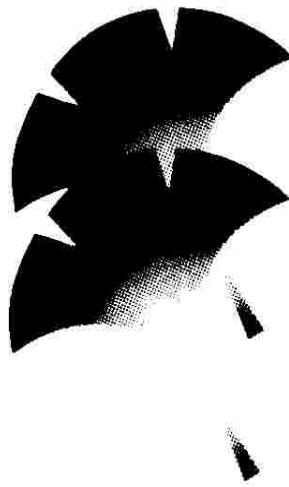


DEUTSCHES INSTITUT FÜR JAPANSTUDIEN



Andreas Moerke & Harald Dolles

Corporate Governance in Multinational
Corporations during Turbulent Times
– Cases from the Automotive Industry

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Contact authors: **Dr. Andreas Moerke**
Deutsches Institut für Japanstudien

Dr. Harald Dolles
Deutsches Institut für Japanstudien

ドイツ・日本研究所
Deutsches Institut für Japanstudien
German Institute for Japanese Studies

Kudan Minami 3-3-6
Chiyoda-ku
Tōkyō 102-0074
Japan

Tel.: +81-3-3222-5077
Fax: +81-3-3222-5420
e-mail:
moerke@dijtokyo.org
dolles@dijtokyo.org
homepage: <http://www.dijtokyo.org>

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Andreas Moerke & Harald Dolles

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	Page:
1. Turbulent times, MNCs and the choice of corporate governance systems	5
2. MNCs and the balance between internal and external pressures...	6
3. Impact of corporate governance systems on the MNC.....	12
3.1 Corporate governance and ownership	13
3.2 Corporate governance and financial institutions	15
3.3 Corporate governance and the role of employees.....	16
3.4 Corporate governance and international strategy	18
4. Case Studies	19
4.1 Case J1: Toyota Motor Corp.....	19
4.2 Case J2: Renault and Nissan Motor Co.	21
4.3 Case J3: DaimlerChrysler and Mitsubishi Motors Corp.	24
5. Conclusion	27
References	29

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Abstract:

In recent times, there are hardly any industries left that show stable and predictable conditions. Deregulation and globalisation have changed whole industry structures. The results are discontinuous, turbulent developments with high uncertainty. One example is the breakdown of borders between nations, industries and organisations. Cases of cross-border alliances, such as DaimlerChrysler, Renault-Nissan, and Vodafone-Mannesmann, have been at the centre of discussion. However, with the ongoing breakdown of borders in these turbulent times, corporate governance structures must be established to facilitate this development. This paper deals with the question of where local differences in the structure of corporate governance schemes of MNC cross-border alliances can be seen. What is demanded and expected, despite legal differences, by both partner companies? The paper will show that global competition between MNCs also implies competition between firms' corporate governance systems on an international level. This leads to the question of to what extent MNCs are aware of these mechanisms, and how they judge them. The article is based on case studies from the automotive industry, namely the Toyota group, the Renault-Nissan alliance, and the DaimlerChrysler-Mitsubishi alliance. Econometric data analysis provides the basic background behind our approach to elaborate the differences between national and corporate culture in MNC corporate governance schemes.

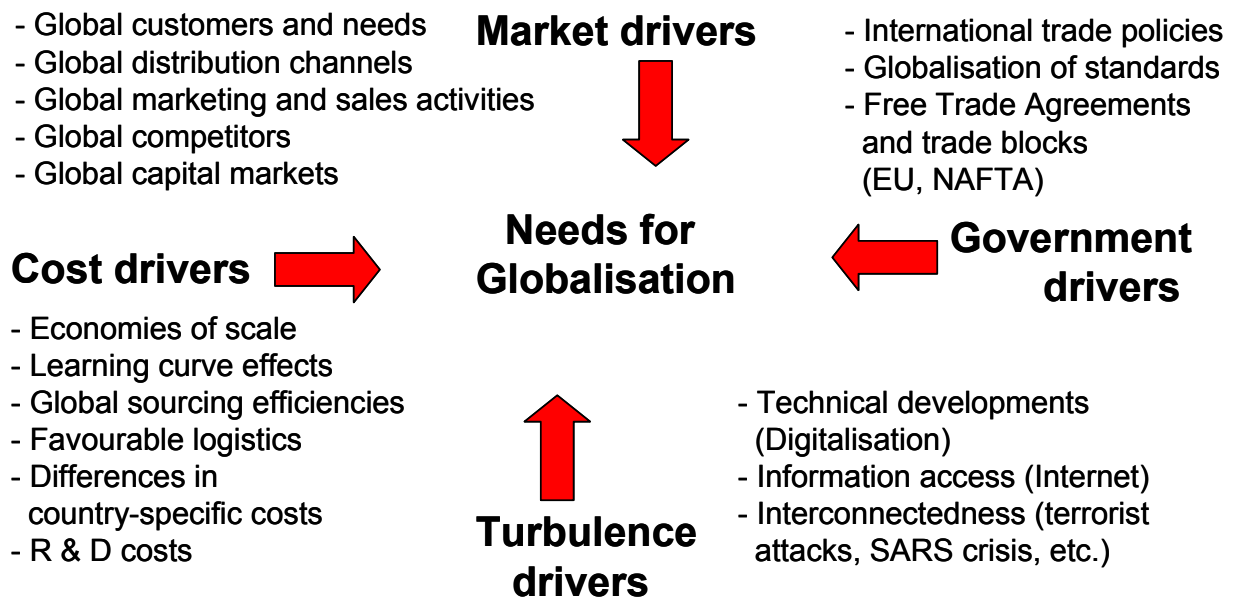
Key Words:

Multinational Corporations, Corporate Governance, Cross-border Alliances, Automotive Industry.

1. Turbulent times, MNCs and the choice of corporate governance systems

In recent times, there are hardly any industries left that show stable and predictable conditions. Digitalisation, deregulation and globalisation have changed whole industry structures. We see the breakdown of borders between nations, industries and organisations. Initially, multinational corporations (MNCs) respond with horizontal and vertical integration and disintegration, the formulation of cross-border alliances and the creation of networks of companies and independent contractors. Cases such as DaimlerChrysler, Renault-Nissan, and Vodafone-Mannesmann have been at the centre of this discussion. In addition, whether caught in a recession or an extreme market correction, the world economy is experiencing significant slowdowns. This has led to budget pressures at every level; profit margins have fallen and consumer confidence is slipping. The results are discontinuous, turbulent developments with high uncertainty. The outlook for immediate recovery is measured – a pragmatism which has been deeply influenced by the September 2001 terrorist attacks in the U.S., the Iraq war, and the SARS crisis.

Figure 1: Forces towards globalisation



Source: own figure

In light of today's changing industrial structures, uncertain marketplaces and extreme budgetary pressures, successful MNCs do not only re-act to changes; they also act and thus are part of the changes. In this sense, forward-thinking enterprises are taking proactive measures to streamline their business environments to achieve higher efficiencies and better returns, while weathering current market conditions. Only enterprises that gain competitive advantage will survive. But how does one get a step ahead of the competition? Corporate governance – understood as the modes of organising ownership and management of a corporation, as well as control of and incentives for management, (Shleifer and Vishny 1997, among others) – could be at the centre of discussion for framing this development. The significance of the subject can also be seen in changing legal frameworks required by the changing, highly volatile international environment, like the Sarbanes Oxley Act in the U.S., the new Commercial Code in Japan, and a number of Corporate Governance Codes in Europe.

