management costs at high levels. Although this problem is important for considering changes in Japanese companies' employment practices, the Chapter 2 analysis indicates the possibility that corporate governance structures have also contributed to such changes.

Managers, Employee Groups and Restructuring -- Chapter 3

○ <Relations between Corporate Governance and Employment Adjustments>

Overemployment, overcapacity and overindebtedness have been cited as key factors behind Japan's long economic slump after the burst of economic bubbles. It is reported that these excesses are closely linked to Japanese companies' corporate governance. What have relations been especially between employment and corporate governance? Based on this question, Chapter 3 analyzes how corporate governance has affected employment adjustments.

The analysis has produced the following interesting findings. First, dismissal probability changes according to attributes of managers. At owner managed companies, the managers contribute to increasing the dismissal probability irrespective of the presence of internally promoted directors or labor unions. At companies, on the contrary, in which managers are promoted internally, the presence of internally promoted directors or labor unions contributes to reducing the dismissal probability. This finding indicates that managers' attributes reflecting stakeholders as their agents affect the dismissal probability. Second, the presence of bank-dispatched directors contributes to reducing the dismissal probability. At companies with labor unions, a heavier dependence on banks contributes to reducing the probability. The finding indicates that banks tend to discourage corporate borrowers from dismissing their employees. Labor unions can increase the tendency. Third, the dismissal probability is lower at companies that depend more on banks and are more responsible for education and training of employees. This indicates the presence of some institutionally complementary relations between banks and their corporate education/training practices.

Governance Structures and Management Efficiency -- Chapter 4

○ <Effects of Governance Structures on Management Efficiency>

Chapter 4 analyzes how corporate governance is linked to labor unions, labor-management consultations and employees' participation in corporate management, and how the linkage affects management efficiency. According to the analysis, contributions of main banks and labor unions to the management efficiency differ according to the origins and attributes of managers. Specifically, companies that depend heavily on banks feature relatively higher management efficiency as measured by TFP (total factor productivity) growth rate, indicating that banks' monitoring can work. Banks' monitoring functions can differ depending on the attributes of managers. At companies that are run by internally promoted managers and have labor unions, higher dependence on banks leads to lower management efficiency. This may mean that those internally promoted managers must give greater priority to employees' benefits compared to owner managers, resulting in difficulties in dismissing employees and deterioration of management efficiency. Meanwhile, labor unions' contributions to management efficiency are greater at companies that are run by internally promoted managers. This apparently indicates that internally promoted managers can bring about greater management efficiency by making labor-management communications and sharing of information relatively smoother to ease the asymmetry of information.

In-house Adaptability of Human Resources Management Measures and Corporate Performances -- Chapter 5

○ <Effects of Japanese Companies' Human Resources Management Measures on Improvement of Corporate Performances>

It is likely that human resources strategies have changed under the influence of corporate governance. How have these changes affected corporate performances? Based on the SHRM (Strategic Human Resources Management) theory, Chapter 5 analyzes whether Japanese copanies' human resources management measures have contributed to improvement of their performances. The analysis has brought about some interesting findings. First, companies' "internal human resources management measures" to build long-term relations with employees and provide them with education and training services can contribute to boosting sales and recurring profit. As for effects of human resources management measures' adaptability to other business strategies, it is acknowledged that complementary relations have been seen not between internal human resources management measures or between market-based financing measures but between internal human resources management measures and market-based financing measures or employment reduction measures. This indicates that human resources management measures that promote employees' longer-term commitment can be combined with greater financial efficiency and employment reductions to improve corporate management efficiency.

Japanese Employment Systems, Management Reform and Women's Positive Performances -- Chapter 6

○ <Corporate Governance/CSR and Utilization of Women Workers>

Earlier chapters have analyzed how corporate governance affects human resources strategies and how such effects influence corporate management efficiency and profitability. Chapter 6 analyzes how these developments have affected utilization of women. First, the author considers (1) whether Japan's traditional employment practices including long-term employment, flexible working styles for companies and community-type corporate cultures have been factors in impeding utilization of women. Then, the author logically demonstrates (2) that corporate management emphasizing social responsibility, shareholders and work-life balance can create an environment for women's positive performance. A questionnaire survey is used for backing up the demonstration. The analysis fails to specify relations between combinations of corporate stakeholders, management reform and women's utilization. However, it endorses the above two assumptions. This means that Japanese employment practices have been an impediment to utilization of women and that the corporate management reform emphasizing social responsibility, shareholders and work-life balance can be a contributing factor to promote utilization of women.