What Will Become of the Corporation? –A Comparative Perspective[1]

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Abstract - *In spite of ever-expanding financial markets and ever-advancing communication networks, there still remains a wide difference in corporate structures and corporate governance among advanced capitalistic economies, notably between America and Japan. American corporations tend to view the returns to shareholders as their sole objective, while Japanese corporations place more emphasis on the survival and growth of their organization as a going concern. The first purpose of this talk is to show how the legal personality of "corporation (or joint stock company)" is capable of generating these seemingly contradictory models within the same institutional framework of capitalism. The second purpose of this talk is to suggest that, despite the growing pervasiveness of the American corporate model, the Japanese model may offer a viable alternative in an age of post-industrialization where the major source of corporate profits is shifting from physical assets (which the shareholders" money can buy) to organization- specific human assets (which it cannot).*

Key words - *comparative corporate governance, corporate personality, human assets, Japanese economy, joint-stock company, post-industrial capitalism, theories of firm.*

1. Two Corporate Systems.

Important Management Goal %	*U.S.A.*	Japan	Europe
Rate of Return on Investment	**78.1**	35.6	64.2
Capital Gains of Shareholders	**63.0**	**2.7**	10.6
Expansion of Market Share	53.4	**50.6**	61.8
Product Portfolio	28.8	11.5	26.0
Maximizing Sales Volume	15.1	27.9	17.9
Ratio of New Products	11.0	**60.8**	14.6
Corporate Social Image	6.8	18.6	18.7
Retention of Employees	1.4	3.8	6.5
Employees' Benefits	0.0	7.7	0.8

Source:*1988 White Paper on Corporations* (Keizai Doyu Kai: Tokyo, Japan, 1988)

The above table reports the results of a 1988 survey that asked corporate managers in America, Japan and Europe to pick out the three most important goals of their management policies. One can see from the entries at the first column that answers given by American corporate managers were consistent with the traditional assumption in economics that the whole purpose of the corporate firm is to maximize the returns to its shareholders. They ranked ROI (the rate of return on investment) at the top (78.1) and capital gains of shareholders second (63.0). In stark contrast to American counterparts, the Japanese corporate managers placed capital gains of shareholders at the very bottom of their ranking (2.7). True that they did rank ROI the third, but the points it gets are not so high (35.5). Instead, they put the ratio of new products and new operations at the top (60.8) and ranked market share second (50.6). These goals are more or less related to the survival and growth of the corporation as a business organization. The answers given by European corporate managers, however, were somewhat murky, due to the diversity of the countries in this category.

This study was conducted more than 20 years ago, and the outlook of the corporate managers, especially those in Japan, have changed since then. But, more recent studies have also shown that there still exists a wide difference between American and Japanese corporate systems. (See [11, 16, 24].) While the major objective of American corporate managers is the maximization of the returns to shareholders, the chief concern of a large number of Japanese corporate managers is the survival and growth of the corporation as an organizational entity comprising of employees and other stakeholders.

However, in spite of this wide difference in attitudes towards the purpose of the corporation, both America and Japan are full-fledged capitalistic economies with similar corporate laws. Indeed, the current Japanese corporate law can be regarded as an amalgam of German law and American law. There thus emerges a theoretical puzzle I now have to solve: How can the same institutional framework of capitalism allow these seemingly contradictory systems of corporation to coexist in this world?

This talk's main theme is that it is the very legal concept of "corporation" (or "joint stock

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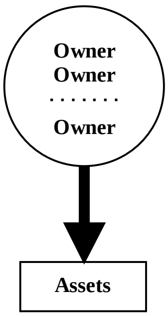
[1] This talk draws heavily from the following work of mine on the theory of corporation: [11, 12, 13, 14].

company") that is responsible for the coexistence of two seemingly contradictory forms of capitalism.

2. What is Corporation?

Suppose you are an owner of a small grocery shop around a corner. Whenever you feel hungry, you can pick up an apple on the shelf and eat it right away. That apple is your property, and the only thing you have to worry about is the wrath of your spouse -- your co-owner. I have chosen a grocery shop as a real-life example of the classical firm in any textbook of economics. As Fig. 1 shows, it consists of a single ownership relationship between an owner (or a group of owners in the case of a partnership firm), and assets such as apples and oranges on the shelf of the grocery store. However, as soon as a firm is "incorporated" and become a "corporation (or a joint stock company)," its ownership structure undergoes a fundamental change.