We organize our paper as follows: In the first part, external and internal pressures on the international activities of MNCs in turbulent times are developed. In the next section, we define corporate governance systems, describe the main differences between the systems that the companies we investigated work in, and finally try to interlink this with the widespread development of MNCs and their international operations. This section also deals with the decision-making process concerning corporate governance structures in MNCs, whereas the fourth section presents the empirical investigation of three major groups in the automotive industry, Toyota, Renault and Nissan, as well as DaimlerChrysler and Mitsubishi Motors. At the end, conclusions are drawn, the limitations of our study are discussed and the potential for further research is examined. We also try to draw preliminary managerial implications out of this research.

2 MNCs and the balance between internal and external pressures

A main driving force behind the modern economy are MNCs, which account for a considerable amount of worldwide GDP and trade. Therefore, MNCs attract an increasing share of attention in research.¹ According to

¹ As indicated by the conferment of the 2003 Palgrave Macmillan/*Journal of International Business Studies* Decade Award to Bruce Kogut and Udo Zander for their article, *Knowledge of the Multi-National Cooperation* (Kogut and

Costello and Costello (2002), management scholars applied existing theory to explain the relations between the mother company and the subsidiary. If this is applied to corporate governance research, however, there is still an unexplained width of variation within the corporate governance mechanisms the firms use. In the framework of Costello and Costello (2002), the firms do not decide upon one certain mechanism to improve competitiveness and adapt to the changing environment, but rather use a bundle of different mechanisms from which some can be substituted by others from the same bundle. The choice of corporate governance mechanisms could be seen in this framework as a function of specific factors that represent critical strategic, environmental, and structural contingencies for the parent-subsidiary relationship in MNCs, such as “(1) the international strategy of the multinational corporation; (2) subsidiary’s importance for the MNC system; (3) subsidiary’s resource dependence on host country factors; (4) level of environmental uncertainty faced by the subsidiary, (5) level of product market competition faced by the subsidiary; (6) subsidiary’s size, and (7) subsidiary’s age” (Costello and Costello 2002, 3).

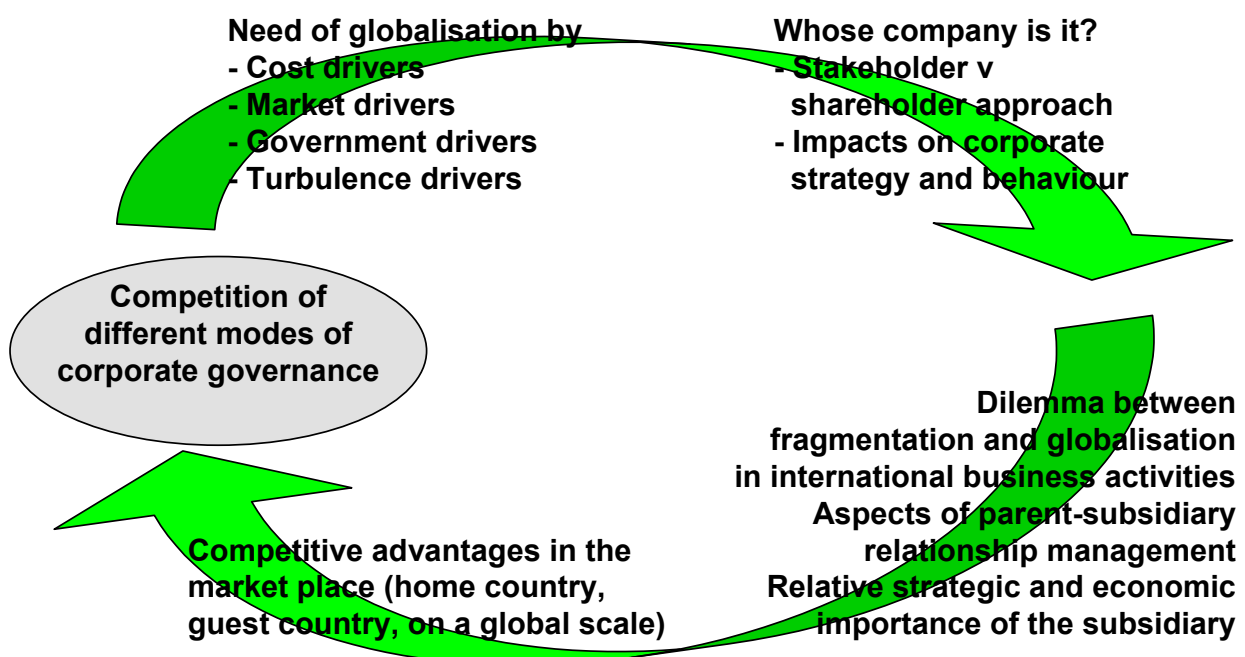
These factors are becoming even more complex due to the enormous variety of subsidiaries in existence. Adapting the definition used by Birkinshaw and Hood (1998, 773), a “subsidiary can refer to the totality of the MNC’s holdings in a host country or to a single entity, such as a manufacturing or sales operation. Subsidiaries are established for a variety of motives (e.g., resource seeking, market seeking, or efficiency seeking) and through a variety of modes (e.g., greenfield, acquisition, or joint venture).” Finally, the relationship of the subsidiary to the parent company can also be anything from legal holding company to fully integrated.

Due to the speed of economic change and political development, MNCs need much quicker processes for decision making, sometimes despite their incomplete information. New regulations require new, robust reporting techniques. Moreover, successful development in turbulent times requires breaking traditional rules and business models, as well as new ways of thinking. Most of these changes cannot be initiated and applied on the basis of traditional competitive thinking. They require new partnerships; they need conversions that cross the boundaries of function, technology, hierarchy, business, and geography. Thus, for MNCs in turbulent times,

Zander 1993), and the recent focused issue of *JIBS* on *Organizing Knowledge Processes in the Multinational Corporation* (Foss and Pedersen 2004).

corporate governance has to, on the one hand, face the following constraints, which, on the other hand, provide ideas for new thinking and acting: (1) There is a parent-subsidiary relationship in MNCs, in addition to the relationship of ownership and control that every firm is faced with, and management of the subsidiary may take certain actions to develop the subsidiary for the benefit of their country or for themselves; (2) MNCs are faced with different corporate governance systems in their home countries compared to their host countries. On the one hand, this also influences the availability and effectiveness of corporate governance mechanisms, and on the other hand, may force the MNCs to undertake activities in a particular country that they would rather do elsewhere; (3) Diversity, creativity and ability to experiment are inherent in the complex international organizational structure of MNCs.

