DEUTSCHES INSTITUT FÜR JAPANSTUDIEN

German Institute for Japanese Studies (DIJ)

Management Careers, Internal Control and Corporate Governance Where Japan and Germany Differ

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Working Paper 17/2

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Where Japan and Germany Differ

Abstract

Career concerns of managers function as an important control mechanism in the context of corporate governance. They bear important motivating and disciplining effects. In Japan, where – in the absence of a well-functioning external market – management careers have been generally restricted to in-house promotions, career concerns also result in efforts by middle management to exert control over and influence top management decisions as they impact their career perspectives. Takaaki Eguchi's paper explains the background and implications of such internal control mechanisms in Japan and points to their limitations in recent years given the increasing need for a stronger top management function. The paper concludes by emphasizing the role institutional investors can play in amending such limitations.
Reviewing relevant empirical research, Franz Waldenberger shows that managerial careers in Germany have long been embedded in an external market. However, market based incentive and control mechanisms remain less important than in the US. The reason can be seen in "internal control" mechanisms specific to German corporate governance. They stem from (a) relatively narrow career paths in terms of fields of expertise requiring a close collaboration among the top management team, (b) the representation of employee representatives on the supervisory board providing the capital side on the board with an additional information channel, and (c) the existence of a major shareholder in most listed companies allowing for direct communication and intervention by the capital side.

Keywords: Corporate governance, internal control, management careers

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The following two papers are revised versions of presentations given at the symposium "Corporate Governance – Comparing Japan and Germany" held in November 2016 in Tokyo at the Hitotsubashi Graduate School of International Corporate Strategy (ICS). The symposium was jointly organized by ICS and the German Institute for Japanese Studies (DIJ) in Tokyo.

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Place of publication: Tokyo, October 2017

Japanese Companies as Internally Governed Organizations

Takaaki Eguchi

1. Japanese corporate governance: what is the real problem?

There are two aspects of corporate governance: external and internal. External governance relates to the processes that work from outside the corporate organization. Examples are shareholder activism and bank monitoring. Internal governance, on the other hand, refers to the processes that operate within the organization. Both forms of governance have effects on how the company's manager behaves. In this essay, the focus of attention is internal governance of Japanese companies. I argue that it is at a crossroads.

My argument is motivated by a current policy discussion regarding corporate governance in Japan. Those who had been interested in this topic were surprised by a sudden focus of policy attention that occurred several years ago. Prime Minister Abe's policy package included as a major goal the revitalization of Japanese companies with a focus on their sustained growth. Corporate governance was positioned as an instrument for leading such growth.[1] This policy framework shaped the nature of the subsequent discussions.

Typically, corporate governance is discussed with respect to fraudulent management behaviors. But fraudulent behaviours are not specific to Japan. We know that we had Toshiba in Japan, but Germany had Volkswagen, and the United States had Wells Fargo. The root cause of these incidences is the pressure for short-term financial performance. This type of problem can be found in any country.

The real issue of corporate governance that is relevant in the current Japanese context, especially with respect to the goal of sustained growth of companies, does not relate to fraudulent behaviour. Instead, it relates to what might be described as the "reconfiguration" of internal processes within a firm. Specifically, though there are exceptions, in a majority of cases the problem of Japanese companies is not that

[1] See Prime Minister of Japan and His Cabinet (2013), 15-16. The report is organized as "I. Overview, 5. Examples of Necessary Key Measures in Line with the 'Roadmap to Growth,' (1) Unleashing the power of the private sector to the fullest extent." The reference to corporate governance is made as part of "Item 3. Reviewing corporate governance and examining the use of public funds, etc."

the manager is "lazy" or cheats shareholders. Rather, the issue is that, even if the manager does not slack off or shirk, the company exhibits chronically low financial performance.[2] There must be something wrong with the ways the company is managed. The old ways do not appear to be working any more. This is a problem of reconfiguration.

Japanese companies are equipped with a variety of institutional apparatuses that prevent concentration of power in a single individual.[3] As I discuss below, the practice of delegation of authority limits the scope for the top manager's hierarchical discretion. Reflecting these limitations, the top manager's influence on the company's outcomes is not so discernible. That is, the choice of the top manager does not explain much of a variation across the companies of their financial performance. Indeed, a cross-country comparison places Japan (along with Korea) at the bottom of 15 countries in terms of degree of the top manager's influence.[4] My argument of reconfiguration addresses this issue of managerial irrelevance and calls for the resurrection of a strong top management function.