<Fig. 1>

Then, what is "corporation"? Toyota is a corporation and NIS is a corporation, and both are business (or for-profit) corporations. University of Belgrade and University of Tokyo are also corporations, though not a business corporation.

Suppose you are a shareholder of a business corporation, for instance, a big supermarket chain. You feel hungry and found one of its stores on your way. If you enter the store, grab an apple from its shelf and eat it right away, what will happen to you? You will be arrested as a thief! Why? It is because a corporate shareholder is not the legal owner of the corporate assets. Who, then, is the owner of those corporate assets? The corporation as a "legal person" is. Then, what is a legal person? The law treats a corporation as a subject of property right capable of owning real property, entering into contracts, suing and being sued, all in its own name, separate and distinct from its shareholders.[1] A corporation is, in other words, a "thing" that is treated legally as a "person." And it is the corporation as a legal person that is the owner of the corporate assets.

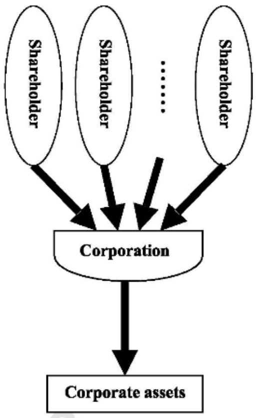
Who, then, are corporate shareholders? The answer is, owners of the corporation. Corporate shareholders are the holders of corporate share -- a bundle of the financial and participatory rights in the corporation that can be bought and sold freely as an object of property right. Indeed, to hold a corporate share is to own a share of the corporation as a thing (an asset) separate and distinct from the underlying corporate assets. It is the corporation as a "thing" that the corporate shareholders own.

This observation will lead us to the most crucial characterization of the business corporation. In contrast to a single ownership firm or a partnership firm, a corporate firm is composed of not one but TWO ownership relations: the shareholders own the corporation, and the corporation in turn owns the corporate assets, as is shown in Fig.2.

Indeed, in this two-tier ownership structure the person/thing duality of corporation is used in an ingenious manner. In regard to things (corporate assets), a corporation acts legally as a person, as a subject of property right; and in regard to persons (shareholders), a corporation is acted on legally as a thing, as an object of property right.[2]

[1] §3.02 of American Bar Association's *Revised Model Business Corporation Act* states that "unless its articles of incorporation provide otherwise, every corporation ... has the same power as an individual to do things necessary or convenient to carry out its business and affairs, including without limitation power…." §1-1-3 of Japanese Corporate Law (Company Act) simply states: "A corporation (company) shall be a legal person (juridical person)."

[2] Our theory of corporation could never be complete without having "managers" (directors and officers) incorporated in it. Even if the corporation has a full-fledged personality in law, it is in reality a mere abstract entity that is incapable of performing any act except through the act of real human beings. In fact, it is a mandatory requirement in corporate law that the corporation must have a board of directors who hold the formal power to act in the name of the corporation. Because of space limitation, however, I leave the detailed discussion on the roles of managers to [11, 12].



<Fig.2>

3. The Corporate Personality Controversy and the Comparative Corporate System

For many centuries, legal scholars and legal philosophers have debated heatedly as to what constitutes the “essence” of the corporate personality. This is called the “corporate personality controversy” – one of the most celebrated controversies in legal theory and legal philosophy. In this age-old controversy, two competing legal theories have emerged, each advancing opposing answers. They are “corporate nominalism” and “corporate realism.” The corporate nominalism asserts that the corporation is a contractual association of individuals, whose legal personality is no more than an abbreviated way of writing their names together. The corporate realism, in opposition, claims that the corporation is a full-fledged entity whose legal personality is no more than an external expression of its real personality in the society. (There is a huge body of writings on this controversy. Some of the best-known works available in English are [18, 7, 5, 25]. For a comprehensive review of various theories of corporate personality before 1930, see [10]. In [12] I have given an extensive discussion on this controversy.)

