POWER VERSUS EFFICIENCY*
-HOLDING COMPANIES IN JAPAN-

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Introduction

Holding company was a controversial issue in Japan since after world war II until this summer. In June Japanese congress passed a bill which revised the Antimonopoly Act and lifted the ban on the formation of holding companies. The amendment could even be enforced this month. Apparently, lifting the ban on the formation of holding companies affects not only the financial sector, but also other industrial sectors, and small and middle-sized companies as well as big business. A great urgency is that, following the decline of the cross-stockholding system and the weakening of major financial institutions, Japanese industrial groups are forced to adapt themselves to the new environment. The purpose of this paper is to examine the possible influence on industrial groups in Japan caused by the lifting of the ban on holding companies, because both their formation in the prewar period and their prohibition in the postwar period were the key factors which shaped the organization of Japanese industry as typified by closed business groups known as Zaibatsu and Keiretsu.

Zaibatsu As A Typical Holding Company

Prewar Zaibatsu, especially the four major zaibatsu emerged as highly diversified, family-dominated industrial groups. The Zaibatsu structure can be divided into four levels(see Figure 1).

The founding family held majority stocks in Honsha(cenral office), which was a pure holding company, “whose principal business is to control the business activities of a company or companies in Japan by means of holding stock (including shares of partnership)”1) .

Generally a Honsha controlled its subsidiaries, which were doing business in various fields of industry, such as banking, trade, manufacture and so on, through property rights, the right to appoint the directors of subsidiaries and financial involvement.

The subsidiaries which belonged to the same Zaibatsu and were conducted solely according to the

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strategical decisions taken by the Honsha, also controlled a number of further subsidiaries, which, in turn, affiliated with their own parent company's core business. These groups were also holding companies, not pure holding companies but operating holding companies, in which the parent company was one of the leading companies in an industry. And at the same time, it was the center of a group whose subsidiaries were doing some business related to the core business of the parent company.

The major Zaibatsu, which evolved into holding companies by 1920s were the dominant power over Japanese industry and foreign trade, and were even involved in political and military activities.

Zaibatsu Dissolution

With the end of World War II, Zaibatsu were dissolved by the occupation forces as part of the 'Economic Democratization Policy'. The Zaibatsu dissolution was carried out in three levels. First, the Zaibatsu family members were purged and the securities in their hands were forced to be transferred to the Holding Company Liquidation Commission. Second, the Honsha was dissolved and the securities in its possession were ordered to be shifted to the Holding Company Liquidation Commission. Third, 18 big companies, including non-Zaibatsu firms, had to dispose of their factories and the stocks in their possession or divide themselves up under the Elimination of Excessive Concentration of Economic Power Act.

It is still unclear why two giant trading companies, Mitsui Bussan, and Mitsubishi Shōji were divided into more than 200 and 100 small companies respectively. The Zaibatsu-affiliated banks and other financial institutions, on the contrary, escaped division.

In addition, the Antimonopoly Act (Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade) was enforced in 1947 in order to prevent the revival of the Zaibatsu. Concerning stockholding, the Act made three provisions. (1) prohibition of the formation of holding companies, (2) general prohibition of intercorporate stockholding by non-financial companies, (3) general restriction on financial companies holding stocks in excess of 5 percent of other companies' stock. It is said that these provisions did not even exist in the Antitrust Law in the U. S. A. The purpose of the Act was to "promote free and fair competition, to stimulate the initiative of entrepreneurs, to encourage
business activities of enterprises, to heighten the level of employment and people's real income, and thereby to promote the democratic and wholesome development of the national economy as well as to assure the interests of consumer in general"}_{2).}

