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Brij N. Kumar

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Brij N. Kumar (Guest Editor)

**Euro-Asian Management and Business II –
Issues in Foreign Subsidiary and National Management**

L. Gnan / L. Songini

Management Styles of Japanese Companies in Italy

N. Chikudate

Network Liaisons as Cultural Interpreters

J. B. Kidd / Y. Teramoto

The Learning Organization: The Case of the Japanese RHQs in Europe

M. Axel

Toward an Analysis of Japanese-style Management

D. Dirks

The Quest for Organizational Competence: Japanese Management Abroad

F.-J. Richter / Y. Teramoto

“Interpreneurship” in Japanese Firms

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European Current Assets Policies

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Structure in Large Malaysian Companies

Japanese Agricultural Cooperatives

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CONTENTS

Guest Editor’s Introduction 3

**Section 1: Management in Japanese Subsidiaries
in Europe 9**

Luca Gnan/Lucrezia Songini
**Management Styles of a Sample of Japanese Manufacturing
Companies in Italy 9**

Nobuyuki Chikudate
**Communication Network Liaisons as Cultural Interpreters
for Organizational Adaptation in Japan-Europe Business
Environments 27**

John B. Kidd/Yoshiya Teramoto
**The Learning Organization: The Case of the Japanese RHQs
in Europe 39**

**Section 2: Culture-bound Aspects
of Japanese Management 57**

Michael Axel

**Toward an Analysis of Japanese-style Management:
A Psycho-cultural and Socio-historical Approach 57**

Daniel Dirks

**The Quest for Organizational Competence:
Japanese Management Abroad 75**

Frank-Jürgen Richter/Yoshiya Teramoto

“Interpreneurship”: A New Management Concept from Japan . . . 91

**Section 3: Aspects of Financial Management
in Europe and Asia 105**

Chun-Hao Chang/Krishnan Dandapani/Arun J. Prakash

**Current Assets Policies of European Corporations:
A Critical Examination 105**

Mohamad H. Mohamad

Capital Structure in Large Malaysian Companies 119

Yasuo Hoshino

**The Performance of Mergers of Japanese Agricultural
Cooperatives 131**

Guest Editor's Introduction

Euro-Asia Developments

The Tenth Annual Conference of the Euro-Asia Management Studies Association (EAMSA), hosted by the Chair of International Management, University Erlangen-Nürnberg, in Nürnberg from November 17–20, 1993, once again showed the growing importance of Euro-Asian economic and business relations. The general theme of the conference: "New Management Concepts and Changing Managerial Roles in Euro-Asian Management" clearly indicated the direction towards "change" in Euro-Asian business and its implication for management. We need to pause and reflect, to try and understand the significance of what is currently happening in the two regions, particularly Asia, and what the likely consequences can be for European and Asian corporations.

Japan, the economic giant in Asia, is presently going through the most dramatic period in its post-war history. The bursting of the so-called "bubble-economy" has not only brought an unprecedented slump and unemployment (which is incidentally much higher than what official figures show) to the country. Perhaps what is more important on long term is the fact that the present crisis has opened the eyes of critical observers in Japan and outside for many traditional traits and ways of Japanese business and management, which to many seem to be outdated and even responsible for the current malaise. While these practices were never questioned before or during the boom years, and while they previously even appeared to be an asset for Japanese global competitiveness, many of them now emerge to the surface as a handicap and barrier in modern economy. Heavily criticized is for example, the size of Japanese companies, considered one time as a competitive advantage: "After decades of aggressive expansion, Japanese companies are suddenly losing vitality. They are suffocating, in large part due to a plethora of do-nothing directors and grossly bloated corporate headquarters" (Tokyo Business Today, June 1994). Another target of increasing criticism to this effect is the regulation in Japanese economy: "Today, even with the nation struggling to escape the painful recession, business remains bound hand and foot by thousands of petty regulations and petty bureaucrats who administer them. The biggest victims are consumers, the biggest beneficiaries are established firms which are forever protected from competition – domestic or foreign ..." (Tokyo Business Today, Dec. 1993).

There is no doubt that when such voices – especially from within the country – are sounded, change is inevitable – even though it may be slow. Western business must be sensitive towards such evolution which will have lasting

impact in terms of new opportunity and risk. In Japan new markets can be in the offering as a result of expected deregulation. But on the other hand greater competition in the home-countries can become a threat, when a host of new fast growing Japanese companies appear on the scene as they break out of oversized and inflexible corporate groups, and seek their fortune independently on global markets.

Six years after Tiananmen **China** stands today as one of the worlds leading growth nations. Because of this – and only for this reason – it is recognized and to a certain extent even respected by all countries as a partner in commerce and industry. Trade ties with the western world are stronger than ever before. Japanese trade with China has been booming since 1989, peaking at roughly U.S. \$ 38 billion in 1993. U.S.-China trade has almost tripled since 1988 to \$ 41 billion in 1993. A similar pattern is seen in China's trade with West Europe which according to Chinese figures amounted to U.S. \$ 22 billion in 1993 which was 50% above the volume reached in 1992. Although in China "actual" investment can be way below "approved" investment, the fact remains, that some U.S. \$ 20 billion have been poured into the country since 1991 and another \$ 12 billion were absorbed in 1992. Of course the lion's share of this capital comes from Hong Kong and (recently) Taiwan. All the same, in all of its foreign business dealings, China has expressed intense interest in acquiring the maximum amount of modern know how and technology from the West which is not available from Hong Kong. Although already outrooted by Japanese and other Asian business, European corporations must buck-up and carefully seek opportunity in competitive fields in the fast changing scenario in China.

ASEAN-nations continue to charge ahead in economic development, with Malaysia and Singapore heading the scene. They have managed to produce impressive growth levels of 8–9% over the past decade which is three to four times of what the western industrialized countries were able to achieve. All predictions for the immediate future go in the same direction. ASEAN can be considered as the most successful regional grouping today, and extension of the Agreement to Vietnam, Cambodia and Laos is planned. This region remains attractive for foreign investors who have helped decisively to achieve sustained and accelerated expansion.

A new phenomenon which must interest western companies is the rise of interregional investment. For example, investments from Taiwan in Malaysia have outstripped those from Japan. This means that the world's fastest growing market is in the process of being distributed among neighboring countries, without European companies being a part of the deal. Europeans are already noticing that economic success has made Asians selfconscious. In Singapore media regularly gleefully announce the end of the "European era". "For the first time in a century or more, the supremacy of Western ideas, whether about governance, society or economic organization, is being questioned clearly if not

challenged, by an increasingly self-confident and assertive Asia" (Wong, in Straits Times, 10.06.1994).

As the situation stands today, East and Southeast Asia depend more on the European market than vice versa. The enormous trade deficits in favor of Asia prove this. European countries trade more with one another. For example the European Union has a bigger trade volume with Switzerland alone than with all ASEAN-countries combined. With the rising of the Iron Curtain this one-sidedness may in fact increase, as Western European firms begin to discover East European markets. But whatever the stand today, markets of the 21st century lie in Asia.

Because of the rapid changes and prospects there, European companies will not only need to change their outlook but also require new economic initiatives and management strategies and concepts to get more intensively involved in the Asian regions.

On the other hand, also Asian companies, led by the Japanese and Korean giant corporations, will have to get established with different modes within Europe if they want to effectively participate in the European Union which now practically encompasses the whole of Western and Northern Europe, with adjoining Eastern countries yearning and striving for quick association. Also this huge market calls for new challenges for those who wish to participate in it.

These developments made up for the background of the general theme of the 1993 – EAMSA Conference. It brought together expertise from 18 different countries to analyze and discuss on the basis of original unpublished research the changing scenarios and the needed responses in Euro-Asia business and management. I am grateful to the Chief Editor of **mir**, Professor Dr. Macharzina, for publishing selected papers in a special edition of the journal. Our thanks also go to the Deutsche Forschungsgemeinschaft (DFG) for the grant given for the conference.

The papers

In line with the Euro-Asia focus and objectives of the Association, the papers submitted and presented at the Conference had two major bearings with the posed general theme: (1) cross-border management and business in Euro-Asia, and (2) management abroad, foreign subsidiary and national management in comparison with respect to Europe and Asia. These two concepts, in general perspective, are in fact the two complementary but distinct approaches taken in the field of International Management and foreign operations of firms.

The papers in the Special Edition of **mir** are more or less grouped together according to these two perspectives. **mir** Special Issue 1/95 „Euro-Asian Man-

agement and Business I: Cross-border Issues“ contains papers dealing with cross-border problems of Euro-Asia business, in **mir** Special Issue 2/95 „Euro-Asian Management and Business: Foreign Subsidiary and National Management“ research on comparative management and business abroad is reported. Each **mir** Special Issue is divided into sections containing papers with related topics.

Keynote Speech

The Conference was opened by the Keynote speech by *Eberhard Kill*, member of the main Board of Managing Directors (Gesamtvorstand) of Siemens AG. He gives an overview of the opportunities and risks awaiting European companies in Asia and shows compatible strategies from the point of view of an electrical multinational company. His proposal is that getting a foothold in Asia is a hallmark of successful companies.

Cross-border issues

Section 1 deals with market entry strategies and contains four papers. The first one by *Mirza et al.* tracks the development of European direct investment in Japan over the course of a decade by revisiting twenty-one companies which were originally interviewed in 1984. The authors discuss the changes in strategy in view of environmental and corporate developments.

In their empirical survey of the international joint ventures in Turkey, *Demirbag et al.* pay specific attention to motives, especially also of the local partners to internalize global advantages of foreign MNCs.

Beschorner et al. examine the Chinese market for environmental technology and the role and market entry strategy suitable for German companies to exploit the good opportunities.