Figure 2: Framework for research

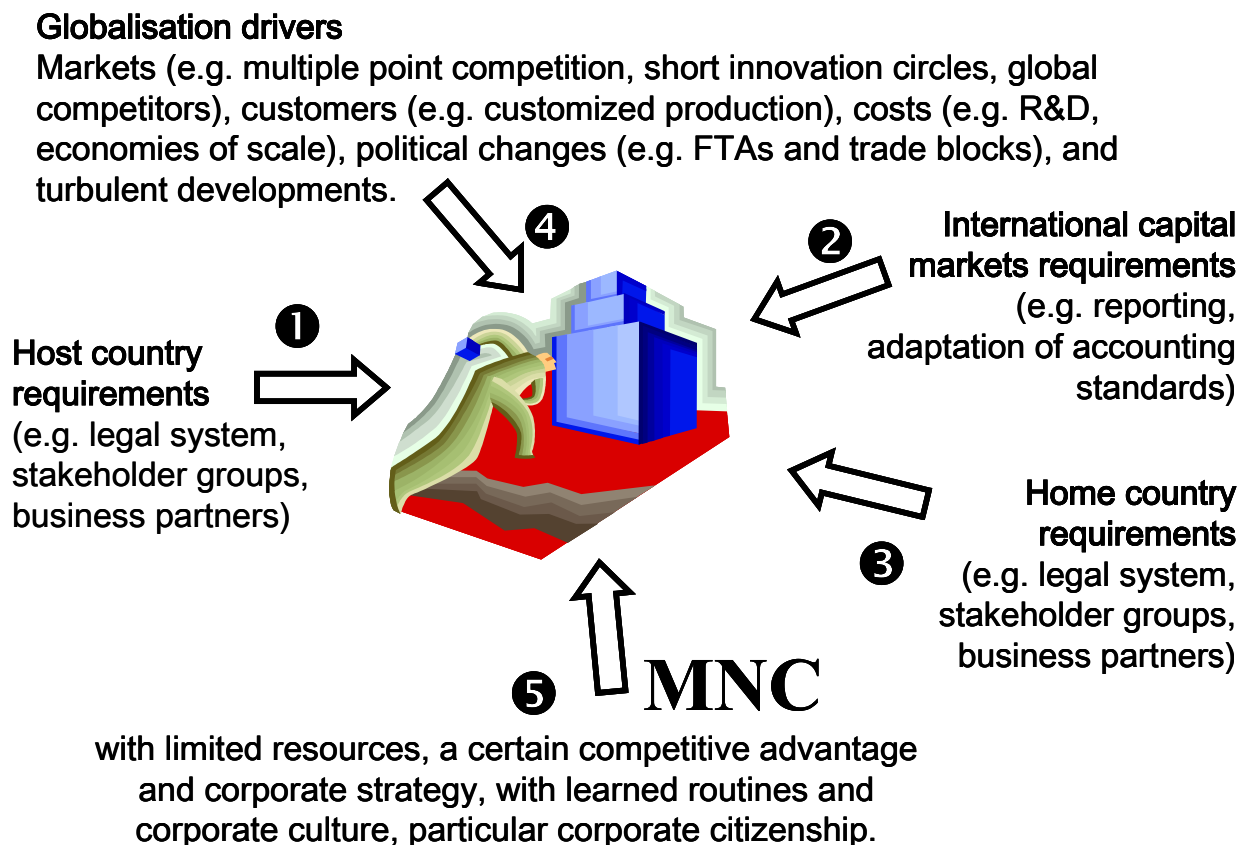


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This is the framework our paper is embedded in (refer also to Figure 2). For this paper we are interested in the question of to what extent subsidiaries of multinational corporations adopt the corporate governance mechanisms of

their mother corporations, their direction towards more flexibility and more strategic innovativeness in managing the overseas investment, and the level of success they achieve in these turbulent times. It is our assumption that the MNC has to find the balance between: (1) the corporate governance system in the host country of the subsidiary, under the legal framework and all its constraints, (2) the demands and expectations from international capital markets and the home country of the mother company, (3) market forces, new regulations etc. which require constant strategy realignment and restructuring, (4) the competitive advantage of the MNC across customers, partners, and suppliers, and (5) the forces towards globalisation (refer to Figure 3).

Figure 3: Balance between internal and external pressures



Source: own figure

A short example explains our assumption. With the Sarbanes-Oxley Act of 2002, all corporations that were listed in the U.S. had to fulfil new requirements concerning their corporate governance. For Japanese and German MNCs, this meant a number of severe difficulties, including legal conflicts involving the laws in the home countries of the parent

corporations. The German system of co-determination, for instance, requires that half of the members of the supervisory board come from the employees' side – which contradicts the Sarbanes-Oxley rule that the majority of board members have to be outsiders. For Japanese corporations, this rule also turned out to be very difficult, since in Japan the most common career path lies within the firm, and therefore most directors simply belong to the firm. In the end, it was agreed that German and Japanese corporations do not have to fulfil all the requirements of the Sarbanes-Oxley Act.

But the need for balance goes far beyond the legal system. To give another example, capital markets in the U.S. and in Japan and Germany operate at different speeds. While in the U.S., quarterly reports are common and the speed is high, in Germany and Japan the orientation tends to be more long-term. Porsche's CEO Wendelin Wiedeking refused a New York Stock Exchange listing because of the quarterly reporting and the enormous pressure for speed that would contradict the strategy of the firm. We therefore hypothesize:

Hypothesis 1: MNCs have to find a balance between the corporate governance systems of their home country, and these of the host countries with established subsidiaries. In this process, the subsidiaries will gain influence in line with their relative strategic and economic importance for the parent company.

Based on these findings and views, it seems important to investigate which choices MNCs have and how they use them. Is Toyota America, in terms of its corporate governance structure, more Japanese? Is Nissan – with Renault as major shareholder – now a company with a European style of corporate governance, or is it still more Japanese? Each type is a fundamentally different approach to creating and sustaining a firm's unique position in the market, combining the type of competitive advantage a firm seeks, and the scope of its strategic target translated into differences in organizational structure and culture. We argue that MNCs in those turbulent times may chose between several systems and mechanisms of corporate governance. Usually an MNC must make a choice between them, or it will become “stuck in the middle”. According to Porter (1985, 16), this strategic position is usually a recipe for below-average performance. An MNC that is stuck in the middle will earn attractive profits only if the

structure of its industry is highly favourable, or if the MNC is fortunate enough to have competitors that are also stuck in the middle.

It is our assumption that any hybrid form of corporate governance mechanism in MNCs will not be successful. Becoming stuck in the middle is mainly a manifestation of an MNC's unwillingness to make choices about how to organize its business and how to compete on the organizational level. It tries for organizational advantages through every means and achieves none, because achieving different modes of corporate governance requires actions that may be not compatible with each other in different economies. This is not only the case for companies with below-average performance, for as Porter (1985, 17) also argues, becoming stuck in the middle also afflicts successful companies, who compromise their advantages for the sake of growth or prestige. Regarding this, we hypothesize:

Hypothesis 2: Only MNCs who can achieve and keep stable corporate governance systems even in different markets worldwide perform more efficiently and effectively. Any hybrid form of corporate governance in MNCs will not be successful.

Of course, changes in economic policy or in industry structure can affect the bases on which corporate governance systems are built, and thus alter the balance among them or the size of advantage that results. And as successful corporate governance systems are also a potential threat to the competitors, it is usually necessary for an MNC continually to observe its strategic goals and premises, and to initiate process thinking in order to improve its position. We are not claiming that MNCs change their corporate governance systems simply to change but, rather, that MNCs change in response to perceived problems in the constraints developed in Figure 3. Structural inertia theorists argue that change is infrequent, particularly among large and/or old organisations. Inertia theory assumes that reproducibility generates strong inertial forces and resistance to change (Hannan and Freeman 1984). Structural resistance to change lengthens the time necessary to make a change. As a consequence, Hanan and Freeman (1984, 162) argued that “although slow response does not necessarily imply a lower rate of attempting structural change, it seems likely that this is the tendency.” Thus, MNCs are likely to behave in the future according to previously used routines. Over time, MNCs develop not only operating

routines, but also “modification routines”: procedures for changing and creating new operating routines (Nelson and Winter 1982, 17). To routinize this process of change, however, an MNC must gain experience in modifying operating routines. In short, “organizations learn to change by changing” (Amburgey, Kelly and Barnett 1993, 54).