**Evolution of the Keiretsu**

As a result of the dissolution of the holding companies, their subsidiaries were no longer under the control of the dissolved Zaibatsu. But at the same time, these independent companies also risked becoming targets of takeovers on the stock market because the stocks they issued were sold to the public at large and mainly went to individual stockholders. For instance, the amount of stocks owned by individual stockholders reached up to 70 percent of the total outstanding stocks in the early 1950s. To protect themselves from the danger of takeovers the companies were forced to find friendly, stable shareholders (both individuals and companies). But having a company as shareholder was prohibited or restricted by the Antimonopoly Act mentioned above. Following the reverse course of U. S. policy towards Japan from 1948 and the conclusion of the Peace Treaty in 1952, the Antimonopoly Act was amended in 1949 and in 1953 in response to the demands from the business sector on the relaxation of the Antimonopoly Act. As far as stockholding is concerned, while the amendments did not lift the ban on the prohibition of the formation of holding companies, a company may hold stocks of other companies which do not compete with itself, insofar as such stockholding does not substantially lessen competition and no company engaged in financial business shall acquire or hold stock of another company in Japan if, by doing so, it holds in excess of 10 percent of the stock. There were more amendments and exemptions after the amendment of the Antimonopoly Act in 1953. It might be interesting to mention here that, first, the relaxation always happened in a period of economic recession in order to strengthen the companies' competitiveness. And second, the Fair Trade Commission was always expected to be active in lessening the negative effects which resulted from the deregulation.

The amendments were decisive in the reshaping of interfirm relations in Postwar Japan (see Figure 2). On the one hand, cross-stockholding was the most important means for big business to protect themselves from potential takeovers. It was natural that the companies re-established connections with former related companies through cross-stockholding. In addition to cross-stockholding, these firms also linked with each other through other ties such as interlocking directorates, long-standing business transactions, and the presidents' meeting. Generally banks and trading companies in each group are the center of the links. This type of business group, to which six large well-known business groups belong, is an alliance of large firms belonging to different industries, and can be referred to as intermarket Keiretsu. Mitsubishi, Mitsui and Sumitomo are connected with former Zaibatsu, but the other three, Fuyo, Sanwa and Daiichikangyo are each centered around a city bank.

On the other hand, as the firms grew, they started to build their own groups through owning stocks, nominating directors, and providing financial assistance. This type of business group, like Toyota group, mostly found in manufacturing fields, consists of one large manufacturing firm and its suppliers.

These are referred to as vertical Keiretsu and can be described as a parent-children relationship. Some of them are members of an intermarket Keiretsu, but some of them are independent of it.

Both intermarket Keiretsu and vertical Keiretsu are an integral part of the Japanese industrial system and have attracted intensive attention both from advocates of its efficiency and from critics of its market power and its closeness to outsiders.

Operating Holding Company

Now it is quite clear that all the Japanese big businesses are vertical keiretsu, and therefore operating holding companies. Although the provision prohibiting the formation of holding companies still remains in the Antimonopoly Act, it only means pure holding companies. As a matter of fact, the formation of operating holding companies has been allowed since 1949, just two years after the enforcement of the Antimonopoly Act. In other words, the amendment of the Antimonopoly Act this time focused on relaxing regulations on the formation of pure holding companies.

So one question is why the advocates insist that the formation of pure holding companies is necessary, why the formation of operating holding companies is not enough to resolve the problems faced by Japanese firms.

Basically Japanese companies introduced a divisional system to cope with the rapid scale growth and diversification in their early development stage (see Figure 3). Recently some big businesses have been introducing an ‘internal company system’ to decentralize and distribute more power to divisional units which are almost independent companies but still stay within the Honsha. Along with further business expansion, spin-off was adopted as a business strategy to keep the headquarters slim and encourage decentralization. Besides, they also invested in some existing companies and created new joint ventures with other companies. By doing so, the boundary of the company was extended to its
subsidiaries, and therefore unified management of the entire group was becoming crucial. Some argue that these companies may take the form of pure holding companies soon after the amendment of the Antimonopoly Act is enforced, because the formation of pure holding companies can make the headquarters completely separate from the business operations and at the same time make the companies’ restructuring through M&A easier.