The corporate personality controversy is not the thing in the past. The rivalry between corporate nominalism and corporate realism has continued up until now. On the one hand, the contractual theory of the firm, whether it is an agency-theory version or a transactions costs economics version, is a direct descendent of corporate nominalism. (See, e.g., [4, 1, 17, 8, 27].) On the other hand, the so-called evolutionary theory of the firm or knowledge-base view of the firm or core-competence view of the firm can be interpreted as a modern representative of corporate realism. (See, e.g., [3, 20, 21, 22, 26].) The former regards the "private corporations" as "simply legal fictions which serve as a nexus for a set of contracting relationships among Individuals." ([17], p. 310.) The latter posits corporate firms as "organizations that know how to do things, ... while individual members come and go." ([28], p. 136.) The corporate personality controversy is far from a relic of the past.

It is not hard to see that the age-old controversy between corporate nominalism and corporate realism and the more recent rivalry between the contractual theory of the firm and the evolutionary theory of the firm more or less correspond to the difference between the American corporate system and the Japanese corporate system.

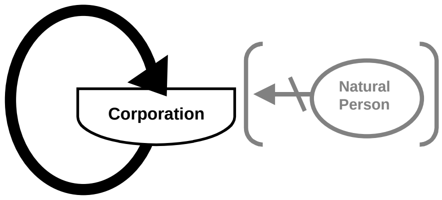
What I would like to do now is to “end” this controversy once and for all. It is, however, not by declaring victory for one side or the other. It is rather by declaring victory for both sides by means of elucidating two legal mechanisms, through which the legal concept of the corporation is capable of generating two seemingly contradictory corporate structures ----- one approximating corporate realism and the other approximating corporate nominalism.

Indeed, if we only look at the downstairs of the two-tier ownership structure depicted in Fig. 2, the corporation appears as a person owning and managing corporate assets, and we draw near to the position of corporate realists and that of the Japanese corporate system. If we look only at the upstairs, the corporation appears as a thing owned and controlled by shareholders, and we draw near to the position of corporate nominalists and that of American corporate system.

We can go further. What I am going to demonstrate is that there are even ways to eliminate either thingness or personality from the corporation, thereby turning it into a full “person” or a mere “thing”, respectively.

4. How to Make a “Realistic” Corporation

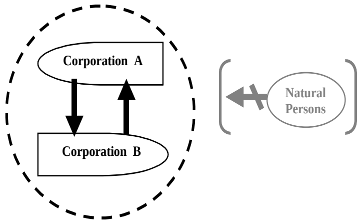
Let me begin with a way to eliminate thingness from corporation. We know that as a legal person a corporation can own things and that as a legal thing a corporation can be owned by persons. This implies that a corporation as a person can in principle own itself as a thing. Indeed, nothing prevents us from imagining a corporation that becomes its own controlling shareholder by holding a majority block of its own shares under its own name, as is shown in Fig. 3. If this were indeed possible, that corporation would be free from any control by real human beings (natural persons) and become a self-determining subject. It would thus acquire a full personality in the province of law.



<Fig.3>

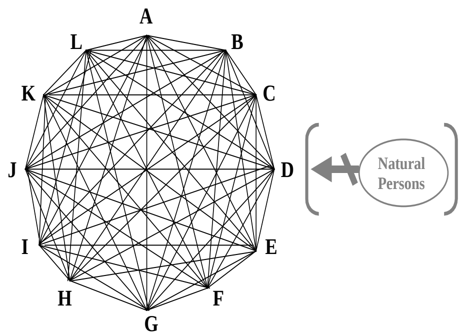
One might dismiss all this as idle speculation. Some countries prohibit a corporation from repurchasing its own outstanding shares. And, in many other countries that allow share repurchases, the repurchased shares usually lose their voting rights in shareholders meetings.[3] In the real economy, therefore, it appears impossible for the corporation to become its own owner.

There is, however, an important leeway to this. Imagine a situation where two corporations, A and B, hold a majority of each other's shares. The corporation A as a person owns the corporation B as a thing, and the corporation B as a person in turn owns the corporation A as a thing. As is shown in Fig. 4, even though each corporation does not own itself directly, it does indirectly through the intermediacy of the other corporation. One might still object to the practical possibility of this leeway by pointing out that some countries impose legal limits on the extent of cross-shareholdings between corporations.[4]



<Fig.4>

Yet, it is possible to circumvent even these limits. Suppose that twelve corporations get together and that each holds 5 percent of each of the other's shares. Then, simple arithmetic ((12 - 1) x5% = 55%) tells us that a majority block of each corporation's shares could be effectively sealed off from real human-beings, without violating legal restrictions on cross-shareholding in any of advanced capitalistic countries. These twelve corporations would indeed become their own owners at least as a group, as is depicted in Fig. 5. It is therefore practically impossible to prevent corporations from becoming their own owners, if they so wish. We have now reached the paradigm of corporate realism -- by extensive cross-shareholdings corporations can get rid of their thingness and become self-determining subjects in the system of law.