Over and above this dynamic, we argue that, in addition, (1) host country requirements, (2) international capital market requirements, (3) home country requirements, and (4) globalisation drivers affect the chances of organisational change in MNCs (refer to Figure 3). In particular, we think that: First, changing routines require that the MNC develops or acquires additional human and physical capital, institutionalizes new processes and objectives, and shifts the distribution of power within the MNC – all potential internal sources for resistance to change according to the literature. Second, the embeddedness of the MNC within a web of inter-organizational relationships, and the taken-for-granted image of the MNC, are external sources of resistance (e.g., refer to Schumpeter 1934; Hannan and Freeman 1984; Granovetter 1985). We therefore hypothesize:

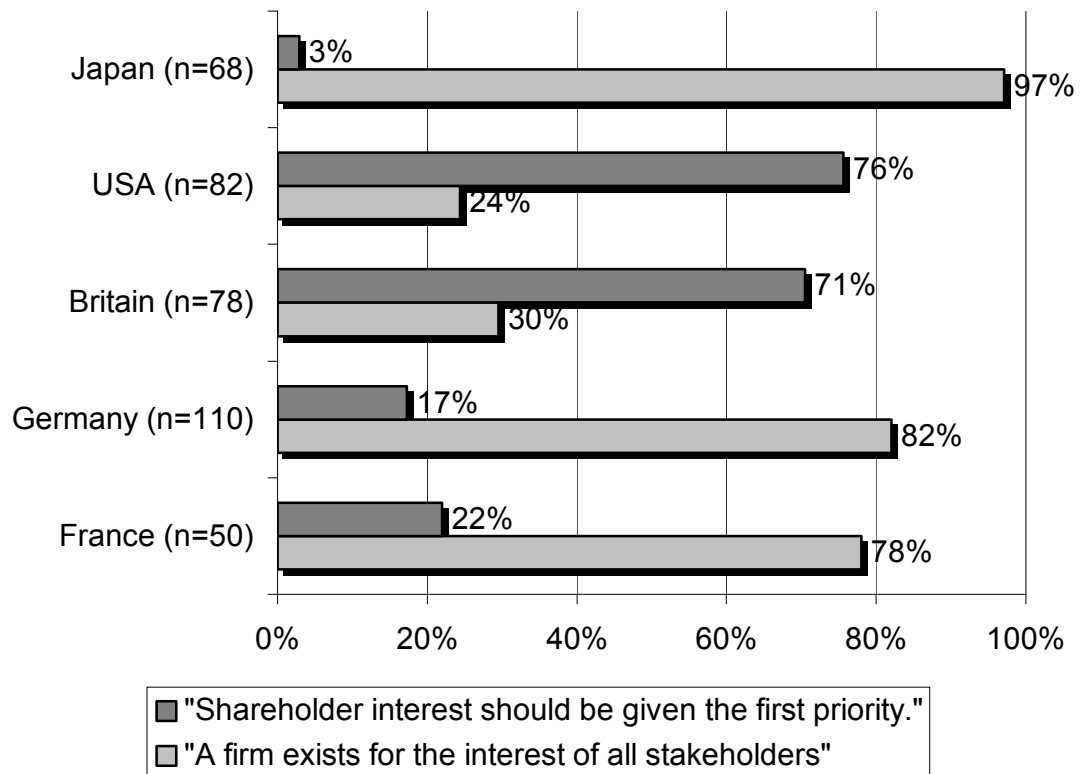
Hypothesis 3: The positive effect of organisational change on performance increases if the aims and objectives are clear in the long term and in accordance with the perception of the relevant stakeholders and the overall international reputation of the MNC.

3 Impact of corporate governance systems on the MNC

Comparative analyses start from the point that in different countries or systems the answers to the same question can differ and do, sometimes, to an enormous degree (Waldenberger 2002, 179). In the context of corporate governance, where the separation of ownership and control is seen as the starting point, the first and foremost question should be “Whose company is it?”, as this is the foundation on which the monitoring system is built. In this context Yoshimori (1995) examines the differences in the concept of the enterprise and their possible implications for corporate performance. He makes clear that the largest differences are to be seen between the U.S. and the U.K. on the one hand, and Japan on the other (cf. Figure 4). The main difference between them is that the Anglo-Saxon system pays more

attention to the shareholders, while in the Japanese system stakeholders (and especially the employees among them) are at the centre of attention.

Figure 4: Whose company is it?



Source: Yoshimori (1995, 34).

We will, therefore, compare the Anglo-Saxon and the Japanese systems of corporate governance, and thereby lay the theoretical foundation for the empirical analysis.

3.1 Corporate governance and ownership

The split between ownership and management does of course apply to many Japanese firms and the majority of the large ones (OECD 1996), which are the topic of our investigation. Although Japan is far from being the litigious society the United States is, the legal system at least protects investors' rights (Shleifer and Vishny 1997, 770). But individual shareholders count for only about a quarter of the outstanding shares, while

institutional shareholders from financial institutions and from the industry count for the rest (Otto 1997, 45; Sheard 1996, 313).

The huge difference lies in the question of who the institutional shareholders are. The institutional funds (pension funds and professional investment funds), which play an important role in the Anglo-Saxon context, hardly play a role in Japan, where ownership structure and industrial organisation features are closely linked. Japanese institutional shareholders tend to be connected via stable cross-shareholdings. As a result, no external monitoring takes place, and these linked corporations distance themselves to a certain degree from the financial markets. This made mergers and acquisitions, and especially hostile takeovers, almost impossible. The most obvious sign of these linkages is the existence of industrial groups that are called “*keiretsu*”. There is an important distinction between horizontal *keiretsu* (*kigyō shudan*) and vertical production *keiretsu* (*seisan keiretsu*) (Dolles 1997, 108-142).

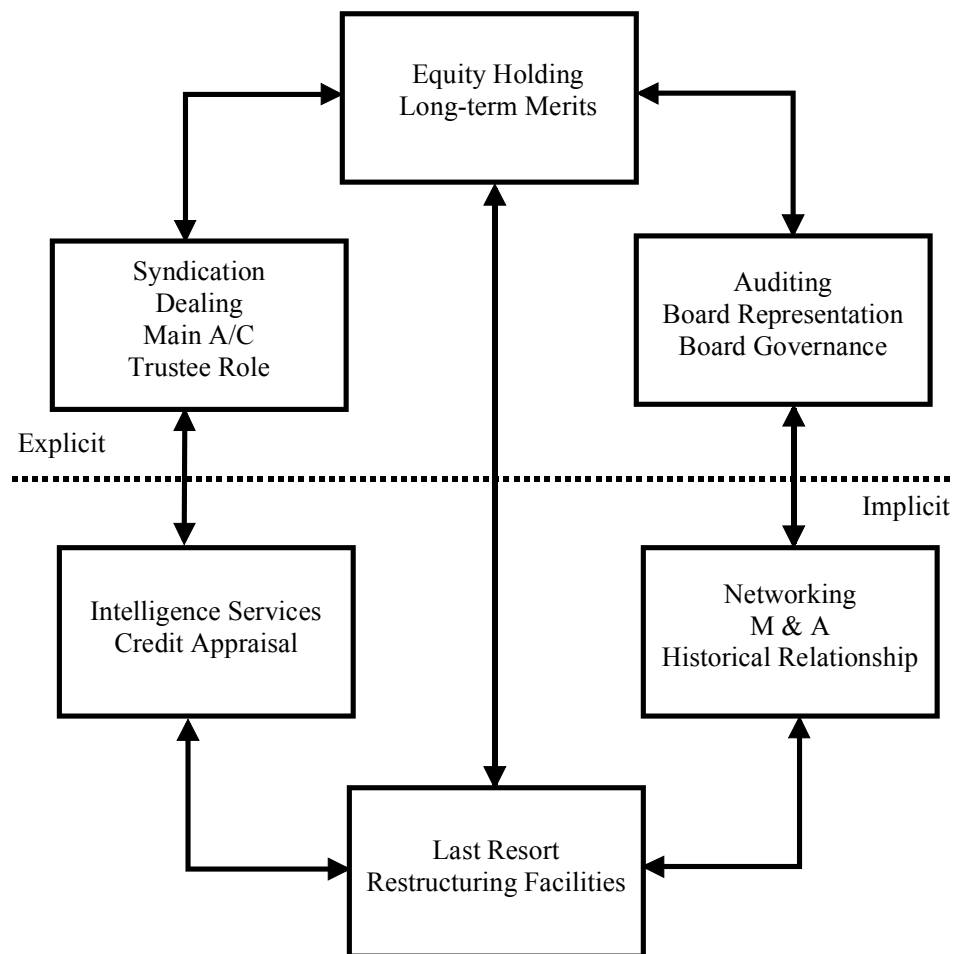
In horizontal *keiretsu*, such as the Mitsui, Mitsubishi etc. groups, shareholding is reciprocal. The monthly “Presidents’ Councils” may be seen as a monitoring body. By holding each other’s shares, companies signal their willingness to act as a group. Independent companies are also tied with other firms through reciprocal (“matrix”, Schaede 1994, 293) shareholding. This can be understood as a sign for business partners that the firms are willing to maintain long-term relationships (for further characteristics see Dolles 1997, 157-177).