But there are still some questions on this suggestion. First, generally the degree of diversification in Japanese companies is low and the proportion of their core business is relatively high compared to their counterparts in other industrialised countries. It will be a realistic choice for big business to introduce intermediary holding companies to control their minor businesses or their domestic or overseas subsidiaries, and keep the core business, which has such a dominant position, directly within the Honsha. The formation of pure holding companies is also a choice for big businesses, but under the control of a pure holding company which holds several large subsidiaries, it is unlikely that double decision-making can be avoided and the Honsha will most likely be far from the operating sector.

Second, according to the transaction cost theory, in contrast with the multi-divisional form structure which combines the divisionalization concept with an internal control and strategic decision-making capability, the holding company form has little general office capability although it is also a

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3) Daiei, Japan’s largest retail store, announced a plan to form a pure holding company, which expected to be the first case in Japan since the enforcement of the amendment of the Antimonopoly Act. The plan calls for an intermediary holding company designed to control more than 100 existing subsidiaries while the core business, represented by Daiei, remains a unit. The Asahi Shimbun, October, 1997.

4) Daimler-Benz AG introduced the form of the pure holding company in 1989, but abandoned it this spring because under the control of a pure holding company, decision-making is too slow to cope with the changing environment. The Nihon Keizai Shimbun, Feb. 1997.
divisionalized form\textsuperscript{5}. Generally speaking, holding companies are highly integrated in terms of ownership, but the control of central office is weak, in many cases, it heavily depends on personal or family links\textsuperscript{6}.

Third, and even more importantly, the strength of the so-called Japanese style of management is closely connected to the formation of operating holding companies. For example, the prohibition of the formation of pure holding companies made M&A difficult in Japan, and therefore diversification through M&A became problematic and expensive. As a result, Japanese companies tended to commit themselves to specialization rather than to vertical integration like American companies. Specialization, in turn, is thought of as one reason for close interfirm relations in Japan.

**Excessive Concentration of Economic Power?**

The relaxation of the ban not only provides a possible tool for change in the internal organization of vertical Keiretsu, but also paves the way for the reshaping of intermarket Keiretsu. Because of the strong influence intermarket Keiretsu have on the market, in July, the Fair Trade Commission announced a Guideline on the formation of pure holding companies which aims to prevent the excessive concentration of economic power. According to the Guideline, the following three types of holding companies will be prohibited.

1. any holding company with total group assets of over 15 trillion Yen, and a total turnover of over 600 billion Yen per year, covering more than five major industries in which each member's total assets is over 300 billion Yen\textsuperscript{7}.

2. any holding company covering a financial institution whose total assets are more than 15 trillion Yen plus an industrial company whose total assets are over 300 billion Yen.

3. any holding company covering more than five related major industries where each member holds more than 10 percent of the market share of the total domestic sales or ranking as one of the top three in each industry or any holding company covering three excessively dominant firms\textsuperscript{8}.

Obviously (1) and (2) are intended to prevent the survival of the intermarket Keiretsu, particularly the combination between financial institutions and major industrial companies. Although a new system is needed to replace troubled cross-shareholding system due to the plunge of the stock price since the early 1990s, it is unrealistic at present to imagine the survival of the former Zaibatsu just thinking how the banks are suffering from the enormous burden of loan default. In this sense, (1) and (2) are very important provisions from a long-term point of view, but have no significant impact on industrial


\textsuperscript{6} See Katsumi Shimada, Torihiki Kankei No Kokusai Hikaku Wo Meguru Sho Mondai(Some Problems Met in the International Comparison of Transaction Relations). April, 1996.

\textsuperscript{7} Limiting total group assets to 15 trillion Yen aims at preventing the rally of six large intermarket Keiretsu since the smallest one, Sumitomo's total assets are estimated at 20 trillion Yen. Against the original proposal by the Liberal Democratic Party that total group assets would be limited to 20 trillion Yen, the Social Democratic Party insisted that it should be 10 trillion Yen. In the end the two sides came to a compromise of 15 trillion Yen.

Among 2,715 listed companies (except for financial institutions) in the Tokyo Stock Exchange, there are only 315 whose assets are more than 300 billion Yen. The Asahi Shim bun, Feb. 26, 1997.

