Management and the Varieties of Capitalism

During the 1990s, capitalism was ascendant. The Soviet Union had collapsed, China was pursuing free enterprise, and in the United States businessmen were lionized as never before. Yet some social scientists observed that no such thing as pure capitalism existed or ever had existed. Rather, capitalism came in different varieties, a point first made by the German historical economists in the nineteenth century.

Today, capitalist nations vary along multiple dimensions. Industry networks, systems for innovation, employment relations, and facets of the business-government relationship are structured differently by different nations. Of recent interest are variations in the internal organization of corporations and in modes of corporate governance. One finds shareholder-oriented governance in the United States and the United Kingdom, statutory stakeholder governance in Europe, and voluntarist stakeholder governance in Japan and other parts of East Asia.1

Interactions between these subsystems within a nation yield distinctive paths to prosperity, each with its advantages and disadvantages. There is no one way that is best—no optimal point on what economists call “the production frontier.” However, the force of this claim has been undercut by the performance of the U.S. economy since the late 1990s: Compared to its main rivals, the German and Japanese economies, it has been stellar. As a result, the focus of research and debate has shifted from analyzing institutional variety to predicting how quickly U.S. patterns of regulation, risk-sharing, and governance will take hold around the world.

Nowhere is the shift more noticeable than in Japan, which in the 1980s was held up as a model for a struggling U.S. economy and later served as a model of how not to run a modern economy. In the past, Japan distinguished itself for having, in addition to its high levels of coordination between business and government, a mode of corporate governance whereby the interests of different stakeholders—shareholders, customers, banks, and employees—were balanced, whereas in the United States sovereignty was given to shareholders. The stakeholder philosophy derived from, and contributed to, such Japanese labor practices as intensive training and long-term employment, the willingness to shelter employees from downturns, and ubiquitous enterprise unions.

A key element in the Japanese system was the headquarters human resources (HR) department, which administered employment and labor rela-
tions. Among its myriad duties were the rotation of managers around the company and the identification of employees for senior positions. HR was linked to corporate governance indirectly, through its grooming of individuals for the board of directors comprised of management insiders, and directly through the board membership of the senior HR executive. On the company board, the HR executive voiced employee concerns to other executives and served as the advocate of the seishain, or core employees, in strategic decision making.

In the United States, by contrast, the senior HR executive traditionally stood at or near the bottom of the managerial hierarchy. Epitomizing the function’s dubious status was the relatively low pay offered to HR executives and the relatively high proportion of women in HR positions. The powerhouse functions inside the U.S. corporation have been production, marketing, and, more recently, finance.

HR did have its day in the sun. During the First and Second World Wars, HR (then called “personnel management”) was temporarily elevated in status as U.S. corporations adapted to the rise of unionization or sought ways to avoid it. In some companies, the HR executive functioned as an employee advocate, being the two-way transmission point between employees and management. Facing new government regulations in the 1960s and 1970s, HR developed systems for complying with the law on affirmative action, occupational safety, and other issues. With respect to corporate governance, many large companies acted on the assumption that the firm was a social institution with responsibilities not only to shareholders but also to employees, customers, and communities, an assumption that boosted HR’s internal status.

In the 1980s and 1990s, however, large U.S. corporations grew increasingly financialized—financial criteria dominated decision making. CFOs rose in prominence, equity prices became an obsession—and also singularly oriented to shareholder concerns. With ties between employees and companies waning, HR executives adapted, or were forced to adapt, to the status quo. They focused on flexibility and on treating employees as costs to be minimized. Some U.S. corporations, however, bucked the trend and sought competitive advantage not only in low costs but in having inimitable resources such as unique organizational processes and intellectual capital. This resource-based approach gave rise to Japanese-style emphases on organizational culture and employee participation.

Today Japanese companies are experiencing pressure to conform to U.S.-style corporate governance and to adopt market-oriented employment practices that would weaken the corporate HR function. Studying the role of the senior HR executive provides a unique window on the process of institutional change in Japan. As for the United States, there has been a decline of career jobs and of mutual loyalty between employers and employees, accompanied by a single-minded focus on share price. At the same time there is awareness that human and intellectual capital are increasingly a company’s most im-
portant assets. Again, the HR function provides a vantage point for analyzing these countervailing U.S. trends and for understanding larger issues of national divergence and convergence.

The flow of management ideas in the 1980s was from east to west, resulting in discussions about the “Japanization” of work organization, quality systems, and industrial relations. Today the flow has reversed, with a huge debate in Japan (and other countries) over the costs and benefits of American modes of employee relations and corporate governance. There is now a sizable literature on convergence—on whether, in the wake of globalization, countries and corporations are becoming more alike. Those who emphasize “varieties of capitalism” tend to be skeptical of claims that convergence is occurring, and those who think that it is occurring tend to believe it spells the end of national business systems. Yet both sides, with some notable exceptions, write about these issues from an often rarified, theoretical perspective. Here I focus on the less glamorous but nevertheless important empirical question of whether one can observe convergence in the organizational roles of HR executives in Japanese and U.S. corporations. For example, is it the case that HR is losing its high standing inside Japanese companies and becoming more like its counterpart in the United States?