Finally, *Kumar* conceptualizes international technology transfer in terms of learning and related influencing factors. Proposals referring to partner-selection criteria as factors of learning success are examined in connection with a sample of Indo-German technical collaborations.

Section 2 deals with cross-border aspects of foreign subsidiary management.

In the first paper *Abo* reports on the management patterns of foreign subsidiaries of Japanese companies in U.S., Europe, and Asia within the spectrum of “application” and “adaptation”. In their study *Kim and Campbell* examine strategic control as practiced by Korean MNCs with respect to their foreign

subsidiaries. The results suggest that strategic control is a success-related variable. *Ralston et al.* in their empirical research of U.S. expatriates in Hong Kong and indigenous Chinese in Hong Kong report on the influence of culture regarding management styles. The findings indicate that there truly are cross-cultural differences involved.

In **Section 3**, three papers relate to cross-border trade-flows and risk management in the Euro-Asian context. *Lo* examines the risks and opportunities faced by Taiwanese enterprises in market entry in and trade with the former socialist countries in Central Europe. As compared to its business relationships with Asian countries substantial risk is involved with which Taiwanese firms are confronted. Taking a pragmatic approach the author identifies several risk management strategies. In their empirical study *Bano and Lane* examine the intra-industry trade (ITT) between New Zealand and some major European and Asian trading partners. The results based on a quantitative model and statistical analysis indicate that ITT has already a significant importance which is likely to grow in the future. In the final paper by *Parhizgari*, trade flows between Europe and Asia are linked with prevailing exchange rates, and the one- or the bidirectional relationships are determined using both the standard Granger causality and Error Correction Models.

Issues in Foreign Subsidiary and National Management in the Euro-Asian Context

As in Part I, papers in this volume are also grouped together in three sections.

Section 1 deals with Management in Japanese subsidiaries in Europe.

Gnan's and Songini's empirical research presents findings of some aspects of Japanese management in Italian subsidiaries of Japanese enterprises. Correlation are shown between management styles and organizational and strategic variables.

Chikudate's paper develops an innovative concept of organizational adaption in foreign business environments from the view of network theories. The author proposes the role of liaisons between Japanese and European business environments as cultural interpreters who can coordinate the two cultural systems in foreign subsidiaries.

In their empirical study *Kidd and Teramoto* examine as to how far Japanese Regional Head Quarters (RHQ) are moving towards the Bartlett/Ghoshal-type of "transnational" mode. Their hypothesis is that Japanese CEOs in RHQ in Europe play a pivotal role with respect to the development and learning in this direction.

The three papers in **Section 2** focus on culture-bound aspects of Japanese management.

The paper by *Axel* attempts to explain economic development and the management system in Japan by drawing on specific cultural features of Japanese society. *Dirks* examines Japanese MNCs' ability based on specific cultural characteristics to advance the "truly" transnational company. His hypothesis is that Japanese MNCs have a better access to an organizational concept that facilitates environmental "fit" and multicultural integration. Finally *Richter and Teramoto* see a new type of entrepreneur emerging in Japan. The "Interpreneur" employs corporate networks in order to exchange and develop resources. The authors discuss the factors contributing to their development and how they compare to the Schumpeterian concept of entrepreneurship.

The final **Section 3** throws light on aspects of financial management in Europe and Asia.

Chang et al. in their empirical analysis study the current asset policies of European corporations. They highlight the probable areas of strengths and weaknesses and compare them with similar corporations in the U.S. *Mohamad*, in a similar vein, analyzes the capital structure in large Malaysian companies. He particularly examines the country-bound determinants. Specific aspects of Malaysian financial markets as well as company characteristics are discussed. In the final paper, *Hoshino* examines empirically the effect of merger on the financial performance of Japanese Agricultural Cooperatives. His conclusions are that non-merging cooperatives' performance is superior. The author discusses the results in light of theory of mergers and acquisitions as applied to the specific situation in Japan.

BRIJ N. KUMAR

Section 1: Management in Japanese Subsidiaries in Europe

Luca Gnan/Lucrezia Songini

Management Styles of a Sample of Japanese Manufacturing Companies in Italy

Abstract

- The article aims to point out the presence of some aspects of Japanese management systems in a sample of Japanese manufacturing enterprises in Italy and analyzes headquarters control on Italian subsidiaries.
- It studies the correlation between management styles of the sample and some organizational and strategic variables (company goals, decision-making responsibility, organizational mechanisms), by applying some multivariate statistical methods.

Key Results

- Management styles of the sample are influenced by a combination of three factors: the degree of local decision-making responsibility, the importance of different company goals and the presence of organizational mechanisms, both Japanese and Western. They are also connected with the company size and capital structure.

Authors

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Indroduction¹

This research set out to study the management systems of a sample of Japanese enterprises in Italy². It aimed, as its main goal, to point out the presence of some aspects of Japanese management systems in the Italian subsidiaries. The research hypotheses were as follows:

- *Japanese enterprises in Italy have unique management styles, which are characteristic of the local context, but, for some aspects, peculiar to the systems used by the Japanese parent company;*
- *The management styles of Japanese enterprises in Italy are influenced by a combination of three factors:*
 - *the degree of local decision-making responsibility;*
 - *the importance of different company goals;*
 - *the presence of specific organizational mechanisms, both Japanese and Western;*
- *The management styles of these companies are connected with the company size and the capital structure (Japanese shareholding and characteristics of the Italian shareholder).*

In order to verify the above hypotheses, a postal questionnaire was sent to all the relevant population units in summer 1993. The population was composed of the 47 Japanese manufacturing companies in Italy, which were both wholly-owned subsidiaries of Japanese multinationals and joint-ventures between Italian and Japanese partners. In October 1993 the data collection step was completed. Eventually the research sample was formed by eighteen enterprises³. Hotelling's principal component analysis (Morrison 1967, Jolliffe 1986) and multiple regression analysis (Bails/Peppers 1982, Iman/Conover 1983, Sen/Srivastava 1990) were the multivariate statistical methods used for data processing and the subsequent analysis.

The Management Style: Theoretical Reference Models

The management style of a company is defined differently by various authors. Generally, two broad management styles are described: the *authoritarian style* and the *participative* one. They differ in the way authority is exercised in the organization. On one hand, management style is defined with regard to individual variables (McGregor 1960, Argyris 1971); on the other hand it is explained by social variables, such as: relationships between bosses and subordinates and group behaviour (Likert 1961, Blake/Mouton 1969). The concept of manage-

ment style is strongly connected with the concept of control. In effect, methods of interaction between people and organizational units influence control processes. In particular, a person's behaviour can be influenced by the rules of the groups in which he is involved (social control), by the rules, the plans, the programmes and the incentives (administrative control) or by identification with organizational goals and objectives (individual control) (Child 1972, Galbraith 1977, Ouchi 1981, Mintzberg 1983). The concept of control can also be extended to the relationships between the headquarters and the peripheral units of an organization. In this case it refers to the degree of influence by the center on strategic decisions of decentralized units (Goold/Campbell 1987). In multinational enterprises the center can influence the strategic decisions with bureaucratic or cultural control systems (Doz/Prahalad 1987). The different combinations of these kinds of control systems identify a *strict control style*, where bureaucratic control is preferred, or a *wider control style*, focused on involvement and individual and social control mechanisms.

Japanese enterprises are defined as *organic companies*, because they are characterized by group and participative decision processes, widespread and agreed corporate values, wide range of stakeholders, both internal and external, strategies focused on total quality, continuous improvement, development and accumulation of invisible resources and core competencies, and organizational mechanisms, both formal and informal (Kono 1984, Kagono/Nonaka/Okumura/Sakakibara 1985, Aoki 1988, Nonaka 1991, Fruin 1992). In the organic companies, participative management styles are most widespread, because of their peculiar features (Burns/Stalker 1961) and control systems are focused both on formal and informal mechanisms and on a cultural rather than a bureaucratic one.

The current study attempted to point out the presence, in the sample enterprises, of both informal organizational mechanisms and participative management styles, which are peculiar to the organic companies. It analyzes headquarters control on Italian subsidiaries too.

The Management Styles of the Sample

The study of management styles of the sample companies aimed to point out that Japanese enterprises in Italy have unique management styles which are characteristic of the local context, but, for some aspects, peculiar to the systems used by the Japanese parent company. In order to verify this first hypothesis, the factors defining management styles were identified by applying principal component analysis to the following original variables, which define the level of importance given to some decision-making processes: *Group responsibility and*

team work, Hierarchical distinctions in management, Top down communications, Bottom up communications and Job specification understood. The first two principal components, PC₁ and PC₂, were chosen, because they explained more than 73% of the total variation of original variables:

Proportions of the Total Variation Accounted for by All the Principal Components

Principal component	Proportion of total variation	Cumulative proportion of total variation
PC ₁	46.58	46.58
PC ₂	26.92	73.50
PC ₃	17.70	91.20
PC ₄	5.72	96.92
PC ₅	3.08	100.00

With respect to the scores of the following tables, the two principal components were conventionally named *Involvement* (PC₁) and *Hierarchy* (PC₂) (Tables 1 and 2).

In particular, the first principal component was named *Involvement* because it has a positive correlation with participative and collective decision-making processes and a negative one with hierarchical processes. The second principal component was defined *Hierarchy*, because it has a positive correlation with vertical and formal decision-making processes.