In vertically integrated groups, shareholding is more likely to be hierarchical in structure, thus, as Schaede (1994, 292) points out, making these groups more comparable to western governance mechanisms. By holding a certain percentage of the shares, the core firm secures its control rights. As part of their management responsibilities, firms may temporarily assign managers to act as members of the board of another firm with which they are connected through cross-shareholding (see Takahashi and Dolles 1993 on the various modes of dispatchment). When the relationship between the firms is vertical in nature, it is common to send, at any one time, several executives of the core firm, i.e. the purchaser, to the supplier firm. When the relationship between firms is horizontal, the number of executives involved is smaller, but there is a reciprocal exchange rather than a one-way movement (Lincoln, Gerlach, and Takahashi 1992).

3.2 Corporate governance and financial institutions

The most crucial difference between the Anglo-Saxon and the Japanese systems of corporate governance, with respect to financing institutions, is that in the U.S. the Glass-Steagall Act prohibited banks, securities firms, and insurance companies from affiliating with and owning shares in firms with which they had a business relationship. In Japan, share ownership of financial institutions is not prohibited, but is limited to ten per cent of the shares. The ratio used to be five per cent but, due to mergers in the financial industry, it became necessary to revise this limit. In an overview of the several types of shareholders given by the Tōkyō Stock Exchange in 2002, about forty per cent of the stocks were owned by financial institutions (Tōkyō Stock Exchange 2002, 4).

Figure 5: Main bank and its tasks



Source: Sunamura (1994, 298).

The debate about the relationship between corporate governance and financial institutions in Japan almost equals the discussion about the main bank system. “‘Main bank’ is a practitioners’ term used by financial institutions, corporations, and regulators, as in ‘Bank X is the main bank of Firm Y’ [...] The traditional academic definition is that a main bank relationship is a long-term relationship between a firm and a particular bank from which the firm obtains its largest share of borrowings” (Aoki, Patrick, and Sheard 1994, 3). Within the horizontal *keiretsu*, if firms are satisfied with each other, the position of the main bank was until recently secure on a long term basis. Sunamura (see Figure 5) points out that all six functions of a main bank are important, however the real qualification of a main bank is the ability “to undertake restructuring or to bear the ultimate credit risk of clients. Such an undertaking is only possible if it is based upon extensive credit appraisal as well as careful monitoring of corporate performance. For this reason, the major qualifications of a main bank must be endorsed by practical managerial capacity in the *ex ante*, interim, and *ex post* relationships with clients” (Sunamura 1994, 297).

The main bank was seen as the delegated monitor and as responsible for revitalization in case of crisis (Fukuda and Hirota 1996; Kojima 1997; Katō 1995). And although the dependence of firms in Japan on the banks has decreased due to the growing use of the capital market, it is still very common for a firm to have a banker, or a person with a background in banking, on the board of directors.

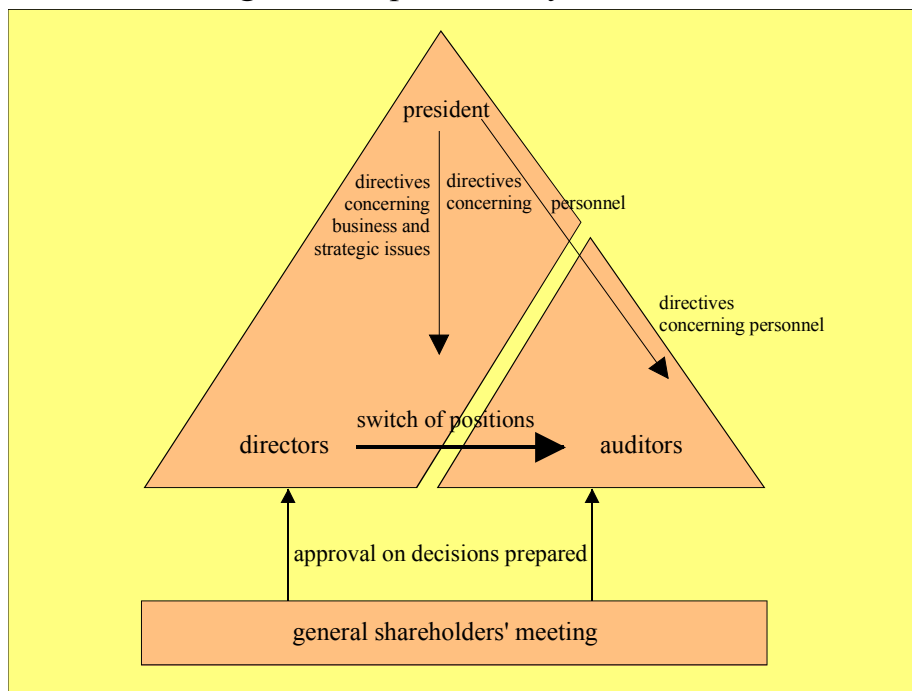
3.3 Corporate governance and the role of employees

Japanese literature on corporate governance constantly stresses the importance of the employees as stakeholders (Matsumura 1994; Sakakibara 1995; Takahashi 1995; Tanzawa 1995, and others). Based on a long-term view, employees accept lower wages at the beginning of their careers, knowing their investment will be compensated later. The situation would be different if Japan had a vivid external labour market (Dolles 2003). A well-developed external labour market would fulfil an insurance function for owners of human capital. Since this is not the case, employees (at least employees from large firms) stay with their firm or their group to pursue their careers. Becoming a member of the board is considered to be the last step in such a career and is fairly common. In fact, the majority of directors are insiders who have spent most of their careers within their firms. Given

the mutual and long-term character of personal relations in Japan, an inside director is continuously monitored by his former colleagues and thus cannot act independently (Moerke 2003).