I begin my discussion by sketching out various ideas that have been taken up in the literature regarding internal governance (Section 2). Of these, perhaps the most popular in the context of Japan are the ideas of internal stakeholder intervention having a constraining effect on the top manager's behaviour. Management scholars and sociologists are their main proponents. A different strand of ideas, which has been developed by economists, focuses on the intra-relations and processes of interaction between different classes of managers. After summarizing both strands of ideas, and building on the latter, I describe the key features of internal governance of Japanese companies (Section 3). I argue that the basic pattern that was formed during the high-growth era is at a crossroads (Section 4). Then, by way of concluding remarks, I discuss what investors can do at this juncture of transition. I propose three areas that investors can engage in with management of their portfolio companies to push the change forward (Section 5).

[2] Mishina (2004/j) points out the shocking fact that the profitability of Japanese companies as a whole has been on a secular decline since the 1960s (pp.29-38).

[3] See footnote 24 below.

[4] Crossland & Hambrick (2011), Table 4.

2. Varieties of ideas about internal governance

Two factors characterized corporate governance in post-war Japan: cross-shareholdings and the monitoring by main banks. The networks of cross-shareholding relations between industrial companies and banks, and also in-between industrial companies, started forming as early as in the 1950s and continued to develop until the 1980s.[5] They had an effect of minimizing shareholders' influence on corporate decision-making. The influence of main banks, considered to be the main source of discipline vis-à-vis management, waned after the 1980s.[6] Because of these developments, some suggest that there has been a vacuum in corporate governance since the 1990s. Other scholars refute this, and instead point out that it may be a lack of external governance, but not the total lack of governance.

A suggestive piece of evidence supporting the latter view is provided by empirical research studying the patterns of top management turnover in large Japanese manufacturers. According to the study, even in the 1990s, top managers were replaced without external interventions when the company's financial performance deteriorated.[7] This is interpreted to mean that some process exists inside the organization that causes the replacement of non-performing managers. Such an internal process that imposes discipline on the manager is referred to as "autonomous governance."[8]

2.1. Internal stakeholder intervention as a governance process: a classic view

There are a variety of ideas regarding what might work as a process of autonomous governance. Of these, probably the most popular in the context of Japan is the idea of bottom-up intervention by various employee groups constraining the top manager's behavior. Typically, two groups of employees are considered as agents of intervention: the middle managers and the company labour union. As for the middle managers, several cases of middle management revolt causing the replacement of

[5] For a brief history of cross-holding relations in Japan, see Eguchi & Shishido (2015), 560-562.

[6] For a detailed analysis, see Arikawa & Miyajima (2007).

[7] Miyajima & Aoki (2001/j), 82-86.

[8] *Id.*, 74.

top managers are well known.[9] Similarly, management scholars have documented cases of top manager replacement taking place under the pressure from the company labour union; company labour unions used the regular communication channels with management, such as employee-employer councils, to exert pressure.[10]

Another idea, which enjoys a certain level of support from Japanese commentators,[11] posits the influence of the retired senior executives playing a material role in the company's governance. Among large Japanese companies, it is not uncommon that former senior executives such as CEOs keep influence over their successors as the elders of the company community even after their retirement. Such influence may be exerted directly through explicit advice given to the top manager or exerted implicitly as the top manager tries to preserve her reputation among the elders. Whatever the channel of influence is, the proponents argue that, under certain circumstances, the elders exert a disciplinary effect that constrains the top manager's behavior.[12]

The common element in these processes of autonomous governance is an act of "voice" performed by an internal stakeholder, such as an employee group or the elders, against the top manager with the intent of suppressing her negative behavior. While an act of this nature may be taken only in crisis situations, it is quite plausible that the possibility of such an event taking place has a constraining effect on the top manager's conduct. Thus, the threat of intervention by internal stakeholders is a good story to tell when one is asked whether there is governance at all in Japanese companies.

Nonetheless, governance is not only about constraining negative behaviors. It is also about ensuring positive outcomes. The reconfiguration of internal processes, which I mentioned as the pressing issue of corporate governance, relates to the latter. To gain insights about this effect, we next turn to the arguments of internal governance that focus on the act of "exit," rather than "voice." As we will see, these

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[9] See Yoshimura (2012/j), 73-122.

[10] *Id.*

[11] See Mishina (2016/j), 59.

[12] Needless to say, the elders' influence could prevent the CEO from implementing a reform policy that would harm her predecessors' reputation. The proponents are aware of this, but think that the positive effect outweighs any negative effect.

arguments show how the intra-relations of different classes of managers ensure the firm's outcomes.