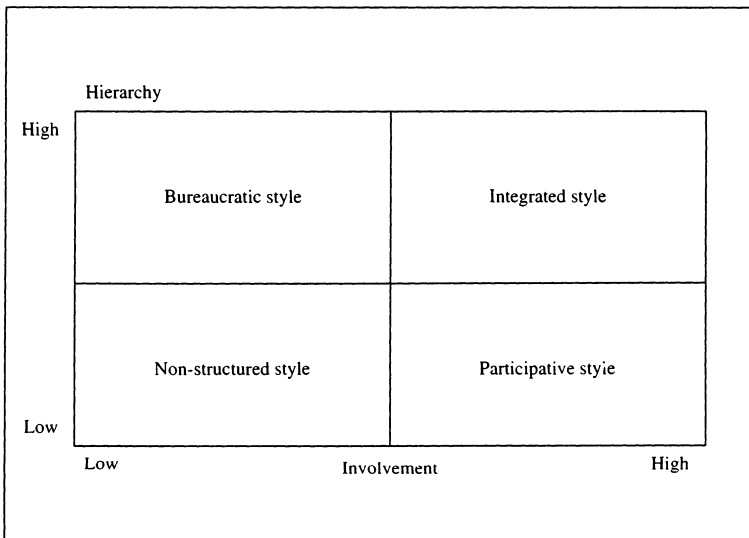
Table 1. Interpretation and Identification of the Conventional Name of the 1st Principal Component

Variables	% of variation explained by PC ₁	
	(correl. +)	(correl. -)
Bottom-up communications	75	
Group responsibility and team work	53	
Job specifications understood	40	
Hierarchical distinctions in management		54
Top-down communications		11

Table 2. Interpretation and Identification of the Conventional Name of the 2nd Principal Component

Variables	% of variation explained by PC ₂	
	(correl. +)	(correl. -)
Top-down communications	73	
Hierarchical distinctions in management	30	
Job specifications understood	18	
Bottom-up communications	9	

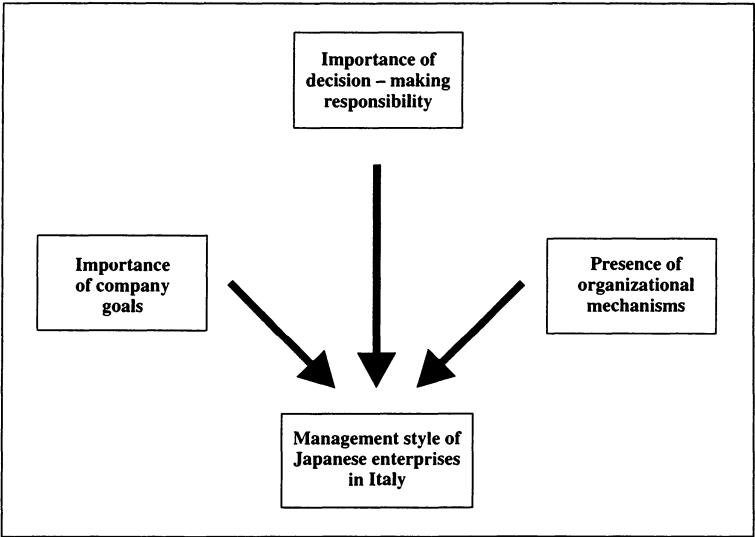
As a consequence of the previous results, four different types of management style were identified, according to the degree of combination of these two principal components (Picture 1). The *Matrix of management styles* allows a precise metric positioning of the sample companies, because its axes are completely independent and are not correlated.

Picture 1. Matrix of Management Styles

The previous analysis of management styles represented the starting point to better outline the eighteen companies in this matrix and, at the same time, to verify the second research hypothesis. Therefore, the variables influencing the four management styles defined above were identified by some organizational and strategic features, such as: decision-making responsibility, company goals and organizational mechanisms. These variables were set in order to consider both Japanese and Western management features, and both bureaucratic and cultural control characteristics. Therefore company goals were defined according to the results of other researches on Japanese companies (Abegglen/Stalk 1985, Kagono/Nonaka/Okumura/Sakakibara 1985, Sakurai/Killough/Brown 1989), while organizational mechanisms were chosen in order to involve both mechanisms established by Western organizational theory and those peculiar to the Japanese context (Galbraith/Nathanson 1978, Ouchi 1981, Aoki 1988, Songini 1991).

To be specific, in order to test the second hypothesis, a cause-and-effect relationship model was identified, which considers the management style of the sample companies (*dependent variable*) due to the influence of the three previous factors (*independent variables*) (Picture 2).

Picture 2. Influencing Factors of Management Styles



In order to verify the degree and type of relationship between management styles and their influencing factors, the following steps were carried out. Firstly, three distinct analyses were realized, in order to identify the principal components of these variables: decision-making responsibility, importance of different company goals, and organizational mechanisms. Secondly, a multiple regression model was identified, which describes the behavioural relationship between the principal components *Involvement* and *Hierarchy*, which define management styles, and the principal components, originated by the analyses on the three influencing factors.

Identification of the Influencing Factors of Management Styles

Decision-making Responsibility

The analysis of decision-making responsibility was done in two steps. Firstly, three analyses, as far as the location of the decision-making autonomy in Italy, in Europe or in Japan was concerned, were carried out. Secondly, the results of the previous analysis were summarized, in order to identify principal components of the type and degree of global decision-making responsibility of sample companies. This goal was achieved by applying principal component analysis to the following variables, resultant from the previous analyses: *Marketing mix responsibility (Italy)*, *Local resources responsibility (Italy)*, *Human resources responsibility (Italy)*, *Global strategy responsibility (Europe)*, *Marketing mix responsibility (Europe)*, *Profit responsibility (Japan)*, *Human and financial resources responsibility (Japan)* and *Distribution channels responsibility (Japan)*. Among the eight principal components identified, the first three were chosen, which explained more than 81% of the total variation of original variables.

The first principal component was named *Centralization of strategic decisions at the headquarters*, because it has a positive correlation with responsibility for profit and global strategy, which came out of the analysis of responsibility in Japan. The second principal component was defined *Centralization of strategic resources*, because it has a positive correlation with managerial responsibility for marketing mix at European headquarters and for human and financial resources at the parent company. The last principal component was named *Distributive autonomy*, because it has a negative correlation with responsibility for distribution channels in Japan.

Company Goals

This part of the study aimed to identify the factors which define the importance of different company goals in the sample. Therefore, principal component analysis was applied to fifteen original variables, which identified the objectives sought by Japanese companies: *Sales, Profit, Return on investment, Return on sales, Increase in market share, New products ratio, Dividends, Efficiency of production, Efficiency of physical distribution, Equity/debt ratio, Sales growth, Earnings growth, Improvement in product quality, Improvement in morale of employees, Improvement in public image of the company*. Among the fifteen principal components identified, the first four were chosen, which explained more than 77% of the total variation of original variables.

The first principal component was named *Profitability*, because it has a positive correlation with goals such as: profit, dividends, earnings growth and return on investment. The second one was defined *Total quality* because it has a positive correlation with the improvement in morale of employees, product quality and efficiency in production. The third principal component was named *Growth* for its positive correlation with growth and return on sales goals, while the last one was defined *Customer assessment of quality*, because it has a positive correlation with goals focused on new products ratio, improvement in image of the company and product quality.

The identified components point out that the sample companies control the more important aspects of the management: the financial, the competitive and the social ones. Moreover, these goals are both those followed by Western enterprises (*Profitability*) and those typical of Japanese firms (*Growth* and *Quality*). However, the emphasis on *Profitability* is not consistent with the results of some researches, which showed that Japanese companies pursue growth and productivity goals (Kono 1984, Kagono/Nonaka/Okumura/Sakakibara 1985, Sakurai/Killough/Brown 1989). Nevertheless, it is noteworthy that the researches above-mentioned were focused only on Japanese companies, while the present sample is constituted by foreign subsidiaries.

Organizational Mechanisms

This part of the study proposed to identify factors related to different organizational mechanisms. Sixteen mechanisms were considered, which are typical both of Western and Japanese companies. Actually, Japanese enterprises on one hand use formal and hierarchical mechanisms, which are consistent with bureaucratic management systems (long-range planning, budgeting, management accounting; reporting), and on the other hand use Japanese mechanisms, such as *nemawashi, ringi*, quality circles and special human resources management,

which are peculiar to participative management styles and cultural control systems (Songini 1991).

Therefore, principal component analysis was applied to the following sixteen original variables: *Strategic planning*, *Middle-range planning*, *Budgeting*, *Management accounting*, *Top executive committees*, *Cross-functional teams*, *Quality circles*, *Personal relationships*, *Informal communications*, *Job rotation*, *Internal training*, *Performance evaluation system*, *Management by objectives*, *Company values*, *Hierarchy* and *Formal rules*. Among the sixteen principal components identified, the first four were chosen, because they explained more than 74% of the total variation of original variables.

The first principal component was named *Completeness of management mechanisms*, because it has a positive correlation with most of the organizational mechanisms. The second one was named *Cross-functional relationship*, due to its positive correlation with mechanisms based on informal and personal relationships and its negative correlation with hierarchical and formal devices⁴. The third principal component was named *Coordination*, because it is positively correlated with mechanisms used for managing non-routine situations and for integrating actions of different organizational units (top executive committees, informal communications, middle-range planning) (Galbraith 1977, Lorange 1980).

The Management Style Model

At this point the second research hypothesis can be verified, which states that management styles of Japanese enterprises in Italy are influenced by a combination of the three following factors: degree of local decision-making responsibility, importance of different company goals and presence of specific organizational mechanisms, both Japanese and Western. Therefore, a multiple regression model was defined, which describes the behavioural relationship between the principal components *Involvement* and *Hierarchy*, which define management styles, and the principal components, originated by the previous analyses (Tables 3 and 4)⁵. This analysis makes it possible to identify the characteristics of the different management styles.