The HR executive’s status in the corporation cannot be understood without appreciating that corporations are more than mechanisms for maximizing profits—that is the textbook economics view—but are also the terrain for conflicts over whether and how to pursue that objective. One type of conflict is distributional: struggles among managers, shareholders, and other stakeholders over how much emphasis to place on profit maximization versus other goals and on how to slice the revenue pie. Different employment arrangements—whether to invest in human capital, for example—are associated with different risk and return patterns for shareholders and for employees. Often the tension is below the surface, but it may occasionally erupt, as in the shareholder-value movement of the 1990s, the post-Enron angst over corporate responsibility, and the current Japanese debate over corporate governance.

Then there are the internecine battles over which business unit or functional area will dominate executive decisions. These disputes are partly the result of a Machiavellian jockeying for power inside the organization, power that brings with it perquisites and organizational status, but they also represent disagreements over how best to pursue competitive strategy—whether to emphasize financial goals, market share, product cost, or employee talent. They also are a proxy for disputes among those who lay claim to a company’s resources. Finance typically aligns itself with shareholders, marketing with customers, and HR with employees. These alignments can be merely opportunistic. Sometimes, though, a principle may be at stake. For example, from the 1920s through the 1960s, General Motors was marked by heated debates over the design of its M-form type of organization. The debates were really about
the distribution of power and resources between managers and shareholders. Functional groups like finance represented the interests of shareholders, while other units, such as operations, were aligned with management.  

The power dimension tends be neglected in studies of corporate organization, whether in economics, political science, or sociology. Those conducting comparative and historical research, however, cannot ignore it. For scholars examining corporations over time, it is hard to miss the interplay between shifting societal coalitions and changes in management orientation. Management, in other words, is socially embedded. Similarly, one can understand what makes American companies “American” only by comparing them to companies elsewhere in the world that operate under different rules of the game. Although some analysts still think that corporations are the epitome of rational decision-making, in fact they are places where power contests and social norms shape what managers think and do.

Recently a flow of excellent comparative and historical studies of management has been appearing. However, one problem with this literature is its tendency to treat management as a monolith: Executives are assumed to share common views on strategy and policy. For example, research focused on employment issues tends to lump a company’s (or a country’s) executives together as “employers.” In fact, during normal times most executives do not care a great deal about employment issues, and during critical periods they tend to form little consensus on how to proceed. The path finally chosen may appear historically determined but is also influenced by an element of uncertainty—of contingency—that is introduced by factional and other disputes within and outside corporations.

Methods

This study combines two different levels of analysis. Through “in-country” analysis, it attempts to identify how recent changes in the workplace are related to changes in the role of the HR executive in each country. The aim of the “between-country” analysis is to determine whether globalization is producing convergence in corporate organization between Japan and the United States. The study uses historical methods to examine changes in the HR role over time, and analyzes contemporary Japan-U.S. differences through case studies of paired corporations and through a survey of HR executives.

All the organizations discussed in the book are large public companies, and the HR executives I study are the senior individuals in their firm. In Japan, they are general managers or directors; in the United States they typically are executive vice presidents reporting to the CEO. In both countries, the role of HR—what decisions HR executives make, how the function is organized, how much power HR has relative to that of other units—is affected both by factors unique to the company (diversification, organizational culture) as well as by
industry factors (technology, labor shortages) and national institutions (modes of corporate governance, government regulation, social norms).

On an everyday basis, HR executives make policy decisions concerning the structure of the employment relationship. They decide, for example, the mix of market principles and internal factors that will guide pay, promotions, and employee relations. Most HR executives also participate in strategic decisions about the company’s future. They mediate the impact that various factors have on decisions related to employees and to corporate strategy. The more pressing or uncertain the factors are—for example, labor shortages, union threats, or legal constraints—the greater will be the power of the HR executive and the greater will be the impact of employee relations on business decisions. This book looks both at the determinants of the role of the HR executive and at the consequences of that role for employment and other business outcomes.

Field studies are an established research technique in sociology and industrial relations but have been adopted slowly in economics. Gradually, however, economists are beginning to appreciate that this kind of research enables them to explore areas for which little data has yet to be collected. And talking directly to senior executives and other economic actors provides information on their objectives and constraints, and that can be the basis for future theorizing and research. At the same time, supplementing qualitative case studies with quantitative survey data allows the researcher to triangulate the subject by combining methods whose strengths compensate for each other’s weaknesses.

What’s Happening in Japan?

After more than a decade of slow growth, Japan is convulsed by debates over its economic future. Critics have taken aim at everything from child-rearing practices to the old-age pension system, although the main nodes of dispute center on corporate organization and on the appropriate design of government economic policy. I will have relatively little to say about the latter, which is discussed in a vast literature on deregulation, trade policy, banking reform, and related topics.

Targets for a steady barrage of criticism are the employment and governance structures of large Japanese corporations. For much of the postwar era, employment in large firms was based on the so-called “three pillars”—lifetime employment, seniority-based pay, and enterprise unions—which supported a host of complementary practices, including flexibility of work organization, employee participation in management, and high levels of investment in worker training. Related to these practices was a system of corporate governance that, compared to the Anglo-American model, did not privilege shareholders, permitting management to balance the interests of employees, banks, suppliers, customers, and other stakeholders.
Foreign observers praised these practices when the Japanese economy was riding high in the 1980s. But the mighty have fallen. Now observers say that what was appropriate or at least tolerable during the postwar decades of catch-up industrialization has become dysfunctional in the current economic climate. Emerging economies like those of Brazil, Korea, and especially China are capturing Japanese export markets. Meanwhile the United States and Europe are moving rapidly into new industries, including biotechnology, the Internet, and telecommunications. The Japanese are being forced to compete in markets that place a premium on risk and speed, neither of which is encouraged by traditional practices such as consensus management and strong corporate cultures. Companies are criticized for being dominated by powerful HR departments that are beholden to enterprise unions and reluctant to make jobs more flexible and market-oriented.