2.2. Internal governance as economic processes

Economists are interested in the leader-follower dynamics that govern the internal organization of a firm. According to them, although a corporate organization is hierarchical, the relationship between the top manager (hereafter, the CEO) and her subordinate manager (hereafter, the subordinate) is not simply that of command and obedience. This is because the CEO needs to elicit the subordinate's active contribution in order for her to be successful. The CEO needs to take into account the subordinate's reaction to her decision, and this implicit requirement constrains her when making a decision. Economists call this requirement and the discipline exerted on the CEO "internal governance."[13]

Economists have looked at different aspects of the company's internal organization and came up with different narratives of how the process of internal governance might operate in practice. One of these aspects is the disparity of opinions among members of the top management team.[14] Since the CEO can be over-confident or caught in hubris, the subordinate's dissenting opinion can improve upon the quality of her decision-making. She has the incentive to incorporate the subordinate's opinion to elicit contributions from him. An implication is that the CEO's decision-making, and hence the company's financial performance, will be better if the top management team includes senior executives who are relatively independent from her in their views and opinions.

An important point is that, in this process, unlike stakeholder interventions, the subordinate does not need to directly confront with the CEO by openly criticizing her view or disobeying her in order to affect her decision. Such an act of "voice" is not necessary, and the mere act of "exit" exhibiting less enthusiasm (and withdrawal from active contributions) will send a message to the CEO, as long as she has rational intelligence.

[13] Landier *et al.* (2013), Acharya *et al.* (2011).

[14] Landier *et al.* (2013).

Another aspect that economists have looked at is the "difference in time horizon" among the managers.[15] To illustrate, think of the CEO and her subordinate working in a firm. The CEO is at the end of her career, and what matters for her is what she can get before retirement. On the other hand, the subordinate expects a much longer career ahead. His time horizon is much longer than the CEO's. So he will be de-motivated if she does not consider his expectation and make a future-oriented decision. Being aware of this, the CEO invests for the long run and for the firm's future to prop up his motivation.

Again, in this process, the subordinate does not need to raise his voice to have his claim heard by the CEO. His de-motivation in the case that she fails to take into account his future-oriented interest will be sufficient to send a message to her.

It should be noted that an implicit assumption in the above argument is that the contributions of both the CEO and subordinate are required for the firm's outcomes. If this does not hold, and only the CEO's contribution determines the firm's financial performance, whether the subordinate contributes does not affect the firm's outcomes. In this case, the present-minded CEO is less likely to make long-term investment, given that investment will certainly detract from the company's current profit. Another point is that the narrative explains the structure of incentives given to the subordinate whose interest is tied to the company's future. The subordinate is willing to exert effort and to contribute to the company's outcomes based on his expectation that his effort will pay off as the company grows; the stronger his expectation, the more willing he is to contribute.

3. Internal governance in Japanese companies

These narratives of interplay between the CEO and subordinate clearly show that management is not as monolithic as often assumed in a discussion of corporate governance. It consists of different classes of managers with different views and interests. Their intra-relations as well as the processes of interaction these relations generate affect corporate decision-making and hence the firm's economic outcomes. Building on the economists' work, I call these intra-relations and the processes that they generate "internal governance." Like the economists' notion, the focal point of

[15] Acharya *et al.* (2011).

"internal governance" is on the processes that affect corporate decision-making in normal times. These are contrasted with the processes of internal stakeholder intervention as the latter are triggered in "abnormal times."

My contention is that, probably up until the 1980s, the pattern of internal governance that was established during the high-growth era was effective in supporting the process of value creation in Japanese companies. But because of the changes that have taken place both inside and outside the organization, sticking to the old pattern can now be a cause for process failure; a reconfiguration is called for.

3.1. Formation of the ba*sic pattern in the high-growth era*

Two institutional features of Japanese companies that are often mentioned are long-term employment and delegation of authority to a lower level of management. They characterize the internal organization of a Japanese company in a fundamental way. During the high-growth era, long-term employment became the standard practice for large Japanese manufacturers. What matters about this practice as it relates to internal governance is that it is a cause and result of the closed nature of the Japanese labour market.[16]

In post-war Japan, career opportunities outside the company were scarce especially for those in the middle management or above. So the only viable option for the subordinate was to bet on the future of the company he worked for. Naturally, his interest was closely tied to the company's future; his incentive came from his expectation that his effort will pay off as the company grows. The competitive nature of the promotion tournament that he needed to go through in order to move forward in the organization further amplified this incentive.[17] The

[16] For more on the practice of long-term employment in Japan in the context of internal governance, see Eguchi & Shishido (2015), 555-557, 558.