Involvement is correlated with components which identify a management style focused on development of company resources in the long-term, total quality, informal and cross-functional mechanisms and human resources motivation. These elements are consistent with cultural and social control systems, participative management styles and management systems peculiar to Japanese and entrepreneurial companies at the same time. However, the presence of the component *Centralization of strategic resources* does not seem consistent with

Involvement, which asks for a decentralization of strategic resources. This fact is probably due to the presence, among sample enterprises, of entrepreneurial companies, which can have both a centralization of strategic decisions by the entrepreneur and a participative style.

Table 3. Degree and Direction of Correlation between *Involvement* and its Influencing Factors

Influencing factors	Model coefficients	
	(+)	(-)
Total quality	0.54605	
Centralization of strategic resources	0.54171	
Completeness management mechanisms	0.49765	
Cross-functional relationship	0.40219	
Profitability	0.07946	
Bureaucracy		0.40543
Centralization str. dec. at headquarters		0.37111
Distributive autonomy		0.26251
Customer assessment of quality		0.23812
Coordination		0.13874
Growth		0.10571

Table 4. Degree and Direction of Correlation Between *Hierarchy* and its Influencing Factors

Influencing factors	Model coefficients	
	(+)	(-)
Growth	0.44391	
Profitability	0.40041	
Completeness management mechanisms	0.35433	
Customer assessment of quality	0.19985	
Bureaucracy	0.14351	
Coordination	0.11431	
Cross-functional relationship		0.64726
Centralization of strategic resources		0.46132
Total quality		0.27115
Distributive autonomy		0.16295
Centralization str. dec. at headquarters		0.00511

In contrast, *Hierarchy* is consistent with an emphasis on competitive and financial results and formal and hierarchical mechanisms. These are elements peculiar to a bureaucratic control style. However, the weight of *Growth*, as most important variable influencing *Hierarchy*, is not consistent with the results of other researches (Kono 1984, Abegglen/Stalk 1985, Kagono/Nonaka/Okumura/Sakakibara 1985). The simultaneous presence of *Growth* and *Profitability* goals as most important factors influencing *Hierarchy* could be due to both the composition of the sample (Italian subsidiaries of Japanese multinationals) and the fact that Japanese companies invest abroad mostly in order to strengthen their competitive position in local markets.

Table 5. Degree and Direction of Correlation between *Involvement* and First Twenty Influencing Original Variables

Influencing original variables	Model coefficients	
	(+)	(-)
Personal relationships	0.24456	
Company values	0.22248	
Marketing policy (Europe)	0.19768	
Improvement in product quality	0.17991	
Cross-functional teams	0.17845	
Improvement in morale of employees	0.13897	
Improvement public image of company	0.13683	
New product ratio	0.12105	
Performance evaluation system	0.11492	
Product distribution (Europe)	0.19739	
Hierarchy		0.22194
Product design modifications (Europe)		0.14163
Formal rules		0.12448
Sales		0.11372
Wage levels (Italy)		0.10416
Capital investment (Europe)		0.09008
Equity/debt ratio		0.08896
Return on sales		0.08352
Top executive committees		0.07523
Product design modifications (Italy)		0.07188

Table 6. Degree and Direction of Correlation Between *Hierarchy* and First Twenty Influencing Original Variables

Influencing original variables	Model coefficients	
	(+)	(-)
Return on sales	0.26937	
Hierarchy	0.24542	
Sales	0.18665	
Management accounting system	0.16975	
Budgeting system	0.16906	
Sales growth	0.14755	
Management by objectives	0.14243	
Product design modifications (Europe)	0.11797	
Dividends	0.10988	
Middle-range planning system	0.10362	
Personal relationships		0.25444
New product ratio		0.20168
Efficiency of physical distribution		0.17691
Job rotation		0.15575
Marketing policy (Europe)		0.13688
Personnel promotion (Japan)		0.11908
Cross-functional teams		0.11786
Capital investment (Japan)		0.08917
Product distribution (Europe)		0.06689
Product pricing (Europe)		0.06257

Since we can go backwards from principal components to their original variables, which define them, the management style model can be re-expressed using standardized values of the original variables too. The analysis based on the original variables confirms the above comments (Tables 5 and 6). In fact, *Involvement* is influenced by cross-functional mechanisms, based on personal relationships and spreading of company values, which are used by cultural control systems. It is also positively correlated with improvement and innovation goals, peculiar to total quality and continuous improvement strategies. It is noteworthy the positive correlation between *Involvement* and marketing and

distribution policies in Europe, as well as the negative correlation with product design modifications, capital investment decisions and wage level policies. This fact seems to reveal both a local autonomy, at the Italian and European level, concerning marketing policies, and a centralization of technological and financial resources control at the headquarters. In contrast, autonomy in defining wage levels in Italy has a negative correlation with *Involvement*, probably because it refers to companies where the entrepreneur centralizes all the most important strategic decisions, even if he promotes a participative management style for other aspects.

Hierarchy is positively correlated with sales goals and formal mechanisms which are focused on short-term results, such as budgeting and management accounting systems. It has also a negative correlation with informal and cross-functional mechanisms, improvement goals and centralization of some decisions at the European or Japanese headquarters.

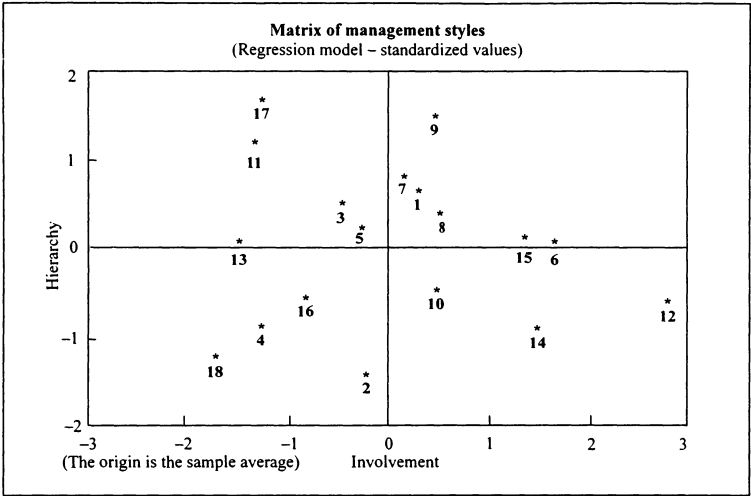
The research results are likely to point out that a management style based on vertical organizational mechanisms and output standardization (Mintzberg 1983) is consistent with sales growth goals. Moreover, the low influence exercised by centralization of strategic decisions at the headquarters on *Hierarchy* could be explained by the autonomy granted to local units if they gain positive results in terms of profit and market share. Eventually, manufacturing units of the sample seem to focus more on the increase in competitive position in the local market than on technological innovation goals.

Analysis of Company Position in the Management Style Matrix

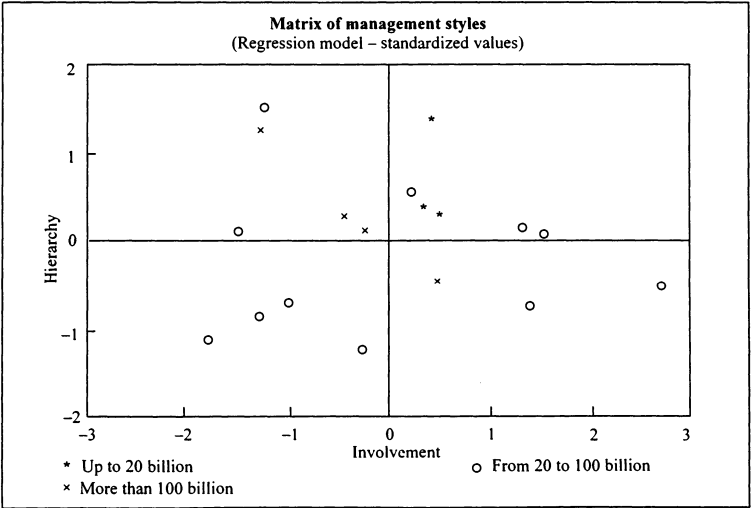
The analysis of sample company positioning allows the verification of the third research hypothesis, which refers to the connection between management styles and company size and capital structure (Japanese shareholding and characteristics of the Italian shareholder). In Pictures 3–6 is shown the positioning of the sample companies in the matrix which identifies the four management styles: bureaucratic, integrated, participative and non-structured. The analysis of the following pictures, which show the company positioning according to company size and capital structure, points out that similar enterprises concentrate in each quadrant.

To be specific, as far as the *Bureaucratic* style is concerned, large companies, which are mainly joint-ventures between big Japanese companies and large Italian enterprises, are positioned in the first quadrant. In fact, company size of both sample companies and partners could be consistent with a management style focused on formal and hierarchical organizational mechanisms and strategies which look for profitability and growth.