<Fig.5>

5. How to Make a "Nominalistic" Corporation.

The way to eliminate the personality from a corporation is much simpler: it is to have someone own more than fifty percent of its shares. That someone then acquires an absolute control over the corporation. The corporation is deprived of its subjectivity and turned into a mere object of property right. Legally speaking, the corporation is still the sole owner of the corporate assets, but in

[3] U. S. has been the most liberal legal rule on share repurchases. Great Britain had made it illegal to acquire its own shares until 1980, but since then the repurchase was allowed under certain conditions. The repurchase had also been illegal in Germany but the ban was lifted in 1998. In France the repurchase had not been illegal but subject to strict procedural rules until 1998. The rules were then much simplified. In fact, most European countries now have similar regulations on open market share repurchases, due to a European directive. Japan used to prohibit share repurchases until 1994, but several law reforms have since liberalized its procedures substantially.

[4] Japanese law forbids a bank to own more than 5 % of the shares of any domestic corporation. In the case of U. S. banks are allowed to own up to 5% of the voting stocks of any non-banking corporation only indirectly through bank holding corporations.

practice it is the dominant shareholder who can exercise the ultimate control over these assets. We are certainly in the world of the corporate nominalists here.

This is of course a common sense. But I now argue that the so-called corporate raiders are daily putting this legal mechanism into practice in the real economy.

That a business corporation consists of two-tier ownership relations implies that it contains in it two kinds of "things" — the corporate assets and the corporation itself. This fact immediately implies that there are also two kinds of values residing in a business corporation. They are, respectively, the value of corporate assets and the value of the corporation as a thing. The former can be defined as the present discounted value of the future profit stream that would accrue from the most efficient use of these assets. This can also be called the "fundamental" value of the corporation. The latter can be identified as the total share price of the corporation in the stock market. And the business of corporate raiders is to exploit the potential difference between these two values by buying corporations whose stock market values are lower than the fundamental value of the underlying assets. In the process, they do become dominant shareholders and turn the target corporation into a purely "nominalistic" corporation.

Corporate raiders thus help to realize the idea of corporate nominalism in this world. It is indeed claimed that even if they are not daily raiding corporations, the mere perception that they may at any time enter the scene works as an effective threat to incumbent managers, steering them away from management policies that may fail to realize the corporate assets' fundamental value. If this is indeed the case, the stock market is said to function as the "market for corporate control." (For the notion of the market for corporate control, see [19].)

6. The Indeterminacy Principle in Corporate Law

I have thus shown that the corporate law is endowed with two legal mechanisms – one turning a person-cum-thing corporation into a full person, and the other turning a person-cum-thing corporation into a mere thing. Indeed, each society can choose any position along a long spectrum that runs from a purely "realistic" to a purely "nominalistic" structure, on the basis of or at least under the influence of economic efficiency, political interests, ideological forces, cultural traditions, historical evolution and other extra-legal factors. My contention is that in the long history of their capitalistic development the Japanese economy and the American economy have chosen from this long legal menu the position close to the "realistic" end and the position close to the "nominalistic" end, as their dominant corporate structure, respectively.

One of the distinguished features of the post-WWII Japanese economy was the extensive cross-shareholdings among large corporations. Indeed, it used to have six major corporate groups (Mitsubishi, Mitsui, Sumitomo, Daiichi-Kan-Gin, Fuji, and Sanwa), each of which was clustered around a main bank, extended over the whole industry, and connected through mutual holdings of shares and mutual exchanges of directors. The percentage of cross-shareholdings reached as high as 32.9% of the total shareholdings of publicly-held corporations in 1990. In contrast, the stock market in America is known to have served as the "market for corporate control" far more effectively than that in Japan.

I believe I have resolved the paradox I stated at the outset of this talk. Because I have now shown that in spite of their seemingly irreconcilable differences, Japanese corporate capitalism and American shareholder capitalism are but two extreme forms of the genus Capitalism.