Meanwhile, Japan’s consumer and financial markets are opening to foreign competition. Japanese companies, especially those serving the home market, face stiff pressure to reduce costs. Foreign investors are buying up shares in Japanese companies and urging them to adopt shareholder sovereignty, accounting transparency, and a focus on quarterly results. Postwar Japanese governance values are being displaced by these Anglo-American norms, a process that is spilling over to the employment sphere. Companies find it difficult to sustain practices (e.g., carrying surplus employees during recessions) that favor employees over shareholders, that give employees a voice in governance, or that require long-term investment horizons, such as career employment and training.

The critics contend that Japan has much to learn from the American experience of the 1980s and 1990s, when large U.S. corporations faced the same pressures now confronting the Japanese: intensified global competition, sluggish domestic industries, and difficulties in sustaining competitive advantage. What revived the U.S. economy, say the critics, were deregulation and the advent of a more active market for corporate control, that is, for challenging and replacing incumbent managers. These developments led to mergers, divestitures, and restructurings. Newly streamlined companies shifted to a focus on shareholders and share prices. With the change in governance came an effort to reduce costs by cutting jobs—not only frontline workers but also middle managers and senior staff at corporate headquarters. Part-time and contingent employment increased, while companies made a point of disavowing—in word, if not always in deed—career-employment principles.

The strong medicine that is believed to have saved American industry is now being prescribed for Japan. Today, Japanese managers are being urged to use resources more efficiently—to stop hoarding labor, cease investment in unrelated and unprofitable ventures, and return excess cash to shareholders. The primary prescription for organizational change is to reform corporate governance. Alignment of managers with shareholders will require an over-
haul of corporate boards, which customarily are appointed by the president and staffed with insiders. The boards are huge, comprising sometimes more than fifty individuals, and allegedly incapable of making decisions or of crit-
icizing the strategy of the incumbent president.

Until recently, stakeholder, rather than shareholder, philosophies were the norm in Japan. Even in the mid-1990s, 97 percent of Japanese managers agreed that the company exists for the benefit of all stakeholders and disagreed that shareholders should have priority. Critics contend that, while emphasis on the stakeholder model may have provided the solidarity necessary to re-
build Japan in the postwar years, it now inhibits the willingness of Japanese companies to make tough decisions—to eliminate surplus jobs, close down weak units, and cut ties with high-cost keiretsu partners.

Next in the crosshairs of the critics of Japanese corporations are HR depart-
ments, the corporate nerve centers of the organization-oriented employment system. Traditionally these departments are in charge of labor relations and employee-welfare services. They also hire employees into lifetime jobs and control their careers through a centralized system of training, performance evaluation, career planning, and job rotation. Through their role in the develop-
ment of managers who will become the company’s leaders and board mem-
bers, HR departments are indirectly involved in corporate governance. Their more direct involvement is through the senior HR executive, who holds a seat on the company’s board of directors and has a say in strategic corporate decisions.

Encapsulating the critique of HR departments is Corporate HR Depart-
ments Are Not Needed, a recent book by economist Naohiro Yashiro, president of the Japan Center for Economic Research. Yashiro asserts that powerful HR executives, whom he casts as both gods and dictators, are preventing internal reform of large Japanese companies. He argues that Japanese firms should shift to systems of employment and corporate governance that are more decen-
tralized and market- and shareholder-oriented. Others criticize Japanese HR managers for administering policies that generate excessive conformity and that compare unfavorably to practices prevailing in Silicon Valley or on Wall Street. The current system is said to undermine creativity, individualism, and competition. As we will see, the depiction of HR departments as all-powerful bureaucracies is a dated stereotype. Nevertheless, it contains sufficient truth to make Yashiro’s book a plausible brief for reform and a contribution to the debate over the Japanese corporation.

Still, defenders of the distinctive Japanese approach to employment and to corporate governance continue to be heard. Within Japan, those who urge preservation or incremental reform of current corporate practices include acade-
ms, labor leaders, and corporate executives—and not only from HR depart-
ments. All of them think that corporations are being blamed for problems that originate in other spheres—the macroeconomy, politics, or banking.
Seen as excessively short-term and individualistic, U.S.-style corporate governance and employment practices are thought to be inappropriate for Japan because they clash with social norms regarding the corporation’s responsibilities—norms embraced both by liberals and by more-conservative nationalists. Some defenders of the Japanese approach express concern that a shift to U.S. practices will erode Japan’s comparative organizational advantage in customer and supplier relations, product quality, incremental innovation, firm-specific human-capital formation, and speed of execution. Even decentralization, a mantra in the United States, is criticized as being one-sided. Its critics say it represents a failure to recognize the many structural advantages that centralization offers to Japanese companies, who tend to have smaller divisions and therefore can rely on headquarters to achieve economies of scale and scope in pursuing strategy, research, and innovation.¹⁵

Those who favored a go-slow approach to organizational change faced an uphill battle in the late 1990s, but recent events have lent credibility to their skeptical perspective. The bust of the U.S. stock market and the spate of corporate scandals in the United States have called into question previous assumptions about the innate superiority of U.S. corporate governance. The fall to earth of dot-com companies and other high-tech start-ups has coincided with successes for some Japanese companies, and that has cast doubt on the assumption that organization-oriented employment practices are incapable of sustaining innovativeness.²⁶

Just how far change has proceeded, and in what direction, will be examined in this book. It analyzes the impact that globalization, recession, and the declining strength of unions have had on Japanese HR departments and employment practices. Is shareholder sovereignty taking hold in Japan? Are HR departments losing their centrality and clout? Is employment becoming more market-oriented? Are companies listening to critics like Yashiro and U.S.-based investors or to those urging gradual reforms consistent with established Japanese practices?