This will become even more evident by taking a close look to the various positions in the Japanese board system (Moerke 2002). The board of directors, which is (de jure) elected at the shareholders' meeting, consists of directors at several levels, beginning with the Chairman (*kaichō*), the President (*shachō*), Senior Managing Directors (*senmu torishimariyaku*), Managing Directors (*jōmu torishimariyaku*) and the Directors (*torishimariyaku*). Every position is not necessarily found in every firm. Representative Directors (*daihyō torishimariyaku*) are chosen among the top level directors; they fulfil the task of representing the company and they often decide upon the firm's strategy and business tasks relatively independently (Koyama 1991, 1992, Hirata 1996, and Otto 1997). So even among the directors, people are not equal. The higher a certain person climbs in the hierarchy, the more influence he or she can exert. The position with the highest degree of freedom to decide things is the President (*shachō*). The following figure shows the “de facto” picture of board structures in Japanese public corporations.

Figure 6: Japanese de-facto Board Structures



Source: Moerke (2002, 69).

It is clear from the above that the board structure is a central point in the corporate governance scheme of a corporation, because it mirrors the balance of power between stakeholders and shareholders, and reflects the legal framework of the country within which the firm is acting. Therefore, our analysis concentrates on the links between stock corporations and certain stakeholders that are formed through director dispatch. But in contrast to several other studies, we do not only take the current dispatches into account, but also take the personal history of every director, and therefore his or her personal network, into consideration.

3.4 Corporate governance and international strategy

According to the international business literature, MNCs may choose from a range of corporative strategies in managing their international operations. Various authors have offered alternative typologies of international strategies to explain the range of options open to MNCs (Bartlett and Ghoshal 1986; Porter 1986; Prahalad and Doz 1987). The specific international strategy that an MNC pursues may have a significant impact on many of its dimensions, ranging from the system of corporate governance to the interest alignment that is necessary to carry out its strategic plans. Adapting the proposition made by Costello and Costello (2002, 9), this leads us to expect “that the international strategy of a multinational can have an impact on the cost-benefit tradeoffs among corporate governance systems for the subsidiaries and the control potential of bundles of monitoring and bonding mechanisms for the multinational’s subsidiaries, thereby influencing the composition of the subsidiary bundles of corporate governance mechanisms.” Following Bartlett and Ghoshal’s (1995) distinction of four types of international strategy (i.e., international, multinational, global, and transnational), we assume that each of these strategies has different implications in terms of the cost-benefit tradeoffs among corporate governance mechanisms for the subsidiary, and the control potential of the bundle of monitoring and bonding mechanisms for the subsidiary.

In much of the mainstream organisation theory literature, scholars view organisational action as constrained and determined by the environment in which it occurs (e.g. Hannan and Freeman 1977; Meyer and Rowan 1977; Pfeffer and Salancik 1978). The literature on international business has adapted this perspective by proposing that each subsidiary of the MNC

operates in its own unique task environment, which constrains and determines the activities of that subsidiary (e.g., refer to Ghoshal and Bartlett 1991; Ghoshal and Nohira 1989; Rosenzweig and Singh 1991; Westney 1994). We argue that each subsidiary operates under a unique set of conditions to which it has to adapt in order to be effective. The nature of the local environment, as defined by market drivers (customers, distribution channels, etc.), cost drivers (economies of scale and scope, learning and experience, R&D costs, etc.), competition drivers (globalised and local competitors, etc.), and government drivers (trade policies, technical and environmental standards, market regulations, etc.), thus has an important influence on the activities undertaken by the subsidiary on the one hand, and on the composition of the bundles of corporate governance mechanisms of the parent company on the other hand.

Those relationships will be even more complicated if we include international joint ventures and mergers and acquisitions in the make-up of the MNC's subsidiaries. Furthermore, globalisation and deregulation, such as recent shifts toward regional free trade agreements, are leading to international disinvestments, rationalizations and mergers and acquisitions, which in turn lead to further changes in the parent-subsidiary relationship.

4 Case studies

For the empirical analysis, we have chosen the automotive industry, because it is characterised by a high degree of globalisation. The consolidation of the industry, mainly through cross-border alliances, led to a high concentration of a few internationally operating corporations as major players, and a number of small corporations as niche-players. Among these players, we have chosen three distinct MNCs, namely the Toyota group, the Renault-Nissan alliance, and the DaimlerChrysler-Mitsubishi alliance. We paid special attention to Japan, since Japan's corporate governance structures are most different from those in the Anglo-Saxon context.

4.1 Case J1: Toyota Motor Corp.

Toyota Motor Corporation is actually number two worldwide in terms of sales, but is number one in terms of profitability. Toyota's consolidated sales – rising every year – amounted to 16 trillion JPY in 2003 and 17.3 trillion JPY in 2004 (Toyota Motor Corp. 2003, 11; Tōyō Keizai Databank

2004). The name Toyota is linked to the famous Toyota Production System, which includes concepts like *just in time*, *kaizen*, *zero-defect*, and others. In Japan, Toyota employs some 65,000 people (consolidated 264,000) and has about 17 subsidiaries (plus 39 foreign subsidiaries) (for a description of the Toyota group and history refer to Dolles 1997, 115-120; or see http://www.toyota.co.jp/en/about_toyota/history, accessed October 24, 2004).

Concerning corporate governance structures inside Japan, it should be mentioned that Toyota officially belongs to one of the horizontal *keiretsu* groups in Japan (the Mitsui group), and is a member of the presidents' council of the group, called "*nimoku kai*". However, Toyota is also at the top of its own production *keiretsu*, with first and second tier suppliers. Due to the enormous economic strength of Toyota, it is questionable whether the presidents' council does in fact fulfil a governing function (as it is said to do in the case of other firms, cf. Schaeede 1994).

A closer look at the board structure reveals that the parent company, Toyota Motor Corp., is a typical Japanese corporation. First, the number of members on the board of directors is fairly large. In 2003, there were 27 directors and 7 auditors (whereas in 2000 there were 56 directors and 5 auditors). Although the reduction is remarkable, Toyota's board size is still on the upper end of the scale of usual board sizes (Moerke 2001, 57).

Second, the board mainly consists of insiders. Among the 34 board members, only one regular director (*torishimariyaku*) and four of the auditors (*kansayaku*) came from outside the firm. The "outside director" came from Tōkyō Kaijō Hoken, an insurance company. But Tōkyō Kaijō does not belong to the top ten shareholders. Two of the so-called "outside" auditors originally came from Toyota's subsidiary Nippon Densō, and Toyota Automatic Loom, another group company. The remaining members started their careers in state institutions and universities. From these facts, one can conclude that Toyota Motor Corp. (Japan) does not fulfil the requirements of the Sarbanes-Oxley act in terms of independent boards. (however, Toyota North America, Inc. does.)

Despite the fact that the board is so big (and huge boards were often said to be inefficient, cf. Hirata 1996), Toyota Motor Corp. is performing well. In the following table, two ratios are given that measure the success of a company for a shareholder, namely return on equity and profit per share. With these figures, one could also say that Toyota, although being a very

Japanese company in terms of structure, is in terms of corporate governance very shareholder-oriented.

Table 1: Toyota's continued success: data from the consolidated statement

	March 1999	March 2000	March 2001	March 2002	March 2003	March 2004
ROE (%)	5.8	6.3	6.8	8.5	12.8	14.2
Profit per Share (JPY)	94.21	109.95	127.88	170.69	272.75	342.90

Source: Toyota's annual report (yūka shōken hōkokusho) June 2003 and Tōyō Keizai CD-ROM Database (kaisha shiki hō).