[17] Ishii (2006/j) points out that there is a misunderstanding even among labour specialists that human resource management in Japanese companies is seniority-based. In fact, among large companies, it started shifting to a system of "long-term internal promotion tournament" by the 1970s. In this system, the promotion game starts when a novice employee joins the company. The process of promotion is slow, and the distinction between winners and the rest is deliberately made unclear until one reaches a rank of middle manager. But after that, the pace of the promotion tournament accelerates with winners and the rest clearly distinguished (pp.345-357).

necessity of winning the tournament prompted him to contribute because otherwise he would be out of the race and miss the prize he had expected to win going into the tournament.[18]

The CEO's important role is to manage the subordinate's expectations by investing for the future. As the investment of this nature involves a vision for growth, a desired quality for the CEO is the ability to create a strategic vision. During the high-growth era, this quality was not considered critically important because, in the days of catch-up and take-over, showing a vision of growth did not require a charismatic talent. It should be also pointed out that the expectation-based, future-oriented incentive suited the general mood of the society. During the high-growth era, people shared a sentiment of optimism that tomorrow will be better than today. Such optimism worked positively for the subordinate's expectations.

Delegation of authority, another institutional feature of Japanese companies, is a human resource management technique that is used to prop up the morale of the follower in a hierarchical organization where the leader exerts control. It is based on the general principle that people are happily engaged and willing to exert effort if they get to decide what they need to do. As such, the technique is widely used in factories and offices not only in Japan but also in the US and other industrial countries. What is unique about the practice in Japan is that it is used widely at the top layer of corporate decision-making.

During the high-growth era, Japanese companies developed a practice of delegating substantive decision-making authority regarding control plan formulation to a select group of middle managers and had them carry out the task of plan deployment. A labour economist calls this group of middle managers "field leaders."[19] Typically these managers have already had more than 15 years of career inside the company and are candidates for promotion to senior management. They are thoroughly familiar with their own field, but also exert influence across the organization. They are often deemed the "key figures" of the organization.

The role of these field leaders in corporate decision-making is that of intra-firm coordinator. Their task is to make sure that the control plans and measures, such as growth strategies, do not neglect the reality of the business operation in the field.

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[18] See Waldman (2013) for a review of economic models of promotion tournaments.

[19] Ishii (1996/j), 25-29.

They work out the details by coordinating across relevant departments and sections and making necessary adjustments in the process. Going through this process of assimilation and adjustment, the control plans and measures become widely shared by those in the field. As the field officer, the field leader may even implement the plan or measure he formulated in his capacity as the coordinator.

This “middle-up” management style, in which the control and field functions are mixed to a certain extent, is effective in motivating those in the field. Being involved in the process of corporate decision-making, those in the field nurture a stronger sense of ownership for the decisions made.[20] Of course, involving them poses a downside risk of their vested interest obstructing a speedy implementation of a decision that works against them. But for Japanese companies the benefits outweighed the downside.[21]

Thus, the pattern of internal governance, which was established during the high-growth era, features a CEO whose hierarchical discretion is limited by partial delegation of authority to the subordinate, and the empowered subordinate who has made a bet on and cares about the company’s future. Delegation of authority, which mixes the control and field functions, reduces the CEO’s monopoly over the task of strategy formulation, and makes it more of a collective endeavor.

3.2. Transformation of the pattern by the 1990s

This pattern of internal governance sustained the financial performance of Japanese companies until around the 1980s. But it started showing its weakness around the same time. One indication of weakness was a phenomenon of top managers assuming the position on short relief in a relay of succession. In the reconstruction era of the 1950s, strong CEOs including company founders reined well over 10 years and laid the foundation of business for the company.[22] After the 1980s, the CEO’s typical tenure shrunk to 6 years and then to 4 years.[23][24] At the same time, CEOs

[20] Mishina (2011/j), 196.

[21] Nobeoka (2002/j), 35-36.

[22] Mishina (2004/j), 226-232; Mishina & Hino (2013).

[23] Mishina (2004/j), *id*.

became older, the size of the board larger, and promotion by the "seniority rule" the standard. By the late 1970s, the typical pattern was that the CEO of 64 years-of-age presided over the board consisting of more than 18 directors and passed the position on to the successor, who would assume it at about the same age.[25]

With the appointment of CEOs becoming more like a short-relief relay, the substantive power of management was assumed by the field leaders. An important job for the CEO was to select the right set of capable field leaders who would coordinate strategic plans and deploy those plans as managers in the field.[26] The CEO's role in the process was to give general guidance and let the field leaders move the organization forward. In this sense, she was playing a role of a "cheerleader"[27] for the reform-minded field leaders.