**The American Scene**

In the United States too in recent years, a debate about HR’s role has occurred, but its point of departure is different. Unlike its counterpart in Japan, HR in U.S. companies has never been a prestigious executive function. Few American CEOs have a background in HR; the salaries of HR executives tend to be lower than those of other corporate specialists; and, until the late 1970s, most HR executives reported to the vice president of operations, or to an officer at similar rank, rather than to the CEO. During certain periods, however, the HR executive did have some clout, typically when confronting problems that created uncertainty for the corporation. These included the rise of
mass unionism in the 1930s and 1940s and increased federal regulation of employment in the 1970s. Although jobs in the United States never were as stable as those in Japan, many companies treated their employees like “lifers” and, in most other respects (employee representation not being one of them), had a Japanese-style system of welfare capitalism.\(^\text{17}\) Companies shared with government the provision of social benefits. And senior executives saw themselves as having responsibilities not only to shareholders but also to employees, customers, and communities. Around 1980, substantial overlap existed between the policies and corporate cultures typical of large U.S. companies and those typical of large Japanese companies.\(^\text{18}\)

During the past twenty years, those corporate cultures have diverged. In the United States, jobs have become more market-oriented—a boon for some knowledge workers but for many others a source of greater instability and insecurity. The strength of unions continues to decline, and the impulse to regulate labor markets has tapered off. Viewed internally, big companies can be seen to have weathered a period of deconstruction. They are more decentralized, and as a result their headquarters are smaller, they rely more heavily on outsourcing, and they invest more power in the hands of line management. Corporate governance in U.S. companies has taken a sharp turn in the direction of shareholder sovereignty. The notion of employees as stakeholders has been widely repudiated.

For HR executives, these changes were, at least initially, traumatizing. Decentralization meant not only fewer standard procedures to ensure company-wide equity but also a transfer of operating authority from the central HR unit to line managers. Under the new approach, as management scholar Peter Cappelli explains, “managers in each office or shop, often at the level of the supervisor, make their own decisions about who should get hired—and fired. They also have the flexibility to set pay for their employees, reflecting local market conditions, and to structure compensation so that it is heavily contingent on performance.”\(^\text{19}\) Whereas the exemplar of the old approach was IBM—it had career jobs, extensive training, and a powerful headquarters HR function—the new exemplars were the intensely market-oriented companies of Silicon Valley, whose employees had no expectation of continuing employment and whose jobs were structured to meet ever shifting market requirements. Corporate loyalty, on both sides, was considered a sucker’s game. The new employment contract was that people would work hard in return for learning opportunities, or even less, at firms like Wal-Mart.

HR executives in U.S. companies are struggling to redefine their responsibilities. With finance dominating corporate decision-making, HR executives stress their contribution to cost-cutting and their role as strategic business partner, that is, as advisor to other managers. Gone are notions of employee advocacy. Having assumed the business-partner role, HR has given up “pacifying disgruntled employees” in favor of “consulting with internal customers.”\(^\text{20}\) The
management literature uses a lot of buzzwords to describe what HR executives should do, but exactly what HR executives are doing as “business partners” remains something of a mystery.

Against this tendency is a contrapuntal movement based on a different conception of what makes companies profitable: Instead of a focus on low wages or market power to boost shareholder value, a resource-based approach is proposed. In the resource-based view of strategy, a company’s competitive advantage derives from inimitable resources, such as intellectual property or unique physical assets, that it possesses and other companies do not. The resource-based view is more inward-looking than the market-oriented approach and, as such, is more concerned with strengthening organizational processes that make a company distinctive. It emphasizes that companies may do better to develop their own talent than to purchase it on the open market. Exemplars of this strategy include Southwest Airlines, knowledge-based companies like software-maker SAS Institute, and more upscale retailers like Men’s Wearhouse and Costco.

Companies taking the resource-based approach construe employees, and the HR function itself, not as cost burdens but as sources of competitive advantage. Headquarters HR has the job of creating a company culture that encourages employee commitment and creativity, monitoring line management to ensure that employees are being trained and treated fairly, and developing HR policies to support good customer and supplier relations. All this means having personnel policies that are organization-oriented. There are similarities between this approach and the tenets of traditional Japanese HR. In fact, Japanese researchers developed an early version of resource-based strategy to explain how Japan’s focused organizations used human capital to build core competencies. These ideas flowed west during the period when Japan served as a model for the United States.

On balance, then, the HR functions of U.S. companies show conflicting tendencies. Some HR executives emphasize shareholder sovereignty and the value of commodifying labor, while others endorse stakeholder governance and a resource-based approach. Which approach is dominant? What do they mean in practice? Note that in Japan the resource-based approach has traditionally been associated with HR power and influence. Does this observation apply to the United States? Finally, it’s not clear what role U.S. human resource executives play in top-level decision-making in decentralized, market-oriented companies. Does HR have any role, in fact, to play there at all?