7. The Future of the Corporate System in the Post-Industrial Capitalism

It is no secret that the traditional Japanese-style management has completed its historical mission. The stock market and property market bubbles burst in the late 1980s. The financial markets were belatedly but rapidly liberalized in the 1990s. And the wave of globalization began to expose Japanese corporations to mega-competition in the world markets. All these movements have weakened the traditional ties between major banks and industrial corporations and loosened the tight network of corporate cross-shareholdings. In fact, the percentage of cross-shareholdings declined to 12.0% in 2006, and the six major corporate groups are now consolidated into three (Mitsubishi-Tokyo, Mitsui-Sumitomo, and Mizuho).

Does this mean that the long-run tide of the corporate system is in the "nominalistic" direction? My answer is, however, a "no." Indeed, I am also discerning another tide that is moving in the opposite direction in the United States, Europe, Japan and other advanced capitalistic economies. It is a tide brought about by the transition from the stage of “industrial” capitalism to the stage of “post-industrial” capitalism. There is now a strong shift in the major source of profits for business corporations from physical assets to organization-specific human assets. What is critical to the long-run competitiveness of business corporations is no longer the scale-and-scope economies of production facilities and distributional networks, but ideas, know-how, coordinating skills, forecasting capabilities, strategic prowess, strong leadership, etc. of managers, researchers, engineers, and other knowledge-oriented employees working inside of organizations.[5] There is a growing body of literature suggesting that the capital values of human assets and other “intangibles” have shown a phenomenal rise in recent years in the U. S. and other advanced capitalist economies. (See, for instance, [2], [5], [9].)

The single most important characteristic of human assets is its inalienability. Money can buy factories, machines, offices, land, and other physical assets. Money can also buy software, licenses, patents, copyrights, trademarks, brand names, and other non-physical but non-human assets. Money, however, cannot directly buy ideas, know-how, skills, capabilities, prowess, leadership, and other human assets because they are all some forms of knowledge stored inside of human brains. As long as there is free will in human, it is impossible to dictate from outside how such knowledge should be employed and accumulated in their brains. The only thing money can do is to provide a variety of incentive schemes that would encourage the employees to effectively utilize the existing knowledge and to willingly develop it toward a new knowledge within their organization. Examples of such schemes are performance bonuses, promotion systems, pension plans, flexible working conditions, intellectual autonomy, comfortable and stimulating environments, etc.

In the old era of industrial capitalism, the shareholders were able to hold an upper-hand in the balance of power within a business corporation, because a large sum of money was required to construct and maintain production facilities and distribution networks that were critical to the firm’s competitive advantage. Now, in this new era of post-industrial capitalism, the physical assets have surrendered its central position to the knowledge-based human assets (i.e., ideas generated by our brains) that money can no longer buy and control. The balance of power within a business corporation is clearly tilting away from suppliers of money towards suppliers of knowledge-based human assets, that is, from shareholders to knowledge-oriented employees. Indeed, the tighter shareholders’ control will breed the worries of hold-ups on the part of employees and impede their efforts to invest in organization-specific human assets the business corporation badly needs for its survival and growth.

I have, however, no intention to argue that one form of corporation is better than the other. I have indeed shown that both “nominalistic” corporations and “realistic” corporations are legally, philosophically, and economically possible forms of corporations. My belief is merely that too much shift to the nominalistic direction may be counterproductive to the value creation of the corporation and ultimately the wealth creation of the economy as a whole in this new era of post-industrial capitalism, where luckily our brains, yours and mine, are more important than shareholders’ money.

[5] It is the exhaustion of the ‘industrial reserve army’ -- the surplus population deposited in rural areas and supported by communal networks -- that is the ultimate cause of this massive phase-transition of capitalistic system from ‘industrial’ to ‘post-industrial.’ The consequent rise in real wages has reduced the profit margins of the existing production facilities and distribution networks so that capitalist enterprises are able to reap profits only by undertaking what Schumpeter [23] called “innovations.” By innovations Schumpeter designated a broad range of events which includes “the introduction of new commodities..., the technological change in the production of commodities already in use, the opening-up of new markets or of new sources of supply, Taylorization of work, improved handling of material, the setting-up of new business organizations … -- in short, any ‘doing things differently’ in the realm of economic life.” Obviously, in order to do things differently, capitalist enterprises need ideas, know-how, coordinating skills, forecasting capabilities, strategic prowess, strong leadership, etc. of real human beings.

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