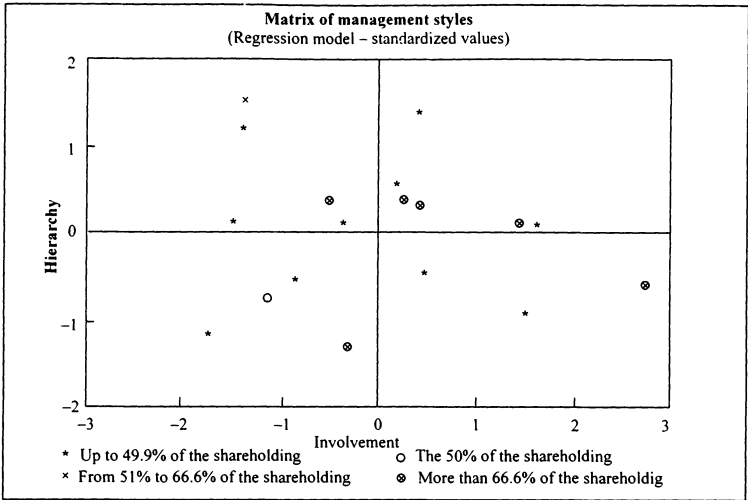
Picture 3. Matrix of Management Styles of Sample Companies



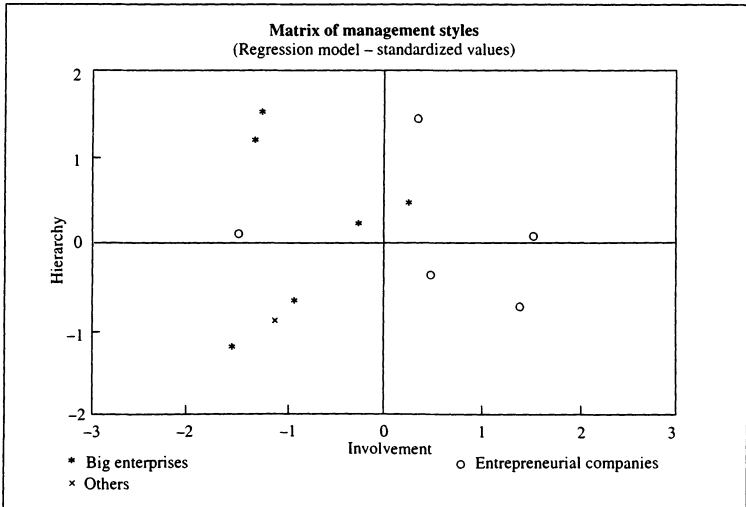
Picture 4. Matrix of Management Styles for Turnover



Picture 5. Matrix of Management Styles for Shareholding



Picture 6. Matrix of Management Styles for Features of the Italian Partner



In the *Integrated* style quadrant, there are small and medium-size enterprises, which are either subsidiaries of Japanese multinationals or joint-ventures with Italian entrepreneurial companies. This management style is characterized by goals and mechanisms peculiar to both *Hierarchy* and *Involvement*. In fact, they use on one hand cross-functional, informal collective and improvement goals and mechanisms, and on the other hand formal mechanisms. The combination of different elements could be a consequence of small size, influence of the entrepreneur on strategies and, at the same time, the need to coordinate local strategies with parent company policies.

The quadrant of *Participative* style identifies medium-size companies, which are either subsidiaries of Japanese multinationals or joint-ventures with Italian entrepreneurial firms. This style derives from both entrepreneurial management, typical of small-size enterprises, and the transfer of involvement-orientated mechanisms by Japanese parent companies.

Finally, the last quadrant shows medium-size companies, which differ in capital structure. In fact, they are joint-ventures which involve large Italian companies, which own the majority of the shareholding, joint-ventures where both shareholders own the same percentage of the shares, and subsidiaries of Japanese multinational companies. The modest emphasis on both *Involvement* and *Hierarchy* could be due to different capital structures, which could be consistent with very different management styles.

Conclusions

Statistical analysis applied to the sample companies seemed to allow us to verify the research hypotheses. In fact, correlations between management styles and some organizational and strategic variables (importance of company goals, degree of local decision-making responsibility, presence of organizational mechanisms) were identified.

Different combinations of the two factors *Involvement* and *Hierarchy* allowed us to define four management styles, which are characterized by different emphases on company goals, decision-making responsibility and organizational mechanisms. Moreover, the analysis of sample company positioning in the management style matrix showed that management styles are explained in some way by company size and capital structure.

As far as the control by Japanese parent companies over their Italian subsidiaries is concerned, the research showed a centralization of strategic resources at the headquarters also in the companies with management styles focused on involvement. In contrast, there is a decentralization of marketing and distribution strategies also in those companies with hierarchical management styles.

Therefore, Japanese companies in Italy seem to play for their headquarters the role of controllers of the market share, rather than autonomous knowledge developers.

Finally, in sample companies there co-exist management styles at once peculiar to Japanese companies and Italian entrepreneurial firms. In order to identify more precisely the real importance of these two kinds of management style, it might be useful to extend the present analysis to the whole population of Japanese manufacturing companies in Italy.

Notes

- 1 Paragraphs 1, 3 and 4 were written by Luca Gnan, while paragraphs 2, 5, 6 and 7 by Lucrezia Songini.
- 2 This research is part of a major research project carried out by Professor Yoshiya Teramoto (Hokkaido University, Sapporo), Professor John Kidd (Aston Business School, Birmingham), Professor Kazuo Inumaru (Pavia University) and Dr. Lucrezia Songini (SDA Bocconi Business School, Milan).
- 3 Sample enterprises belonged to the following sectors: mechanical (55.55%), chemical-pharmaceutical (27.77%), textile (11.12%) and electronic (5.56%). With regard to size, 16.67% of the sample had a turnover up to 20 billion lire, 61.11% from 20 to 100 billion lire and 22.22% more than 100 billion lire. Referring to Japanese shareholding, in 55.55% of the sample it was up to 49.9%, in 11.12% from 50% to 66.6%, in 33.33% more than 66.6%.
- 4 This component could be consistent with the presence of Japanese management systems and, at the same time, of entrepreneurial management systems typical of small firms.
- 5 The identified model explains more than 74% of variation. Actually the two equations have coefficients of multiple determination which are equal to:
 $R^2_1 = 0.75732$ (corrected $R^2_1 = 0.48430$),
 $R^2_2 = 0.74276$ (corrected $R^2_2 = 0.45335$).
 Values of Durbin-Watson statistic d are $d_1 = 2.44845$ and $d_2 = 1.39577$. The last one lead to an inconclusive result, since more observations are required. However, values of the autocorrelation coefficients r_t of the second equation of the model are not significantly different from zero (for example $r_t = 0.302115$, while $s_{rt} = 0.47140$). These results seem to let us conclude that no other regressor could be introduced in the model as influencing factor of the defining components of management styles of the sample.

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Nobuyuki Chikudate

Communication Network Liaisons as Cultural Interpreters for Organizational Adaptation in Japan-Europe Business Environments

Abstract

- The purpose of this study is to propose a design for organizational adaptation in foreign business environments from the view of network theories.
- This study elaborates the role of liaisons as cultural interpreters who can coordinate two or more different cultural systems.

Key Results

- Based on network theories in terms of managing foreign branch operations in Japan-Europe business environments, a new role (liaison) must be created to handle conflicts and/or problems caused by cultural differences.

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Introduction

The difficulties in managing foreign branch units of Japanese multinational corporations have been the major focus of international management studies. The media also picked up such issues in the late of 1980s. Industry Week (1987), for example, reports that the failure in managing local employees in foreign subsidiaries of Japanese multinational corporation is due to the transfer of Japanese management practices based on harmony, groupism, and consensus. These group oriented management practices forced Japanese expatriate managers to be concerned only about maintaining their positions in headquarters for the time after their overseas assignments. As a result, while they live in foreign countries, they form their own cultural groups that make it easy to re-adjust to the culture of headquarters. Gelbe (1986) reports that there is an obvious segregation of Japanese business communities in their residential areas in Germany.

On the other hand, the difficulties in managing branch units of foreign corporations in Japan have also been the focus of investigations. SanAntonio (1987, 1991), for example, reports that the major source causing communication problems in an American company is its language policy which prohibits Japanese employees to use Japanese language for in-house communication. There are also many other factors causing the hostile relationship between American MBAs and Japanese engineers. As a result, the turnover rate among Japanese engineer is extremely high, and there is a constant shortage of Japanese engineers to maintain the research and development section of the company.

Although many studies have tried to investigate the managerial problems in foreign branch units, many have not discussed solutions to these problems and/or preventive mechanisms. The purpose of this study is to develop an innovative concept of role to overcome the problems caused by cultural differences which can act as a preventive function in order to fit the need of corporations that operate in changing Japan-Europe business environments.

Solutions for Adaptation Problems

When a multinational corporation adopts a uniform principle in structuring an entire corporation, it is likely to find adaptation problems for foreign branch units in local cultural environments. Hofstede (1991) contends that top managers in headquarters too often satisfy their need for simple solutions, but they are bound to violate the needs of some parts the organizations (foreign branch units).

Some scholars argue that the acculturation practice of management is a strategy to conduct a successful operation in foreign countries. The repre-

sentative study which signifies the acculturation of management practices to local sociocultural environments is by Hofstede (1984). He showed how work related values are different across cultures even within one multinational corporation by presenting "cultural maps" to locate each country's work values, and argued the significance of cultural relativism for human resource management. This study suggests that multinational corporations have to be sensitive to local socio-cultural environments for successful overseas operations. Hofstede's study should be regarded as the product of the first empirical investigation with massive amounts of data. However, Hofstede (1984) himself admits Japanese should be treated as a special case in which their work values cannot be appropriately investigated in his research framework. Therefore, the argument definitely needs some elaboration, when the focus is on Japanese.

Edström and Galbraith (1977) suggest that effective organizational design by means of transfer of managers often brings successful management in multinational corporations. Edström and Galbraith (1977) mention that the acculturation strategy may be effective for the purpose of adaptation, but it often yields the isolation of branch units from overall coordination in a whole organizational structure. To avoid such problems, the transferred managers have to be placed in the center of the network in headquarters. Then, they adopt the socialization practices that include speaking the local language and learning the local culture. Their study also suggests that the creation of a homogenized corporate culture works effectively for easing culture shock for the transferred managers. The idea seems to be very effective in controlling and coordinating activities in multinational corporations. In other words, their study seems to be present a solution to the dilemma of coordination in multinational corporations; the coordination of business operation between headquarters and foreign branch units and the coordination between expatriate groups and local employees within foreign branch units need to be successfully operated at the same time.