Toyota is ranked as the world's number two top automotive group, manufacturing 6,008 thousand units of passenger and light commercial vehicles in 2003. Toyota's role as a leading OEM for the group can also be seen in the board structure and in the shares Toyota owns. With respect to ownership, Toyota seems to follow the strategy of wholly-owned subsidiaries wherever possible. This can be seen in Japan (with more than half of the subsidiaries being fully-owned), but is even more apparent overseas. Out of the 27 biggest subsidiaries outside Japan, 22 are fully-owned, and in two more Toyota's stake is 99% and 90% respectively. The link with the subsidiaries in foreign countries is also visible on the board of directors, insofar as ten of the directors are or were representatives of Toyota Motor Corp. in their subsidiaries.

4.2 Case J2: Renault and Nissan Motor Co.

The case of Renault and Nissan Motor Co. is certainly one of the most interesting in this field. Before Renault acquired 36.8% (now 44.4%) of Nissan's shares, the troubled Japanese car maker had been talking unsuccessfully with Daimler-Benz. Daimler-Benz considered Nissan to be the wrong option and therefore chose Mitsubishi Motors. Nissan, the former number two in the Japanese market, was performing badly at that time. It had operative losses for seven years in a row, a huge amount of debt, sluggish sales and diminishing popularity among the customers.

Unlike Toyota Motor Corp. and Mitsubishi Motors, Nissan was not part of a horizontal keiretsu group, and therefore no group of companies held a

major percentage of Nissan's shares (and no group of companies was trying to influence the management). One can only speculate if Nissan would have done better if it was a member of a horizontal *keiretsu* group, monitored by others and eligible for using the so-called insurance function of horizontal groups (i.e. mutual support in times of crisis).

Nissan's corporate governance structures were what is usually described as typically Japanese, namely a huge but ineffective board (43 directors in several positions in 1998), almost all from inside the corporation. Instead of control by and transparency for the shareholders, the company followed the aims of the CEO. He made decisions on the board of directors and statutory auditors, but the statutory auditors did not have the power to control the CEO's actions, and could not intervene when something did not meet good corporate governance standards. Furthermore, Nissan showed strong bureaucratic tendencies,² and the corporate culture was characterized by a lack of personal responsibility for one's own actions (Takarabe 2002, 22).

The engagement of Renault at Nissan was accompanied by the acquisition of 15% of Renault's shares by Nissan through a reserved capital increase. However, there is an important difference between the two share purchase arrangements. Renault's share ownership means voting rights and the right to dispatch personnel and make decisions, while the shares Nissan bought did not give the company any voting rights. With the transactions, the shareholding structure of both corporations changed, but to differing degrees. For Renault, the biggest shareholder is still the French state with 17.7%, followed by Nissan (15%), the group of employees (4.1%) and treasury stock (4%). The remaining 61.2 % are publicly traded. Nissan changed from being a company with a very dispersed ownership (where the ten major shareholders combined owned roughly 20% of the shares) into a company with one dominant shareholder. In 2002, the jointly and equally owned Renault-Nissan bv³ was founded as a strategic alliance management company to define a common strategy and to manage synergies (Renault-Nissan 2004).

Being the dominant shareholder, Renault exercised its right to dispatch personnel to the board of directors and restructure Nissan. In the first stage,

² According to an interview, Nissan was nick-named the "MITI of Ginza". The Ministry for International Trade and Industry, now METI, can be seen as the symbol for bureaucracy in Japan. Ginza is the district in Tōkyō where Nissan's headquarters are located.

³ bv (besloten vennootschap) is a closed limited liability company under Dutch law.

the number of directors was reduced – from forty three in 1998 to ten, and is seven now, plus four auditors. Among the seven board members, there are only two members who were dispatched from Renault, CEO Carlos Ghosn and Patrick Pélata. Besides the board of directors, Nissan now has an Executive Committee with eight members (out of which six are also represented on the board), and a group of twenty four so-called “corporate officers”. Almost all members of the board of directors are also members of this group of corporate officers. Nissan obviously adopted Renault’s top management structure, where there is a “Group Executive Committee, CEG” led by CEO & Chairman Louis Schweitzer, a “Management Committee” that consists of the CEG and eighteen other members, and an additional group of fourteen vice presidents with corporate functions, as well as a group of four auditors.

Together with this new board system, Renault started a wide-ranging restructuring of Nissan’s purchasing policy and supplier relations, production structure, and model change etc (for detailed descriptions see Renault-Nissan 2004; Takarabe 2002). In terms of corporate governance, the introduction of personal responsibility and the improvement of transparency are worth mentioning. Nissan changed from a typical Japanese corporation into a subsidiary and partner of a western-type firm, or to use transaction cost theory terminology, Nissan shifted from organisation to market (-orientation).

Due to this shift, the economic downturn could be stopped, and turnaround could be reached (for details, refer to Takarabe 2002). It is even more remarkable that last year Nissan’s revenues as well as Nissan’s net income were higher than the revenue and net income of Renault. The combined production of Renault and Nissan today represents over 9% of the global market, at 5,199 thousand passenger and light commercial vehicles a year. The Renault-Nissan alliance is one of the top five carmakers in the world, with its five brands: Nissan and Infiniti for the Nissan group; Renault, Dacia and Samsung for the Renault Group (Renault 2004).

Table 2: Nissan's recovery: data from the consolidated statement

	March 1999	March 2000	March 2001	March 2002	March 2003	March 2004
ROE (%)	n.a.	n.a.	35.08	28.87	28.88	26.29
Profit per Share (JPY)	-11.03	-179.98	85.53	92.61	117.75	122.02

Source: Nissan's annual report (*yūka shōken hōkokusho*), June 2003 and June 2004.

4.3 Case J3: DaimlerChrysler and Mitsubishi Motors Corp.

Mitsubishi Motors Corp. was not in very good shape when DaimlerChrysler AG offered to buy about one third of its shares. It had mounting operative losses, diminishing customer interest, and considerable delay in product development. All these features seem very much like those in the Nissan and Renault case, but DaimlerChrysler, as well as Mitsubishi Motors Corp., always refused to accept this comparison. A closer look reveals important structural differences.

The first and most obvious difference lies in the organisational structure of corporate governance relations. Mitsubishi Motors Corp. was, and still is, one of the core corporations of the horizontal Mitsubishi *keiretsu*. Horizontal groups are characterised by stable cross-shareholding, director dispatch and presidents' councils. And this is also the reason that Mitsubishi Motor's main shareholders came from the Mitsubishi group: Mitsubishi Heavy Industries, Mitsubishi Corp., and the Bank of Tōkyō Mitsubishi. It should be added that Mitsubishi Motors Corp. is the spin-off of Mitsubishi Heavy's automotive section in 1964, when the three Heavy-Industries merged into Mitsubishi Heavy Industries (refer to <http://www.mitsubishi-motors.com/corporate/museum/history>, accessed October 24, 2004). Due to these structures, it comes as no surprise that the board of directors was dominated by people from the Mitsubishi group.

When analysing Mitsubishi Motors Corp.'s corporate governance structure, one fact should not be forgotten, namely that Mitsubishi Motors Corp. lacked transparency and rules of good governance. To give two examples, customers' complaints were hidden for years at Mitsubishi Motors Corp.,

and they consistently refused to intensively investigate the reason behind design defects in truck wheel hubs at the spun-off Mitsubishi Fuso⁴. With the investment in (and alliance with) Mitsubishi Motors Corp., DaimlerChrysler wanted to get closer to the “World AG”, i.e. the strategic vision of a truly globally operating car manufacturer. The merger of Daimler-Benz and Chrysler – which can be viewed as an acquisition of Chrysler – took place in 1998. Two years later the investment in Mitsubishi Motors Corp. was realized.