Just as the weakening of the top management function was underway, however, the many new businesses that took off right after the war reached the stage of maturity and decline in the 1970s and '80s.[28] The transformation of the existing business and the reshuffling of the business portfolio became the top management agenda. The future prospect of the company was not as predictable as before. But with CEOs coming and going in a short cycle, top management of Japanese companies was not able to hammer out a solid vision for long-term growth. The expectation of growth shrank, and the morale of the organization that was driven by the expectation also shrank.

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[24] Institutional arrangements to limit the CEO's tenure, such as fixed terms and mandatory retirement for senior executives, may partly reflect the company management's determination to curtail the entrenchment risk of a CEO with a long tenure (Mishina 2011: 199-200). It is, indeed, plausible that a CEO of a long tenure can cause stagnation if she loses touch with the fast-moving business environment. On the other hand, a rule unilaterally limiting the CEO's tenure makes the appointment of a strong CEO difficult even in difficult times when a CEO with visions and strong leadership is needed. In this essay, I do not dwell upon the issue of the optimal length of tenure for a CEO. I simply cite the empirical observation that the tenure had shrunk as evidence of a weakening top management function.

[25] Miyajima & Aoki (2002/j), 75-79.

[26] Ishii (1996/j), 191-195.

[27] Mishina (2006/j) points out that being a cheerleader is a preferred management style if the goal is to maximize the motivation of those in the field. He contrasts "cheerleader" CEOs in Japanese companies with "quarterback" CEOs in US companies (pp. 108-109).

[28] Hino & Mishina (2013/j), 34.

4. Internal governance at a crossroads

The strength of field operation is considered one of the key features of Japanese companies. The pattern of internal governance that emphasizes the incentive of those in the field is consistent with this feature. However, the strong field operation does not produce good corporate outcomes unless the "location" for business, on which the operation is deployed, is right.[29] If the location, which was right in the old days, no longer looks promising, a new location needs to be determined.

The problem is that the pattern of internal governance that mixes the control and field functions does not support this type of task. Involving those in the field is very effective in having plans and measures shared widely by them. The plans and measures for a sweeping change cannot be left to their judgment, however, because then the plans and measures become piece-meal, lacking thrust necessary for a strategic change. Strategic decisions, such as determining the new location for business, should be initiated and handled by those in control with support of staff that is separated from the field.[30]

Grafting the stronger control function to the pattern of internal governance that empowers those in the field is likely to cause a high level of organizational tension. For instance, a conflict may arise between the CEO's top-down guidance and the coordination by the field leader if the guidance does not give latitude for assimilation and adjustment.[31] Also, the internal promotion system may need to undergo a major design change as grooming CEOs with stronger leadership and visions for growth requires picking the candidates, and giving them an appropriate training, at a much earlier stage than the current practice.[32] These are all new

[29] I am borrowing the word from Kazuhiro Mishina's terminology. See Mishina (2007/j) for a full exposition of his idea (pp. 101-123).

[30] Nobeoka (2002/j) points out that achieving a control goal with initiatives of those in the field would require the highest level of organizational capabilities (p. 37).

[31] Being aware of the need to strengthen the top management function, many Japanese companies have started to re-design internal governance by making corporate decision-making more top-down. Anecdotal evidence suggests that strong top-down initiatives cause a withering of the middle-up coordination activity. There is also a possibility of animosity developing between the CEO's direct staff that has gained power and the field leaders that have lost power.

[32] Mishina (2006/j) proposes an internal promotion system with a "side track." In this system, those in the pre-manager stage, in their early 30s, are offered an option to run a new business as

elements of internal governance and are likely to cause a change in the existing pattern.

5. Concluding remarks: the role for investors

If internal governance of Japanese companies is at a crossroads, what can investors do to promote the change so that their portfolio companies regain prowess in value creation? Apparently, resurrecting a strong CEO is not a task for outsiders. But given the conflicts and tension it is likely to cause inside the organization, a push from outside should be helpful. I believe that investors can play a role of catalyst for change by engaging with management in three areas: methods of grooming future CEOs, business restructuring and equity story-telling by CEOs.

While a strong CEO may have a long tenure and a top-down management style, what makes a strong CEO are not these externally observable qualities, but a talent capable of leading the company to a new growth path. Grooming such a talent is of utmost importance for the company's future. Many companies are aware of the urgency, and some have already started implementing new programs. Investors can push this move forward by asking management for disclosure of not only how the nomination committee appoints the CEO from the list of finalists, but also how the company picks and grooms future CEO candidates.