\textsuperscript{8} For instance, Toyota, Asahi Glass, New Nippon Iron and Steel and Bridgestone are related to the production of automobiles. If they came under the control of a pure holding company, it would not be permitted by the Fair Trade Commission.
organization on a short-term basis.

But we have to examine (3) carefully because it reserves a place for the formation of financial holding companies.

Financial Holding Company

The financial sector was heavily protected by the government in postwar Japan. On the one hand, it was free from new entry competition since its territories were separated and fenced off by law. On the other hand, it was designed to channel capital resources to the industrial sector in order to achieve high speed economic growth. But financial liberalization required the financial sector to undertake structural reform, for instance, liberalizing interest rates and eliminating barriers in order to promote competition. However, the financial sector, especially the banking sector, rather than implementing structural reform, competed to pour money into the stock market and the real estate sector, which resulted in the rise and the fall of the bubble economy.

It is quite clear that in the aftermath of the collapse of the stock and land prices since the early 1990s, it was particularly the enormous non-performing loans burdening the banks that prevented the recovery process.

In order to rescue the stagnant economy, the Japanese government has taken many stimulative measures mainly aimed at supporting the troubled financial sectors. The Bank of Japan reduced the interest rates to a record low level and the government implemented special budgets several times to increase public spending. Needless to say, the record low interest rates aimed at helping banks write-off their bad loans at the expense of depositers. Recently the government announced another emergency package in an attempt to encourage the economy. It focused on the relaxation of property regulations, which were decisive factors in the banks' bad loans predicament.

Unfortunately these measures could not change the situation. Last month three major financial institutions, including Yamaichi Securities, the forth largest securities company in Japan went bankrupt, and the recent currency crisis which started in the South-east Asian countries is another threat to the Japanese banking sector.

In response to the current economic difficulties, the Japanese government has promised 'structural reforms' once again, giving priority to the financial sector. The formation of financial holding companies is considered as a centerpiece of 'The Big Bang Plan'.

In 1993 as one measure to eliminate the existing barriers, the Ministry of Finance made a lot of efforts to pass a law which allowed financial institutions to set up subsidiaries to enter into other territories. For instance, a bank can begin a securities business by owning a subsidiary stockbroker (see Figure 4). From the organizational point of view in this case, the bank is taking the form of an

9) Japanese interest rates were pushed down to 0.5 percent two years ago. First, the rates were lower than ever in Japan, then less than in Britain during a bout of deflation in the late 19th century. Most recently, lower than after America's Great Depression. The yield on Japan's long-term bond also slipped to 1.7 percent in the middle of October. The Wall Street Journal Europe, October 15, 1997.

10) The most important measures were aimed at the troubled property sector where debts have hobbled Japan's banks. Financial Times, Oct. 22, 1997.
operating holding company. By contrast, financial holding companies cover subsidiaries including banks, security agents and insurance companies and other financial institutions, and take the form of pure holding companies.

Suppose that the subsidiaries controlled by a financial holding company were limited to small-sized financial institutions, then there would be no big difference between the 'subsidiary way' and the 'financial holding company way', because the operating holding company or the intermediary holding company is capable of coping with entry to other financial areas through small-sized subsidiaries, while avoiding the organizational problems caused by the introduction of a pure holding company.

Now the Financial Holding Company Act which was proposed by the Ministry of Finance has been passed by the House of Representatives\textsuperscript{11}. Case 3 in the Guideline mentioned above provides a framework for the formation of financial holding companies.