DaimlerChrysler is still a German corporation in terms of shareholdings – 55% of the shares are owned in Germany by Germans, and Deutsche Bank is still one of the biggest shareholders (12%). DaimlerChrysler has the German dual organizational structure with a management board and a supervisory council. The management board is rather small, for it only has fourteen members. The supervisory council is bigger, it has twenty members, and in accordance with the German co-determination law, half of them are from the employees’ side.

By buying about one third of Mitsubishi Motors Corp.’s shares (33.70%), DaimlerChrysler became the largest shareholder of Mitsubishi Motors Corp. However, the second-largest shareholder is Mitsubishi Heavy (14.82%), followed by Mitsubishi Corp. (5.21%). Overall, the Mitsubishi group holds about 26.21% of Mitsubishi Motors Corp.’s shares – and is a powerful counterpart to DaimlerChrysler. DaimlerChrysler, of course, used the right of sending personnel to the Japanese automaker, and started to restructure the firm. Similar to Nissan, the board was reduced in size. As of May 2004 it consists of ten directors (five of whom are foreigners from DaimlerChrysler, one of them being the German-born Rolf Eckroth who is CEO) and four auditors. Four of the five Japanese directors are, again, insiders from the Mitsubishi group, and so are all statutory auditors. In other words, there was and is no independent monitoring and auditing of the firm. In addition to the board of directors, a committee of executives (*shikkōyaku*) was created. It consists of 36 people, out of which only nine came from Daimler or Chrysler. Bearing these figures and the background of the directors in mind, it is questionable if there really was a balance of power (if not, the Mitsubishi group still had the final decision).

⁴ With DaimlerChrysler now owning 65% of the shares, new investigations have been made and have led to the conclusion that a design mistake can not be excluded. Therefore, Fuso’s chairman Takashi Usami had to resign on April 16th 2004.

Furthermore, the German top-management team was quite eager to obey the rules of the Mitsubishi game. It was often stated that Rolf Eckroth, as Mitsubishi Motors Corp.'s CEO, participated in the monthly Mitsubishi group presidents' council because he felt this would be necessary. Mitsubishi Motors Corp. remained a Japanese corporation – even though the major shareholder was German and the company was increasingly being integrated into DaimlerChrysler's strategy. Despite the announced dissolution of the “suppliers' council” (an association of the suppliers that used to engage in negotiations with the OEM) in order to save costs, Mitsubishi Motors Corp. continued to purchase within the Mitsubishi group, such as engines at Mitsubishi Heavy, car electronics at Mitsubishi Electric, etc. Finally, the sluggish sales in the U.S. that were responsible for a huge part of Mitsubishi Motors Corp.'s losses last fiscal year, show that DaimlerChrysler neither managed to secure proper monitoring and reporting nor risk management. With appropriate governance mechanisms, it should have been possible to track and communicate the development of the U.S. market. It is somewhat ironic that Mitsubishi Motors Corp.'s vice president of international sales, who was responsible for the U.S. market, originally came from Chrysler and, after being forced to leave Mitsubishi Motors Corp. to take responsibility for the losses, moved back to DaimlerChrysler in the U.S.

The combined production of Daimler-Chrysler and Mitsubishi Motors Corp. increased their sales to 5,535 thousand passenger vehicles and light commercial vehicles in 2003, with the alliance thus ranking as number four out of the top automotive groups. The following table shows the development of Mitsubishi Motors Corp.'s return on equity and profit per share. If compared with the other two examples, it becomes clear that the performance is worse than that of Nissan, and at least in terms of profit per share, is also worse than that of Toyota.

Table 3: Mitsubishi Motors Corp.: data from the consolidated statement

	March 1999	March 2000	March 2001	March 2002	March 2003	March 2004
ROE (%)	1.60	n.a.	n.a.	4.27	13.56	-138.86
Profit per Share (JPY)	6.15	-24.87	-232.77	7.66	25.35	-145.22

Source: Mitsubishi's annual report (yūka shōken hōkokusho), June 2003 and June 2004

5 Conclusion

This paper deals with the question of to what extent subsidiaries of an MNC adopt the corporate governance mechanisms of their parent corporations, and the level of success they achieve. We proved the assumption that even in turbulent times successful corporations are able to establish stable corporate governance systems.

Toyota Motor Corp., although very Japanese in its corporate governance structure (understood as board size, insider-orientation of the board, representation of personnel from financial institutions on the board) shows top performance and has been doing so for many years. And as successful corporate governance systems are also a potential threat to competitors, it is not unusual that Toyota invests in order to continually improve its position. From that we conclude that Japanese corporate structures can be very effective and are not limited to a period of economic growth. This view is also shared by the most recent study of Yoshimori (2004), and contradicts the previous research of, for instance, Hirata (1996). With respect to our hypothesis, we see that if a contingent strategy is followed, economic success can be achieved (H1, H2).

With successful restructuring and change in the case of the Nissan Renault cross-border alliance, it is obvious that it is possible to change the Japanese features in the corporate governance system of a Japanese company towards more market-orientation, and still be economically successful. The point is that Renault was able to develop a strategy that moved Nissan in the right direction. Of course this strategy was adjusted and implemented through experimentation, but it was a clear strategic vision of corporate governance through action which has led to above average performance today (H3).

What does not function, however, are MNCs that are stuck in the middle through combinations of different systems and orientations. In the automotive industry, the alliance between DaimlerChrysler and Mitsubishi Motors Corp. is the best example (H2). To sum up the findings for Mitsubishi Motors Corp., it seems quite clear that the attempt to create a hybrid form of governance system was not, and indeed cannot be successful. It remains an open question as to whether this was DaimlerChrysler's strategic fault, or whether the almighty Mitsubishi group

did not allow DaimlerChrysler to act as they had wanted (H3). At the beginning of October 2004, Mitsubishi Motors Corp. announced the revival of their umbrella-organisation for the suppliers (Nikkei Shinbun, October 9, 2004). This is only one indicator showing that Mitsubishi Motors Corp. – after DaimlerChrysler refused to participate in the capital increase and was therefore overtaken as number one shareholder by Phoenix Capital – has returned to old organisational structures.

We are aware of limitations in our research so far: Although the firms investigated represent major players in the industry, the number is still small. Concentration on one industry may lead to misinterpretations since industry-specific characteristics may be wrongly taken for common characteristics. Therefore, in the next step the number of corporations should be extended, and MNCs from the electrical and electronic industry should be included for further comparisons. In conclusion, we believe that the phenomenon of choosing corporate governance systems for MNCs in these turbulent times has considerable potential as an area for future research.

What are the managerial implications of this study? At this stage of theory development, it is inappropriate to be too specific about the managerial consequences of our thinking, but nonetheless a few issues can be highlighted. The primary message is that the subsidiary on the one hand appears to need a certain level of decision-making autonomy to be able to pursue charter-enhancing and reinforcement initiatives. On the other hand, the corporate governance of an MNC's activities needs to focus on keeping the unique firm-specific competitive advantage worldwide. It is the balancing of these two perspectives that is one of the essential questions regarding the choice of MNC corporate governance system. A second point is that subsidiary management should pay attention to the capabilities of the subsidiary and perceptions of the relevant shareholders. Capabilities need to be sharpened and upgraded in the face of the local environment and the priorities of the MNC as a whole.

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