When insiders are running the company's affairs without external pressures, the decision for restructuring the declining business tends to be late. The economic reason is that insiders do not own capital and fail to consider the opportunity cost of employing capital.[33] Investors need to exert pressure on management by asking for higher profitability so that management is kept on its toes for the restructuring effort.

When the company raises capital, it needs to provide a story of profit and growth, dubbed an "equity story," in order to attain the investors' buy-in. An equity story

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the chief executive. This is a self-election process. Those that are risk-averse are not likely to exercise this option; they remain on the regular track. (p. 179).

[33] See Lambrecht & Myers (2007).

highlights the company's business model.[34] Investors can request the CEO to tell equity stories irrespective of whether the company is raising capital or not. Their request should send the message to management that they are looking for strategic visions for the company's growth.

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[34] For the investors' views and opinions about the current state of the company's business model disclosure, see Forum of Investors Japan (2017/j).

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Management in Germany – Control and Incentive Mechanisms

Franz Waldenberger

1. Background and outline

Japanese and German corporate governance are similar in some respects, but they also have their own specific features. Common characteristics that are often cited are stakeholder orientation attributed to the goal function of top management or the traditionally limited control function of stock markets. Major differences can be found in the development of managerial talent and in the patterns of managerial careers. The "internal governance" mechanism that Mr. Eguchi described in his presentation only works because managerial careers are constrained to in-house promotions due to the absence of a well-developed external market for managerial labour (Waldenberger 2016). The prospects for Japanese junior managers of continuing their career by moving to another company are anything but promising. The success of their career depends not only on how they perform in their job, but also on the future wellbeing of their company. In Germany, this kind of internal control is absent, because managerial careers are embedded in an external market for managerial labour.

So how is German management controlled and incentivized? Figure 1 distinguishes three fields where managerial action is being monitored, rewarded and/or sanctioned: the stock market, the corporate structure and the managerial labour market. They constitute separate areas, but they are in many ways interlinked. For example, the outcome of the trading of shares in the stock market decides the shareholder structure, which in turn determines the composition of the general shareholder meeting and thus ultimately influences the composition of the board – the supervisory board in the context of the German two-tier structure. A specific characteristic of the German supervisory board is co-determination, i.e. the representation of employee interests on the board (Page 2011). Co-determination constitutes the legal manifestation of German "stakeholder orientation." It functions like a kind of "internal governance mechanism," though very different from what Mr. Eguchi described. Remuneration, a central incentive device in the US, plays a less important role in the Japanese and German context, as we will see later. The remuneration of the top-management team is in all countries decided by the board, but other areas nevertheless exert influence. Some portion of executive pay often depends on how the company is evaluated in the stock market. In the presence of an external market for managerial labour, the overall level of pay has to consider the outside career options in order to recruit outside candidates or to prevent incumbents from leaving. Finally, we need to consider the role of managerial careers. Their importance for corporate governance is considerably under-researched. Managers not only care about what they are paid and how the stock market evaluates their performance, they are also concerned about their career options. With the exception of Japan, these always include outside options in addition to in-house promotions.

Figure 1: Fields, institutions and instruments of corporate control

Stock market	**Corporation**	**Managerial labour market**
Shareholder structure →	Supervisory board	
Share price formation →	Compensation	← Wage formation
Market for corporate control	Internal promotion and training/development	Outside career opportunities

2. Remuneration

Table 1 shows the growth of the top management team's (TMT) remuneration for the DAX 30 companies. The index contains the largest companies in terms of market capitalization. Thirty is a small number, but overall there only about 700 German companies listed on the stock market. Over the last 25 years, the average remuneration per member of the TMT increased more than six-fold. Executive compensation grew on average 3.5 times faster than the average personnel expenses in the respective companies. In 1990, a member of a DAX management team would earn 14 times the average personnel expenses of his company's employees. In 2015 this ratio had increased to 50 times. However, there has been little change since 2007, when the ratio had already been at 49. 2007 is the year when the world financial crisis erupted. It is also one year after a law was passed that obliges German listed stock companies to disclose the remuneration of the TMT on an individual basis. For some, the relatively moderate movement of executive pay after 2007 is seen as evidence that the improved transparency functioned as intended by the law. It might however just be a coincidence.