However, a careful examination of the cases from which Edström and Galbraith (1977) inducted their model finds that most of the cases used were limited to the European operation of European multinational corporations where employees have already known cultural similarities and differences to some degree. In this situation, transferred managers who are in the center of the headquarter's network may be capable of handling intercultural problems in branch units at the same time.

This study, however, hypothesizes the situation of Japanese and Europeans in one particular work context. In this situation, cultural knowledge is still limited because of relatively infrequent interaction between the two nationalities in general. Therefore, although there are some implications from the model of Edström and Galbraith (1977), it is doubtful that it works effectively in the relations between Japanese and Europeans. Furthermore, this study also investigates the problem that the coordination between foreign branch units and

headquarters and the coordination between expatriate groups and local groups within foreign branch units need to be successfully reconciled with each other.

According to a report in the Wall Street Journal (1987), American firms in Tokyo actively seek Japanese cultural literates, including scholars and students with degree in Japanese literature and culture, but without any training in business or economics for staffing positions in their Japanese subsidiaries. They found that expatriate American managers who are MBA trained had difficulties to be successful managers in Japanese branch units. On the other hand, Americans with Japanese cultural literacy found greater acceptance in their role as managers.

This study examines the role of such staff members from the perspectives of organizational structures. It develops a new concept which can be utilized for effective management of foreign branch units by examining such roles.

Theoretical Foundation

As a theoretical foundation, network model will be utilized. This study selects the social and communication model from the various models of network. The reason is that the focus of this study is on the nature of bonds and relations that social and communication network models have dealt with. Fulk and Boyd (1991) show a variety of ways in theory building of network and communication models: (1) induction from existing research finding, (2) deduction from broader social theory, (3) application of existing theory to a new context, (4) applying one set of existing theories to account for anomalies found in tests of other imported theories, and (5) building more comprehensive theories in part from analysis of existing capabilities of communication technologies. Among these, this study adopts the third way, the application of existing theory to a new context, in theory construction procedure. Before discussing the theory construction, it is necessary to summarize the background of network models in this study.

Background of Network Approaches

This study views a network as “a specific set of linkages among a defined set of persons, with the additional property that the characteristics of these linkages as a whole may be used to interpret the social behaviour of the persons involved” (Mitchell 1969, p. 2). Network approaches are not unique to the discipline of management. The concept of network has its roots in both anthropology and sociology among social scientific disciplines. Tichy and Fombrun (1979) summarized the roots of network as both anthropological (i. e., through emphasizing

the content of the relationships of individuals, the condition under which they would exist, and the evolution of bonds), and sociological (i. e., emphasizing patterns of interaction and communication to understand social life).

There are two aspects in network approaches: (1) analytical tools, and (2) theories. Fulk and Boyd (1991) describe communication network analysis as "a conceptually sophisticated tool for studying patterns of information exchange and communication" (p. 429). Tichy and Fombrun (1979) emphasize network as "one method of conceptualizing organizations that captures the interaction of both static and dynamic aspects of organization by focusing on the linkage between social objects over time" (p. 508).

Network approaches also have a potential for further advancing our theoretical understanding of organizations (Fulk and Boyd 1991). Pearce and David (1983) suggest that network approaches contribute to structural theories for organizing. They provide one way to study organizational phenomena so as to examine the formal and informal ties that connect groups and individuals within a firm. In this study, the theoretical aspects of the network model will be applied to solve the coordination dilemma in multinational corporations. The following section discusses network as a theory rather than as an analysis.

Network Theory Rather than Analysis

When network is used as a conceptual tool for studying organizational phenomenon, there are two major concepts; (1) nodes and (2) links (Farace, Taylor, and Stewart 1978). Nodes are distinguished by two types, individuals and clusters (groups). The lines between the nodes are links that represent a relationship between the two entities. Network analysis also identifies the roles individuals play in the network (Pearce and David 1983, Fulk and Boyd 1991). Farace, Monge, and Russell (1977) identified three types of communicative roles in complex networks of organizations: (1) bridge, (2) liaisons, and (3) isolates. A bridge is a node which is a member of a group, who also links to another group, providing a path for information to flow between groups. Their function is to coordinate activities between the two groups in the complex network. The liaison is a node which is not a member of a group, but which links groups together. An isolate, functionally, is not a participant in the groups.

Organizational development proceeds by designing network structures with the combination of node functions described above. Nelson (1989) suggests that the facilitation of forming strong ties between groups is effective in organizational development intervention. A good example of the application of such an organizational development view can be observed in Edström and Galbraith's (1977) study. The strategic transfer of managers is viewed as the actualization of the bridge role by which multinational corporations try to avoid the isolation of foreign branch units and facilitate the forming of strong ties between head-

quarters and foreign branch units. The strategic transfer of managers seems to present a solution to half of the dilemma of coordination in multinational corporations; that is the coordination between headquarters and foreign branch units. However, the other half of the dilemma of coordination, which is the coordination between expatriate groups and local employees within foreign branch units, is still not solved. This study presents one solution to this matter.

In network conception, the formation of strong ties between groups is effective in organizational development. As applying this theory to the case of organizational development in foreign branch units, the formation of strong ties between expatriate groups and local employees is an effective intervention. As described in the previous section, the failure in managing the Japanese branch unit in an American corporation can be attributed to the divergence (non-tie formation) between American MBAs and Japanese engineers.

Although both bridges and liaisons can form strong ties between groups within organizations, this study adopts the role of liaisons. There are two reasons to justify this argument. One reason is that liaisons seems to be superior to bridges in terms of resolving conflicts between two groups. Nelson (1989) explains that conflict seems to be less probable when the third party (possibly liaison) mediate between all other groups. The facilitation of forming ties between two culturally different groups could be an effective intervention in foreign branch units. Another reason is that the role of liaison is crucial in creating the total organizational structure, and their removal destroys the connected unity of the organization (Ross and Harary 1955). This means that if management need to create connected unity between expatriate and local groups in the organization, they should actualize a role of liaison in designing organizational structure. Up to this point, how network approaches can be generally applied to coordinate between expatriate groups and local employees in foreign branch units by improving the divergence problems between these two groups is discussed. The following section discusses how liaisons can specifically perform as mediator between two groups by developing linkages or ties.

Network Formation

Johanson and Mattsson (1987) conceptually explain how network links or ties are formed in business environments. The formation of network links or ties requires a communication process which creates adaptations in attitudes and knowledge of the parties. As a result of interaction, a mutual orientation develops. This mutual orientation is manifested in a common language regarding technical matters, contracting rules, and standardization of processes, products and routines. Less overt aspects of the mutual orientation may involve views on

business ethics, technical philosophy, and handling of organizational problems. To maintain relationships, management have to learn conflict-resolution methods other than switching to new counterparts. The most important aspect of the mutual orientation is mutual knowledge, knowledge which the parties assume each has about the other and upon which they draw in communication with each other. It is a subtle knowledge based on personal experience, and takes time to develop.

These procedures for forming network links and ties seem to be reasonable if the degree of heterogeneity between the two parties is small. However, Boisot (1983) argues that the creation of a common language is dependent on the possibility of codifying knowledge and is very limited in the context of intercultural interaction. The codification of diffusibility of knowledge depends on the building up of shared experiences and common premises for action between members of a community. Cultural boundaries constitute a major zone of discontinuity in the diffusion space. Discontinuity occurs throughout the space in one form or another; some groups, for instance, may choose to codify experiences which other groups are happy to leave uncoded; different subgroups may codify the same experience in different ways to suit their particular requirements or expectations and so on.

The development of mutual orientation between two different cultural groups in foreign branch units may be possible by their own efforts after a long process of interaction. However, at the beginning of the interaction process, such branch units may become high-conflict organizations where groups are not bound together in an orderly manner by strong ties (Nelson 1986). As a result, they have to devote time and energy to developing a mutual orientation in which the two parties can share common knowledge. However, if the third party consults at the beginning of interaction process, their devotion to developing mutual orientation would be smaller. Liaisons may be able to contribute toward interpreting the common language for both parties through the process of codifying knowledge and developing mutual orientation. The following section discusses how liaisons contribute toward developing mutual orientation.

Liaison and Cultural Interpreter

All the functions that liaisons have to play as cultural interpreters are facilitated by establishing the particular properties of network links. The properties of network links that should be obtained by liaisons include, what Fulk and Boyd (1991) summarized, reachability (the degree to which people can be within a minimum of intermediaries) and openness (the extent of linkage outside of the groups). In the case of foreign branch, liaisons must be located in a position

where there is no intervention and gatekeeper in the organizational structure of foreign branch units; they must be directly available from both expatriate groups and local groups. Liaisons also should not strictly restrict the issues to be consulted; they must keep their consultation policy open. There are at least *three* functions that liaisons have to play in the role of cultural interpreters. The following sections discuss three functions in detail.

Liaison as Equivocal Communicator

The *first* function that liaisons have to play in the role of cultural interpreters is to be the interpreter for equivocal aspects of organizing (Weick 1979, Daft and Weick 1984) of branch units. Weick (1979) and Daft and Weick (1984) argue that the reality of organizational operation is based on interpretation, so the standardization of procedures is not meaningful. Daft and Weick (1984, p. 286) describe the equivocal aspect of organizing: "organization must make interpretation. Managers literally must wade into the ocean of events that surround the organization and actively try to make sense of them." Interpretation is also a crucial function of management. Daft and Weick (1984, p. 286) explain that "the job of management is to interpret, not to do the operational work of the organization. The model calls attention to the need in organizations to make sense of things, to be aware of external events, and to translate cues into meaning for organizational participant. Managers, especially to managers, are responsible for this process and are actively involved in it."