Convergence and National Models

Over the past twenty years, advanced nations have become more economically interdependent as a result of increased trade and rising capital flows. Some prefer to say that the world economy remains inter-national rather than
global, but no one disputes that the economic integration of nations is tighter now than in the past. The big debate is over the consequences of globalization. Does it mean convergence of previously distinctive national systems, of the varieties of capitalism? If so, will convergence be disproportionately influenced by the American model—shareholder sovereignty, arm’s-length employment and business relationships—or will some new hybrids emerge?

The Japan-U.S. comparison offers a way of exploring these questions. Because of globalization, Japanese and U.S. companies increasingly must satisfy the same customers and investors, and that is a potential source of convergence. More generally, what favors convergence is that the two economies are enmeshed with each other. U.S. investors and consultants are active in Japan, trying to persuade local executives to adopt U.S.-style business practices, just as U.S. policymakers have been urging the Japanese government to emulate American laws regarding trade, commerce, and intellectual property. On the other side, Japanese companies have made massive investments in the United States and now have a sizable number of U.S.-based employees, some of whom return to Japan regularly. As companies on each side of the Pacific become more aware of each other, they compare themselves and are more likely to adopt each other’s practices, especially at the level of the industry in which they compete.

Because the United States is a global hegemon, however, some practices and ideas flow in only one direction. American values are transmitted through advertising, mass media, and other channels. Japanese youth model themselves after their counterparts in the United States. Young college graduates are leery of jobs in big companies and more inclined than their parents to take risks and assert their individuality. Affluent Japanese of all ages are more individualistic than were affluent Japanese of earlier generations. Japan today is marked by considerably less social solidarity than in the decades immediately following the Second World War, and by less willingness to tolerate egalitarianism in social policy and at the workplace.

The HR executive’s role in large corporations is just one of many reference points for the study of convergence, but it has the advantage of providing material in which any tendencies toward convergence are likely to show up in sharp relief, as Japanese and U.S. companies entered the 1980s with rather different approaches to HR, employment, and corporate governance. On average, Japanese companies were relatively organization-oriented, meaning that employment was of extended duration and turnover low; training was extensive; and internal considerations—equity, seniority—dominated decisions making on wages and allocation. Stakeholder corporate governance and enterprise unions supported the firm’s organization orientation. All these features undergirded a high-status, centralized HR function in Japan.

In the United States, employment practices tended to be more market-oriented with shorter job durations and higher turnover, low training expenditures, and pay and allocation based on going rates and other external criteria.
Corporate governance privileged shareholders, and unions were either industrial in orientation or, more commonly, did not exist. Compared to Japanese employees, dissatisfied workers in the United States were more inclined to exit, and they had fewer opportunities for “voice.” The HR function lacked the centrality and influence of its Japanese counterpart.

Figure 1.1 represents the distribution of corporate employment systems in U.S. and Japanese firms in the early 1980s. What we see is that the United States and Japan had disparate means (assuming normal distributions). That is, on average they took different approaches to managing employees. One interpretation of convergence is that the Japanese mean is moving gradually closer to that of the United States. We will consider that hypothesis as we analyze the respective developments in the two countries.

The story, though, is more involved than that. Although Japan and the United States started from different positions, from the beginning there was overlap between them, as is shown in figure 1.1. Some Japanese companies and some U.S. companies resembled each other more than they adhered to their national central tendencies. It is possible that, over time, the variance of the national distributions will widen so that cross-national overlap increases while the central tendencies change little, if at all. This too could be considered a type of convergence.

Complicating the situation is the dynamic nature of the distributions. Their shape and location are changing over time. If both countries shift in a market-oriented direction, as indicated by the arrows, it is possible that the distance between the national means will not change. In my view, this would still be an instance of convergence—what I call ‘directional convergence.’

The existence of national models that other countries emulate is not unique to the present period of globalization. In famous essays on “economic backwardness,” Alexander Gerschenkron argued that late-developing countries like Germany and Russia were able to accelerate their industrialization process by borrowing ideas and institutions from more advanced countries like
England. In Japan, the Meiji modernizers of the nineteenth century looked to Europe, and to a lesser extent the United States, for lessons in designing the army, the police, the schools, the legal system, the postal service, and other political and social institutions. The Meiji reformers picked and chose the national models that were considered “best practice” of the day, but they favored those that fit with preexisting Japanese characteristics—hence their preference for the French police system, which was centralized, over the English version, which was comparatively decentralized. Later, after the First World War, when large Japanese companies sought ways to spur efficiency without labor strife, they looked to the United States—it was industrializing rapidly without a strong labor movement—and borrowed practices such as scientific management and welfare capitalism.

After the Second World War, Europe and Japan attributed America’s role in the Allied victory to the superiority of its economic and political systems. Within the United States, too, social scientists in the 1950s and 1960s were infatuated with the idea that American institutions were the most advanced in the world, and they predicted that eventually other countries would converge on the U.S. model. Modernization theorists expected convergence not only of business institutions but also of labor unions (with U.S. business unionism seen as the “mature” approach), of societal culture (individualism would supplant “collectivism”), and of political systems (pluralist democracy would become the norm and totalitarianism would disintegrate under the logic of industrialism). Just to be sure, America’s foreign-aid and development programs, like those that defined its occupation and economic rehabilitation of Japan, prescribed the adoption of U.S. practices.