Table 1: Average total compensation for TMT members of DAX 30 companies, 1990-2015

Year	1000 Euro	1990 = 100	Ratio to average personnel expenses
1990	547	100	14
2000	1 699	311	29
2007	2 836	518	49
2015	3 341	611	50

Source: Schwalbach 2009, DSW 2016

Table 2 draws an international comparison of the level and structure of executive pay by focusing on the remuneration of the CEOs of companies included in national stock indices comparable to the DAX. The comparison includes the Dow Jones Industrial Average (30 companies), the Swiss SMI (30 companies), the Euro Stoxx (50 companies) and the French CAC (40 companies). DAX CEOs are not the best paid in this group. They come fourth after DJIA, SMI and EuroStoxx, but before CAC. In terms of structure, DAX compensation packages have the highest share of fixed income (30%) and variable cash income (45%), and the smallest stock-based component (25%). Clearly, the stock market-based evaluation is less important in the German context then in the US, where the largest income component by far is stock based (63%).

Table 2: Level and structure of CEO compensation – comparing US and Europe, 2015

1000 Euro (per cent)

Index	Fix	Variable cash	Stock based	Total
DJIA	1 822 (11)	4 311 (26)	10 264 (63)	16 397 (100)
SMI	1 941 (28)	1 407 (21)	3 475 (51)	6 823 (100)
EuroStoxx 50	1 577 (28)	2 192 (39)	1 923 (34)	5 692 (100)
DAX 30	1 511 (39)	2 309 (45)	1 281 (25)	5 101 (100)
CAC 40	1 307 (28)	1 590 (34)	1 819 (39)	4 716 (100)

Source: DSW 2016

How are these differences to be interpreted? To draw governance conclusions from differences in the CEO pay levels among the various indices, one needs to control for other variables that are known to influence executive pay like company size, industry and compensation structure. Controlling for such variables reduces, but does not fully eliminate the gap between the German and the US level of compensation (Conyon et al 2011). Remaining differences might be attributed to the stronger bargaining position of an US CEO who is not likely to face a controlling shareholder or employee representatives on the board. Japanese CEOs tend to earn even less than their German colleagues. The main explanation here seems to be that in the absence of managerial labour markets, pay levels are determined by the logic of the tournament competition typical for in-house careers (Waldenberger 2013).

Differences in the structure of pay, especially in the share of stock-based compensation point to differences in the way interests of managers and shareholders are aligned. In the absence of controlling shareholders, US companies have to rely on stock-based compensation, as it aligns the income interests of managers and shareholders. This however comes at a cost, because risk-averse managers will have to be compensated for the risk they bear when a large portion of their income depends on volatile stock prices. In Germany, controlling shareholders supported by employee representatives sitting on boards avoid these costs by directly monitoring top management. In Japan, too, stock based compensation plays a minor role in executive pay. Here it is not the presence of a controlling shareholder, but the control exerted by peers and lower-level managers as explained by Mr. Eguchi that makes costly pecuniary incentives unnecessary.

3. Career patterns

How do you become a top manager in Germany? What is the typical educational and career background? What does the path to the top look like? Careers provide selection and incentive mechanisms. They form a central element of corporate governance. Career patterns of German members of the TMT differ fundamentally from their Japanese counterparts in that they are embedded in an external labour market. German careers are not restricted to in-house promotions. This might seem surprising, because in terms of average tenure of male employees Germany and Japan are quite similar.[1] However, in Japan lifetime employment is typical for those who make it to the top. Turnover in managerial positions is lower than for employees on average (Naganuma 2014). In Germany, the opposite is the case. Managers are more likely to build their career by changing on average at least once. The evidence on German managerial careers presented below focuses on demographics, education, professional experience and mobility.

Demographics

Freye (2010) in her study of the career paths of 338 CEOs of the 50 largest industrial companies between 1960 and 2005 found that the average age at appointment declined from 53 to 51 years. Average tenure equally declined from 11.3 to 8.4 years. The average age at appointment for members of the TMT among DAX 30 companies was 48 years in 2009 (Davione and Ravasi 2013). 27 per cent were foreigners, but only one per cent were female. The low representation of women is of course similar to Japan.

[1] In 2015, the average tenure for male employees over all age groups was 13.5 years in Japan (http://www.jil.go.jp/kokunai/statistics/timeseries/html/g0213.html). In Germany, a male employee had on average worked 11.1 years for his present employer (https://stats.oecd.org).

Education

Davione and Ravasi (2013) find no dominant university among the TMT members of the DAX 30 in 2009, confirming the absence of "elite" universities in Germany. 90% had graduated from university. 53% held a degree in business, management or economics, and 45% had completed a doctorate degree. This is again very different from Japan where it is imperative to find a job directly after completing one's undergraduate studies. In-house careers put those who enter later at a disadvantage.

The portion of law degree holders among CEOs of the 50 largest industrial companies sharply declined between 1960 and 2005. Whereas business and economics had been the dominant specialization among CEOs in the 1990s, engineering and science degrees recaptured that position in the 2000s.