Factors explaining the differences in organizational beliefs about the environment include characteristics of the environment and management's previous interpretation experience (Daft and Weick 1984). Boisot (1983) argues that previous experiences of managers determine interpretation and if they encounter new environments, they cannot interpret them meaningfully.

Applying these frameworks of interpretation, it is doubtful that expatriate managers can be successful in foreign branch units regardless of their academic qualification and previous job experiences in their home lands. They may not be able to use their previous managerial skills appropriately in different socio-cultural environments. Consequently, there is a special need for branch units to have the role of cultural interpreters who can interpret the events of environment adequately, translate them, and support expatriate managers. These cultural interpreters can be liaisons.

Liaison as Conflict Mediator

The *second* function as cultural interpreters is to be a conflict mediator. At the beginning of the interaction process, since expatriate managers tend to make sense of organizational operation by their own frames of reference, there are

some aspects of operation which do not make any sense to them. In this situation, there is a high likelihood of conflicts between expatriate managers and local employees. Therefore, liaisons should be in the position of problem solving or conflict resolution between expatriate groups and local groups. The confrontation between expatriate groups and local groups is caused by differences in conception (Omens, Jenner, and Beatty 1987). Chikudate (1991) explored that the differences of cognitive systems shared by organizational members across cultures involve the potential of causing conflict by sophisticated research methods of the combination of linguistic analyses and statistical data analyses. If there are troubles caused by cultural misunderstanding, liaisons have to mediate between the two groups by interpreting the equivocality appropriately and explaining the meanings to both groups. Of course, the function of preventing disasters is required. Liaisons have to facilitate a good climate between expatriate groups and local groups. The monitoring of this climate is also a part of their daily routines. Such a role of liaisons, if not the case of cultural interpreters, usually is performed by public relations or corporate communication staffs. They mediate between the management and workers.

Liaison as Cultural Guide

The *last* function is to be a guide for expatriate managers to proper acculturation. The significance of acculturation of expatriate managers to the local cultural environment have been discussed by several researchers (e. g., Hofstede 1984, 1991). Edström and Galbraith (1977, p. 255) explain that: "the expatriate was to integrate into the local unit, speak the language, and learn the culture. As a result, these expatriates would be less likely to have stereotypes about the local people and culture and less likely to evaluate them in terms of their own value system."

The successful outcome of acculturation can be achieved by the self-learning of transferred managers with some training (Torbiörn 1982, Grove and Torbiörn 1985). However, Gudykunst (1991) shows a variety of problems for self-learning of new cultures through the process of discovery. Therefore, it is reasonable to seek for another way to learn a new culture. This study seeks a solution from what cultural anthropologists do in their fieldwork. Cultural anthropologists who conduct fieldwork (studying culture) in different cultural environments usually find "key informants" who guide them to culturally appropriate interpretation of specific events. It is not exaggerated to say that the success of fieldwork depends on whether good key informants are available or not. In the case of foreign branch units of multinational corporations, the role of key informants can be artificially created and be a guide for expatriate managers to acculturate into local culture. The role of key informants can be played by liaisons in this case.

In summary, liaison in network models plays a role of cultural interpreters who coordinate activities and mediate between expatriate groups and local groups. Liaisons as cultural interpreters have functions of interpreting equivocal aspects of organizing, mediating in conflict-resolution and problem solving, and guiding expatriate managers to assimilate into local cultural environments.

Conclusion

This study discusses the significance of liaison role in multinational corporations where communication difficulties between expatriate groups and local groups are likely to occur. Personnel policies have tended to ignore the appropriateness of employee relocation in multinational corporations, or the management cannot easily hire the appropriate workers for overseas relocation. Although Bush and Frohman (1991, p. 28) argue the "liaison function does become part of each parson's job, rather than a role performed by designated individuals or groups," they did not hypothesize the case of multinational corporations where the equivocality reduction is more crucial than information processing. This study suggests a special role of liaisons should be created in organizational units in the case of multinational corporations.

This study initially develops the insight by investigating the problems in Japanese multinational corporations in the U.S. and U.S. multinational corporations in Japan. However, the interviews with several personnel staffs of Japanese/European multinational corporations that have relatively rooted in European or Japanese soil revealed that they have intentionally or unintentionally adopted this approach. The role of liaisons can be established as either a full-time position within multinational corporations or the use of outside consultants for a limited period of time. It depends on the availability of such a personnel and the task which they are assigned. In the context of Japanese-European business environments, such a personnel has already emerged. In the case of Japanese cultural interpreters in European business situations, Japanese who have studied anthropology, philosophy and art in Europe actually are engaged in the types of consultation described in this study. There are a few Japanese multinational corporations that adopt this approach. It is likely that such corporations have an unusual corporate culture which is not heavily bound by the work values and business culture shared by other corporations in their home countries. Although the volume of Japanese direct investment to Europe is decreasing and the European counterparts in Japan is small, the recent trend of yen evaluation may force Japanese corporations in Europe to further localize their manufacturing processes, and the deregulation of Japanese market may entice European corporations to operate in Japan. In both cases, the idea of cultural interpreters should

be utilized for smoothing their transitory activities in “multicultural” rather than “multinational” corporations.

Notes

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John B. Kidd/Yoshiya Teramoto

The Learning Organization: The Case of the Japanese RHQs in Europe

Abstract

- In 1992 and 1993 we undertook interviews with Chief Executive Officers (CEOs) of European Regional headquarters (RHQs) of Japanese companies situated in the U.K. and in continental Europe.
- We saw little evidence that the Japanese firms in Europe were becoming “learning organizations”. However, we consider the CEOs of the Japanese RHQs occupy a pivotal role with respect to the development of their organizational learning. Such processes, derived in Europe, may become models for their other RHQ, given they might be changing slowly towards being “transnationals”.

Key Results

- Our main observation is that the CEOs are consolidating their European operations, slowly moving towards becoming “transnational” enterprises: yet the CEOs stated that “they were just observing and undertaking changes, on step at a time” – we had heard just those sentiments in 1980 when there were only 18 production subsidiaries in the U.K., now there are over 200.

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Introduction

Japanese Investment in Europe

We have seen a gradual increase in the numbers of Japanese production firms in Europe since 1966 when YKK and Pentel invested in their production in the U.K. and France respectively, there are now close to 1000 production units in Europe. The major beneficiary countries over the years have been the United Kingdom, Germany and France. Roughly they have absorbed 55–60% of the total European Foreign Direct Investment (FDI) from Japan. The data are illustrated in Figure 1.

Figure 1: Comparisons of Production Subsidiaries FDI and Total Japanese FDI
Figure 1a.: Japanese FDI – Productions Firms in Europe

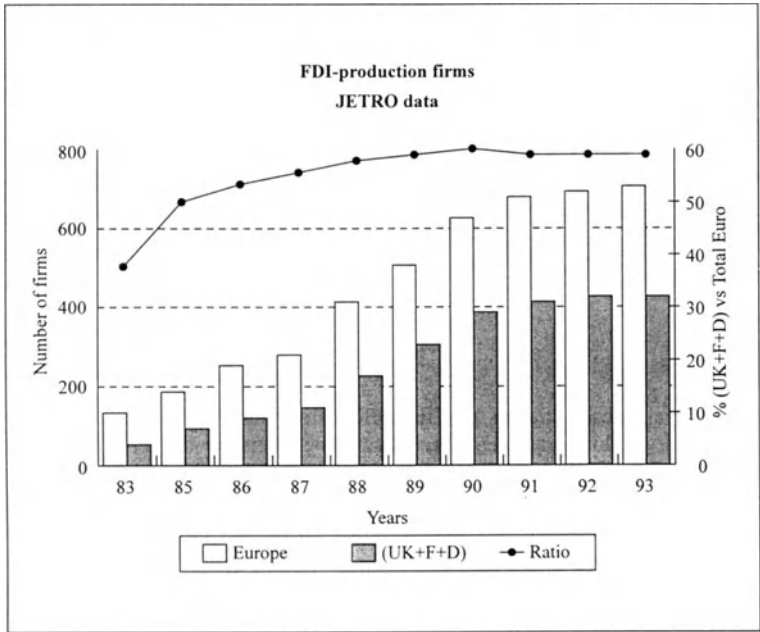
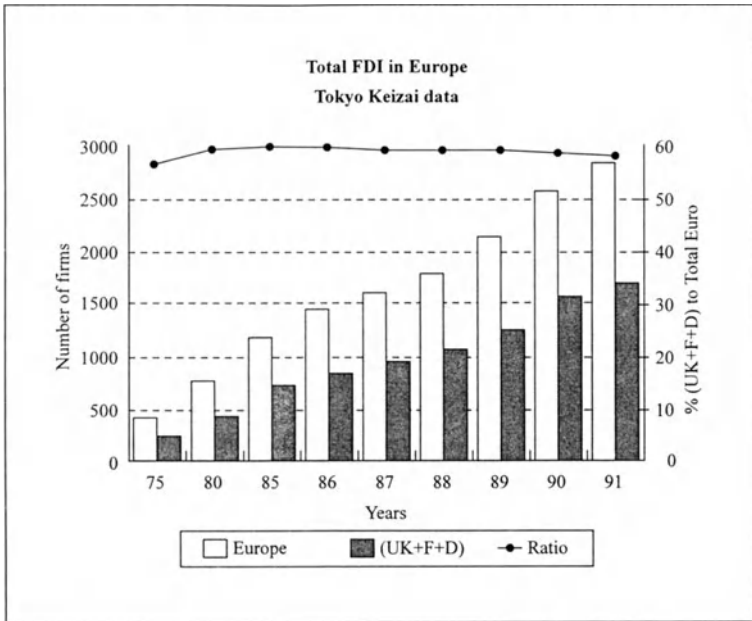


Figure 1b: Total Japanese FDI in Europe



Many of the Japanese organizations in Europe comprise several manufacturing/assembly plants, R&D, distribution, marketing and sales units which sell to end-users products that may be wholly made in Europe, or derive from outside the European Market, or be a mixture of components. We noted a trend to introduce a *regional* headquarters office to coordinate and control the "local" operations in Europe. Thus we decided as part of our longterm survey of the management of production firms to study management issues of concern on the European Regional Headquarters.