In the 1950s and 1960s, Japanese businessmen and government officials made regular study trips to the United States to learn about the ostensibly superior American system. In economic-development jargon, this was a “demonstration effect.” But, as in the Meiji era, the reformers selected only those elements that fit with Japanese practices. They grafted their borrowings onto existing Japanese institutions. The net effect was to preserve the underlying structure, as was the case with Japanese labor law.

The postwar U.S. economic boom came to an end in the early 1970s. Productivity declined, inflation rose, and imports began to claim a larger share of the U.S. market. Against the debacle of Vietnam and the end of the Bretton Woods system, the economic giant that was the United States appeared wounded. No longer was it touted as a model for other countries. It was precisely at this moment that a new “varieties of capitalism” literature began to flourish. First it was the corporatist European economies, and then Japan, that were held forth as desirable alternatives. In the 1980s, political economists such as Lester Thurow and Michel Albert predicted that three types of capitalism—European (the “Rhine” model), Japanese, and Anglo-American—would contend for market share in an increasingly globalized world.
Students of the Japanese model were impressed by its highly trained workers, high-quality products, and efficient manufacturing systems. Cooperation—between workers and managers, suppliers and users, business and government—was thought to be the key to Japanese success. Also, Japan played Gerschenkron’s late-developer role with consummate skill. By the 1980s, the tables had turned. Now it was U.S. businessmen who took regular trips to Japan to learn the secrets of its manufacturing prowess, while Japanese companies used their surplus profits to purchase real estate in downtown New York. Just as in earlier periods the Japanese had tried to adapt U.S. practices to their native economy, now U.S. companies struggled to assimilate quality circles, just-in-time methods, and union-management cooperation. Not only in manufacturing but also in the semiconductor and other high-technology industries, the Japanese appeared to be beating the United States and had long since outpaced the British, who in the 1980s tried to market themselves to Japanese investors as a low-wage assembly zone for export to Europe. Economic fortunes fluctuate, however, and the 1990s saw another reversal. Now the United States recaptured the lead, as Japan and Europe experienced slow growth and record high levels of unemployment.

Our brief history of national models suggests the following principle: When a nation enjoys macroeconomic success, it will be regarded as a model by its slower-growing peers. Consistent with this prediction, U.S. ideas and institutions in the 1990s were once again prescribed as good for what ailed the stagnant economies of Europe and Japan. The performance of the U.S. economy in the 1990s, especially its ability to generate millions of new jobs, silenced earlier assertions that Rhenish capitalism—or Nordic, Northern Italian, or East Asian capitalism, for that matter—were superior to the U.S. version. The shoe was now on the other foot, and it was the American model—flexible employment arrangements, shareholder sovereignty, decentralized companies, and venture capital—that was held up as the exemplar.

The problem, however, is the difficulty of identifying which micro-level institutions are responsible for a country’s superior macroeconomic performance. Hence, those who wanted to emulate American success had little idea of where to start. Some countries, or the companies within them, imitated U.S. accounting practices; others set up venture-capital funds; still others tried to build business-university linkages, in hopes of creating new Silicon Valleys.

Cynics said that nothing was worth imitating, because U.S. success was simply a matter of luck, of so-called first-mover advantages—it was first out of the chutes with information and Internet technologies. Others, more taken with the idea of national systems but less sanguine about convergence, noted that economic systems are composed of myriad small pieces that fit together as a result of having coevolved over long periods of time. That is, “institutional complementarities” exist that make it difficult, if not impossible, to chip off an institution from one setting, implant it in a different matrix, and have it
achieve the same results. For example, Silicon Valley requires not only venture capital and university talent but also high employee mobility and particular kinds of intellectual-property law. The parts fit together in fortuitous ways that are difficult to replicate piecemeal.

In light of these developments, the varieties-of-capitalism literature became more cautious about advocating models. Now there was closer examination of the costs as well as the benefits of different national systems. On the upside, the U.S. economy in the 1990s generated millions of new jobs, thousands of new businesses, and a booming equities market. Shareholder sovereignty meant that companies were willing to take risks on behalf of their investors. On the downside, wage growth was slow and unevenly distributed; output per hour was about the same as in Western Europe; and per capita growth rates were not higher than in other advanced countries, including Japan. The downside of shareholder sovereignty became clearer after the U.S. boom ended in 2001, as news about managerial self-dealing and ineffectual boards came to light. Even so, productivity recently has improved greatly in the United States and, if that turns out to be a lasting development, proponents of the U.S. model will have something to crow about, assuming, however, it does not sink under the weight of its current-account and budgetary deficits.

At this moment, though, much remains unclear, including the extent to which America’s “new economy” is driven by first-mover technological advantages that may not be sustainable for very long. Since the 1950s, in fact, the United States has at different periods seemed to enjoy an advantage that was soon dissipated by overseas entrants with different economic institutions. It happened in transistors, consumer applications of integrated circuits, and, for a while, in semiconductors. It may happen yet again, or it may not. Economic success at any point in time is often a matter of having all the right pieces at the right moment. (Perhaps that is what’s meant by luck.) If economic actors don’t know what contributes to a country’s success and the success of the companies within it, it may elicit less imitation—and less convergence—than proponents of convergence believe should occur.

Consider corporate governance, for example. In the late 1990s, it was popular to blame the collapse and slow recovery of the Asian “tigers” on their corporate-governance systems, which were said to be opaque and prone to insider cronism. Japan was criticized on the same grounds. In both cases, the exemplar for corporate governance was the United States, where ownership was dispersed and corporate boards were small and composed of outsiders. These features of the U.S. model were held responsible for the high growth rates and booming equity prices in the United States in the 1990s.