Professional experience

Members of the TMT of the DAX 30 in 2009 had worked in many different positions before reaching the top. However, these positions tended to be within the same functional domain (Davione and Ravasi 2013). This confirms findings of earlier career studies that have compared the career paths of German managers with that of a "mountain" or "chimney" climber. Managers gain deep, but relatively narrow expertise in specific field ("management by expert knowledge").

Mobility

In the same study by Freye (2010) of the career paths of 338 CEOs of the 50 largest industrial companies between 1960 and 2005, she found that the share of CEOs that had spent more than one third of their career in the company they were running had fluctuated between 50 and 70% over time. There is no clear trend. The share was higher in the 1980s, but then declined again after 1995. Careers within company groups became more important. Their share increased from 20 to 60%.

In 2009, the typical member of a TMT at a DAX 30 company had on average worked for 2.4 employees, which means that German top managers change their employer at least once on the way to the top (Davione and Ravasi 2013). Only one third had spent their entire career in one company. 15% had been working for a large consultant company, normally at the beginning of their professional career. Holders of an MBA degree showed higher mobility.

Between 2000 and 2008 the 100 largest German companies filled the position of CEO in 23% of all cases with outside candidates (Balsmeier and Buchwald 2014). In Japan, the equivalent share would be below 5% (Waldenberger 2013).

In-house promotions are important in the German context, but they are not the rule as in Japan. Careers are embedded in a managerial labour market leaving employees with the option to move elsewhere and companies with the option to recruit outsiders even for the position of CEO. As a consequence, German managers remain very much in control of their career, even when staying with the same company for a long time.

4. Influence

How much influence or power does a CEO have? This is certainly difficult to answer. One way to approach the question is by looking at stock market reactions to CEO turnover (Crossland and Hambrick 2007). The impact tends to be strongest in the US and lowest in Japan with Germany occupying the middle position. The low impact in the Japanese case reflects the strong team and consensus orientation in decision-making. A Japanese CEO does not necessarily need to fulfil the role of the superior strategic mind. He is much more needed as a consensus builder. In Germany, the lower degree of influence compared with the US can be related to the narrow scope of experience of the typical German CEO, which renders close collaboration with other members of the TMT important (Daviane and Ravasi 2013).

Another indicator of influence or power is the level of pay. A statistical analysis of shareholder structure and compensation levels shows that shareholder control limits the level of the income of German executives (Rapp and Wolff 2010). The German Corporate Governance Code does not intend for the CEO to become chairman of the supervisory board upon his retirement from the management board. Nevertheless, this continues to happen. Many interpret such a move as sign of the CEO's strong power. However, such a conclusion seems too simple. The stock market reaction to a retired CEO becoming chairman of the board is generally positive (Anders et al 2014). So even if the promotion to chairman of the board goes along with strong influence, it seems that shareholders expect such influence to have a positive impact on performance.

The system of co-determination, whereby companies with 500 to 1999 employees must fill one third and those with 2000 and more employees must fill half of the seats of their supervisory board with employee representatives, has long been criticized for distracting management from shareholder value maximization. However, a study by Fauver and Fuerst (2006) shows that the presence of employee representatives elected from among the body of employees can have a positive effect on share prices. Their interpretation is that such representatives provide an additional information channel about corporate conditions that constrains the CEO´s ability to distort or manipulate the information he or she provides to the board.

5. Final remarks

The different research results presented here underline that even in the age of globalization national characteristics with regard to the career patterns of TMT members continue to be clearly visible. If at all, they are only slowly changing. In Germany, careers are embedded in an external labour market resulting in a mix between in-house and market-based careers. Doctorate degrees outside of engineering and the natural sciences remain an important qualification for German top managers. A doctorate degree obtained under the supervision from a well-known business or economics professor partly compensates the absence of an elite university system and the selection, signalling and networking advantages such a system provides. German managerial careers remain narrow in terms of functional scope. This implies reliance on the expertise of other members of the TMT, which in turn requires more collaboration with the effect of reducing the influence or power of the CEO. Other important arrangements typically found in the German context that fulfil the function of monitoring the CEO are the presence of a controlling shareholder and co-determination. The presence of a controlling shareholder might in fact be necessitated by co-determination as suggested by Mark Roe (1998). He argues that a controlling shareholder is originally not needed to check management, but to counterbalance employee interests in the board.

A controlling shareholder and employees sitting on boards can be considered insiders, because they have privileged access to company information. Their monitoring function might therefore also be interpreted as constituting some kind of internal control mechanisms. However, it is quite different from the Japanese logic of internal governance.

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