As a matter of fact, several moves in this direction have been reported. Before the Guideline was presented in July, the president of the Mitsui Life announced a proposal to the other three financial institutions which belong to the Mitsui group to set up a financial holding company\textsuperscript{12}. As soon as the Guideline was announced, the financial sector assessed it and thought it would make it possible for city banks to combine with other financial institutions belonging to the same groups under the control of a financial holding company, such as the Mitsubishi group and the Sumitomo group, for example\textsuperscript{13}. Recently three Fuyo group financial companies including the Fuji Bank provided a helping hand to the ailing Yasuda Trust Bank, which is also a member of Fuyo group. So the formation of financial holding companies is no longer only an idea on paper. Through the 'subsidiary way', financial companies have already penetrated into each other's territories. As a result, overlapping competition among the financial companies belonging to the same intermarket Keiretsu is becoming unavoidable. Therefore, the formation of financial holding companies is considered as a useful tool to prevent overlapping competition within an intermarket Keiretsu, and at the same time, to promote the competition among

\textsuperscript{11) The Asahi Shimbun, November 28, 1997.}

\textsuperscript{12) The proposed financial holding company includes Mitsui Life, Sakura Bank, Mitsui Trust Bank and Mitsui Marine & Fire. The Asahi Shimbun, March 1, 1997.}

\textsuperscript{13) The Asahi Shimbun, July 25, 1997.}
the different intermarket Keiretsu. Hence, as long as one financial holding company covering major financial institutions was set up, other group and financial institutions would follow this move sooner or later. In this sense, the formation of financial holding companies could be an important step for the restructuring of Japanese industrial groups.

What is more, the Financial Holding Company Act put some shareholding limits on bank holding companies, that is, financial companies centered around a bank can only hold, at most, 15 percent of a same other company's stock. This decision paves a way for the financial institutions to set up a financial holding company without breaking the law, even though they each hold some stocks in the same other company. The Fair Trade Commission went even further. It insisted that general restriction on financial companies holding stocks in excess of 5 percent of other companies' stock should not apply to financial holding companies since they are not financial institutions. In other words, there is no problem if financial institutions under the control of a financial holding company hold more than 15 percent of the same other company's stock.

Conclusion

It might be unreasonable to keep on prohibiting the formation of any pure holding companies, even taking the scale or the negative effects on the market into consideration, since pure holding companies themselves just provide an organizational form for a company's choice. But it is also unrealistic to place excessively high expectations on the formation of pure holding companies. In fact, many companies are considering the formation of a pure holding company as a tool for saving tax, withholding information, or accumulating wealth rather than pursuing production efficiency. It is funny that the merits of lifting the ban as emphasized by the advocates of the policy are quite similar with the purpose of the Antimonopoly Act mentioned above.

As we have examined above, big business may introduce intermediary holding companies to control their minor businesses, or domestic and overseas subsidiaries, but many of them may continue to choose operating holding companies as their primary organizational form, because the divisional system and the internal company system offer great potential for improving organizational capability. That is why so few companies are showing interest in forming pure holding companies. Or frankly speaking, "It has no advantages unless consolidate accounting and taxation are introduced".

On the contrary, the financial sector is a totally different story. On the one hand, it has been suffering from the collapse of the bubble economy since the early 1990s. On the other hand, it faces the competition both from domestic and overseas rivals. The financial holding company is designed to stabilize the financial system and heighten competitive power. That is why the financial sector, particularly the banks strongly support it and the government is in such a hurry to relax legislation on the formation of holding companies.

Indeed the original Antimonopoly Act was the strictest one in the world in terms of regulation, but it became spineless after several amendments and exemptions were made during the recession period.

As a result of the deregulation, interfirm relations in Japan became strong and stable, creating a tendency to exclude outsiders, and incited criticism for its closeness. Apparently the trade-off between deregulation and closeness is a challenge to Japanese firms. Now the last stronghold—the prohibition of holding companies—has been taken away, people wonder how the relaxation of the Antimonopoly Act is consistent with efforts to open up the Japanese market.

Surely people should be able to expect the Fair Trade Commission to play a crucial role in preventing the possible negative effects. It is said that the Fair Trade Commission has reversed its insistence from basic prohibition to partial lifting to basic lifting of the ban on the formation of holding companies within a surprisingly short time, teasingly referred to as ‘Step and Jump’\(^\text{16}\) in exchange for the expansion of its own size. People wonder how the Fair Trade Commission can become a really effective watchdog and promote free and fair competition if it does not undergo a complete change of attitude.