What many failed to realize is that the U.S. governance model is substantially the same as that found in Britain and Canada, whose economies in the 1990s were far from stellar. Britain’s per capita GDP levels were below Japan’s, while its output growth lagged behind Germany’s throughout the 1990s. In
per capita income, Britain’s rank among the nations actually declined between 1980 and the late 1990s, at a time when it was imitating other features of the U.S. model. Canada’s performance was even worse: In per capita GDP, it fell from third to seventh, despite what by U.S. standards was an enviable corporate-governance system.40

Putting to one side the hubris of Wall Street and The City, note that any attribution of America’s recent economic performance to shareholder sovereignty (which also exists in Britain and Canada) is based more on faith than on facts. The absence of certain knowledge of how, or even if, U.S.-style governance contributed to America’s economic performance sharply curtails the incentive that other countries might feel to emulate American practices.

There are other problems with convergence theory. The notion of a dominant model may have more to do with how social scientists think than with the realities of economic growth. As economist Richard Freeman observes, the assumption that there exists an optimal set of institutions for governing firms and markets owes much to the idea, ingrained in economics, of single-peak optimality. The historical evidence suggests that a wide variety of economic systems foster growth—that there are multiple equilibria—and that what appears as the best model is shaped as much by fad and fashion as by evidence. With respect to the same example, corporate governance, the data show no relationship between different types of corporate governance and variations in per capita GDP. Hence one should be wary, once again, of claims that there is one best way of structuring modern economies.41

Another defect of the dominant-model form of convergence is that it tends to minimize or ignore the diversity that exists within a nation. For small (and relatively homogeneous) countries, this may not pose a significant problem. For large countries, however, it does. What the convergence literature gives us is—instead of a realistic portrayal of a large nation’s economic institutions—something resembling a Weberian ideal type. The dominant-model school focuses on national means and ignores within-country dispersion (see figure 1.1). Japan has long been characterized as a country with substantial economic dualism—its small and middling firms are significantly different from its large ones. Today that characteristic is magnified by the split between Japan’s export-oriented companies and companies, such as those in the retailing and construction industries, that are based on the home market. In the United States too, companies divide along various lines, such as that between unionized and nonunionized, between family-owned and public, and between diversified and focused. Hence, in some sectors in Japan and in the United States, companies resemble their counterparts across the Pacific more than their national models, and that causes the distributional overlap shown in figure 1.1.

This, however, raises a question: Does globalization lead to convergence at the industrial level, resulting in greater within-country dispersion and fewer companies clustered near the national mean? Referring to the idea that it
does, the economists Harry C. Katz and Owen Darbishire write of “converging divergences.” They find evidence of this phenomenon in the employment systems of telecommunications and automotive firms in Europe and the United States. In the past, distinctive national institutions, such as collective bargaining—the laws and customs of which vary from country to country—molded corporate employment practices. Today, according to Katz and Darbishire, those institutions exert less influence than do the common technological and competitive forces operating at the industry level. Industry-level convergence is, however, rather different from what is seen in the dominant-model view: It is limited to particular sectors and implies the declining significance of macro-level national institutions. Another implication of the industry-level view is that national economies, instead of converging on the U.S. approach, borrow and imitate in multiple directions, as, for example, European and U.S. automotive firms copy Japanese work practices, while Japanese financial companies move to the more decentralized wage systems characteristic of the United States.42

One difficulty for the converging-divergences argument is that economic actors adapt to common environmental pressures in different ways. At the end of the adaptation process, the institutions have changed—they are now hybrids of some sort—but national differences persist. The logic underpinning this outcome is rooted in the theory of path dependence. Countries begin the development process at different starting points and move along separate trajectories. Over time, a nation’s economic institutions interact and form complementarities. Think of diesel versus rotary engines: The parts are different but the function, generating torque or horsepower, is the same.43

Some countries are what economist David Soskice calls “coordinated market economies,” in which, over time, complementarities among their systems of employment relations, labor relations, corporate governance, and external relations (relations with government and others businesses) develop. In Sweden’s economy, for example, the parts that yield coordination may be different from those in Germany, the Netherlands, or Japan, but in each case the purpose of those different sets of parts is similar.44

The same observation holds true of the U.S.-Japan comparison. Japan has been repeatedly criticized for lacking a well-developed venture-capital industry like that found in the United States. That’s one reason why Softbank, the Internet incubator of Masayoshi Son, created such a stir in the late 1990s. What was not well understood at the time is that Japan has an alternative mechanism for funding new ventures: growing them inside large companies and then spinning them off as independent entities. Another example of countries arriving at similar results through different approaches is that companies in Germany, Japan, and the United States, while differing from each other vastly in their systems of corporate governance, share the same response to sagging corporate performance: They are equally likely to replace top execu-
tives. It is precisely the response one would expect from a well-functioning
corporate-governance system. The reduction of emissions from a diesel engine
and from a rotary engine requires two different methods.) While nations in
theory could implement an entirely new set of institutions, sunk costs and
uncertainty keep them from straying off a given path; incrementalism trumps
synoptic change. Another example: Technological innovation in the 1980s called
into question existing systems for regulating telecommunications, but nations (including
the United States) did not respond with across-the-board deregulation. Instead
they made incremental adaptations that constituted what political scientist
Steven Vogel calls “re-regulation,” whereby national differences were pre
served, even while the different adaptations tried by various countries moved
each of them in the same direction. An example from the corporate level is
the steel industry of the advanced nations, which since the 1970s has been
plagued by excess capacity and competition from low-cost producers. All the
advanced countries have shrunk their capacity, but their means of achieving
that result varied: rapid downsizing via layoffs and bankruptcies, pay cuts,
ggradual job cuts combined with government subsidies. Choice of adjustment
strategy was dictated by existing labor-management and business-government
relations. A third example comes from the automotive industry. When con
fronted with quality problems in the 1980s, U.S. manufacturers at first tried
imitating Japanese quality practices but quickly found that in the U.S. context
they failed to perform as intended, and eventually fashioned their own alternative
methods.

Path dependence also provides an explanation for a conundrum relevant to
the U.S.-Japan relationship: the high level of exchange between the developed
countries of the North. What could be the basis for comparative advantage
between countries with similarly efficient industries and endowments? Path
dependence suggests that different national starting points and subsequent
trajectories can give rise to institutional diversity, and that some constellations
of national institutions may be better than others at facilitating certain types
of innovation or business strategy. Companies, and the countries in which
they are embedded, can then secure international markets by specializing
in particular product types, because competitors with different institutional
structures will have difficulty imitating them. The emphasis, therefore, on
human capital—high training levels—in Germany (craft skills) and Japan
(firm-specific skills) supports production-based technological learning, incremen
tal innovation, and high-quality products. By contrast, U.S. institutions
encourage resource mobility, general skills, and high short-term rewards. That
has the effect of directing resources to big-bang technological breakthroughs but not to implementation prowess. Path dependence, then, offers not only an explanation for North-North trade but also a larger lesson: Sustaining institutional diversity permits nations to reap continuing benefits from trade with each other.49

The implications for convergence theory are straightforward. At the gross level, diverse national infrastructures may appear to be designed to yield the same results, just as different engines all generate horsepower or torque. At a fine-grained level, however, those institutions are in fact defining slightly different production possibilities, which permit companies to occupy disparate competitive niches, just as some engines are better for powering a truck and others work best in marine applications. At that level of analysis, countries can be seen as not only structurally but also functionally dissimilar, and successful adaptations are those that prevent the dissipation of national advantages. Convergence pressure from common environmental changes may be resisted or may lead to a form of hybridization that preserves national diversity.

These observations lead to four different predictions about the role of HR executives and the nature of employment practices in Japan and the United States. First, the national-model argument: At the present time, the United States is an exemplar for other countries, including Japan, so one can expect to see Japan move in a more market-oriented direction, toward shareholder-oriented corporate governance and weaker ties to employees, other businesses, and government. The pressure for convergence could follow myriad paths. It might arise in product markets or in financial markets, or it might come as a result of legislation. Whatever the source, the result will be movement of the Japanese mean towards the U.S. mean shown in figure 1.1, leading to a weaker HR function in Japan.

Second, according to the converging-divergences argument, national patterns in all countries, including the United States and Japan, will fade as companies grow more sensitive to industry-level competition and model themselves on each other. Borrowing will be bidirectional, as it is not in the national-model case, so the net effect will be a two-way reduction in the distance between national means. At the same time, national dispersion—the variance around the mean—will increase. With respect to HR executives, one would expect to see greater industry-specific commonalities, with ideas and practices flowing between Japan and the United States.

Third, according to the weak-path-dependence prediction, national economies will adapt to common environmental changes in a similar way but will fashion those adaptations to fit preexisting institutions. The result is hybridization in each country. In terms of figure 1.1, national models will move in the same direction—both Japan and the United States will become more market-oriented—but the distance between their national means may not change. For
HR, this might mean greater decentralization in both Japan and the United States but within the confines of differently organized corporate structures. Finally, according to the strong-path-dependence prediction, countries will preserve their dissimilarity—to sustain comparative advantage, because they find it too costly to change in the face of complex interdependencies, or because vested interests block reform and promote inertia. Figure 1.1 remains fixed, a case of plus ça change, plus c’est la même chose.50

A Look Ahead

To understand developments in Japan and the United States, and to determine whether convergence is occurring, requires a close look inside large corporations that dominate each nation’s economy. Admittedly, the present situation of HR executives is only a piece in a much larger puzzle about the future directions of corporations and capitalism in different parts of the world. But a clear advantage of studying these executives and what they do is that it offers a unique vantage point from which the larger process of change can be seen. Because the HR function mediates between the economic environment and corporate practices, its organizational role affects a broad range of decisions—about business strategy, employment policy, and corporate governance. These decisions lie at the heart of what constitutes the varieties of capitalism.

Figure 1.1 offers a guide to the structure of this book. In chapter 2, I analyze the traditional Japanese system—the central tendency that existed in the early 1980s—and then examine the pressures for change that have developed over the past twenty years. Chapter 3 presents findings from field research inside large Japanese corporations, focusing on the diversity that exists in Japan today. Chapter 4 is devoted to the evolution of the HR function in the United States. There I look at the traditional U.S. system and at changes that have occurred since the 1980s. Chapter 5—which presents field research on a set of U.S. companies matched with the Japanese firms—examines U.S. diversity as well as industry-specific overlap with Japan. Chapter 6 presents survey data on the central tendency in each country today, allowing us to gauge how near to—or distant from—each other the countries are. Chapter 7 rounds out the book with a summary and conclusions.