Study Objectives

While we have undertaken empirical research to elicit concerns amongst the Chief Executive Officers (CEOs) of the RHQs we also wished to ascertain how our sample of companies "fitted" to the framework of Barlett and Ghoshal (1989) in terms of a perceived organizational form. Following their descriptions

we have assumed the Japanese companies wish to aspire to be “transnational” within their European and/or Global operations. One should note that hereafter RHQ assumes a Japanese Firm.

Given the categorisation we look to aspects of organization learning, networking and psychodynamics that affect the management of the RHQs – noting how the CEOs react to these issues. Finally we suggest that “learning to network” is central to the European RHQ solution in which new integrative modes, managed by the RHQ CEOs, may provide an integration superior to that which may, or may not, arise naturally between members of the company firms located in several countries in Europe, if there was not a RHQ to co-ordinate managerial development.

Concept and Methodology

Concepts Upholding the Survey

We had noted in earlier surveys in the United Kingdom that some companies were initiating a European headquarters office. Initially the managers herein were simply “keeping a watching brief” – they were not taking an active stance between the managers in Japan and those in the local, national firms. Later some of the RHQ managers were to become regional controllers and co-ordinators.

In our RHQ survey we wished to elicit the factors perceived by the CEOs to mitigate against integration and harmonization of their operations. We also were looking for the degree to which concepts like learning mechanisms and networking were being initiated or upheld, since these were purported to aid organizational performance.

Here we consider a “learning organization” quite broadly as one which instigates mechanisms to promote deep and wide exchange of information on company policy, on products, and on new developments so that members of the firm may feel a sense of belonging and have a sense of knowing what they are doing and why. To aid this exchange of explicit and implicit data there is an expectation that individual-to-individual networking will be supported and encouraged by the company.

Surveys of the CEOs of the RHQs

For the U.K. production subsidiaries surveys that we undertook in 1980 and 1990 we requested the completion of a long questionnaire prior to personal interviews with the CEOs (for ease of completion we presented two questionnaires, one in Japanese and the other in English). In contrast, for our RHQ interviews we did not ask for data other than was available in their public

documents. We were grateful for other data that was proffered, which of course might be subject to commercial confidentiality. However, at the time of arranging the interviews, we suggest four focused questions which were faxed to the chief executives as we confirmed our meeting. Basically, the four questions were as follows:

1. To discuss the general nature of your operations, with respect to:
 - your continental European sites and offices,
 - your U.K. sites and offices,
 - your Japanese headquarters and other RHQ (if any).
2. To discuss the managerial mechanisms whereby you control, co-ordinate and manage your European operations.
3. To discuss the managerial mechanisms whereby you co-operate with other RHQ and Headquarters to manage your global operations.
4. To discuss the processes and methods of information interchange between your offices.

It may be surmised that in such informal interviews there would be a drift “round the topics”. Indeed this was true, usually however we interviewed two persons; one person in the Japanese language (often the CEO), and one person in English (often a senior manager) – later we compared results. There was a slight emphasis bias, with the CEO being more concerned with longer term issues, and most certainly with issues concerning the relationship of the RHQ and its “subsidiaries” with the Japanese HQ and persons therein. The senior manager might be concerned more with pan-European issues, such as the drift (or sliding) of goods from a higher VAT country to a lower.

Evidence for Transnationals Based on RHQ Interviews

We mentioned earlier that we assumed the Japanese firms in Europe, especially those that have initiated RHQs, would wish to operate outside of national boundaries in order to achieve global effectiveness. These would be the “transnational” firms as described by Bartlett and Ghoshal (1989), whose organizational schema is summarised in Table 1.

We note Bartlett and Ghoshal define the *transnational* firm as one that searches for efficiency as a way of reaching global competitiveness. It looks for local responsiveness as a tool for achieving flexible operations. It looks for local responsiveness as a tool for achieving flexible operations. Most important, *from our viewpoint*, is that organizational learning and the development of innovations are understood to be within the overall operations, rather than being the

unique preserve of either the centre or the peripheral firm. Thus managers in transnationals would see issues in a broad way, not overly coloured by local needs (to be cost effective, for instance), nor will they be “persuaded” by remote senior managers to undertake operations which at some local level will not be appropriate within the whole without extensive modifications. Nor would they support a strong Divisional or Product-based approach to organizational design if this does not support a holistic view.

Table 1. Distinctions Between Forms of Organizations

Organizational characteristics	Organizational forms			
	Multinational	Global	International	Transnational
Configuration of their assets	Decentralized and nationally sufficient	Centralized and globally scaled	Sources of core competency centralized, others decentralized	Dispersed, interdependent and specialized
Role of their overseas operations	Sensing and exploiting local opportunities	Implementing parent company strategies	Adapting and leveraging parent company competencies	Differentiated contributions by national units to integrated worldwide operations
Development and diffusion of knowledge	Knowledge development retained within each unit	Knowledge developed and retained at centre	Knowledge developed at centre and transferred overseas	Knowledge developed jointly and shared worldwide

Source: Bartlett and Ghoshal, 1989, p. 65

We have noted subjectively in Table 2 how our RHQ firms fit the Bartlett and Ghoshal categories. The reason for using a subjective approach is simple – as we did not use their questionnaire – we were obliged to link the statements of the CEOs with published data (such as the degree of assets or sales attributed to Europe, or whether they publish only consolidated financial data) to assign firms to the framework.

Indeed, one firm which seems to fit as a “transnational” undertook its asset management on a county by county basis, so in this category it was noted as a “multi-national”. Another example of the analysis of our discussions with the

CEOs showed few mechanisms in place for the “development and diffusion of knowledge”; so for this category we note there are few firms which fit the “international” or “transnational” categories. For reasons of confidentiality we have not quoted the names of the firms.

Table 2. The Japanese RHQs Operations According to Bartlett and Ghoshal

	Multinational	Global	International	Transnational
Assets	4	9	2	1
O/seas opn's	3	9	2	2
Knowledge	5	6	3	2

Cell values represent numbers of firms.

Discussion

Based on the above framework the results of our RHQ surveys in 1992 and 1993 show that the RHQ are mainly “global” organizations with few developing to be “international” or “transnational”. What then are the difficulties in this transference? And how could the RHQ managers promote this transference? We look below at aspects of Learning, Training and Networking, and briefly at Culture in the final section.

Learning Firms

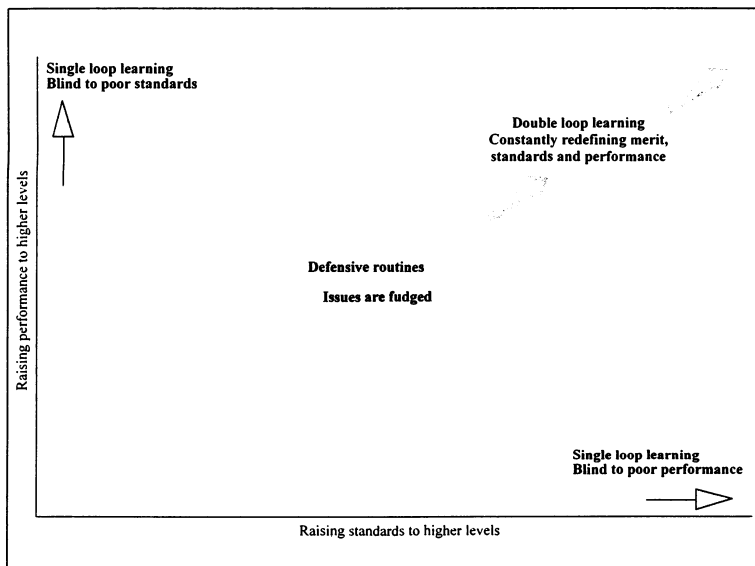
One aspiration looked for by the CEOs was that their staff should increase their learning about how their firm's culture operates. We had noted this clearly in 1992 following one long interview in which the CEO was at pains to discuss a mechanism that enjoined the Japanese corporate culture with that of individualistic learning, that is a characteristic of Euro-U.S. persons. Whilst we have noted the details (in Kidd and Teramoto 1991, and Kidd 1994) we consider it important to again discuss its impact with respect to “organizational learning”.

European newcomers to the firm tend to look for little information about the firm as a whole, but acquire only the data with which to survive and complete their work load. Of course we would see this as a good initial strategy, but the CEO was concerned that later there was too strong and continuing attachment to individualistic learning that precluded enquiry, and thus prevented broader learning about the firm as a whole. In contrast, the Japanese managers, higher in the organization, had achieved a broad view of the organization and could

place in context data from the shop floor, as well as data pertaining to competitors or the economy as a whole – they knew what it means to the organization, and not just to themselves as individuals. They may be said to “have a sense of the organization”. The CEO was striving to find a mechanism by which the individualistic persons could also gain this holistic “sense of the organization”.

The absorption is made more difficult for the Occidental in two ways – firstly they often do not speak Japanese well, if at all, so will not understand the public addresses by the most senior staff as they expound their philosophy and mission of the firm. Secondly, many expositions from senior staff are particularly oblique, and not easy to understand, even for long-term Japanese salarymen. Thus one might see extensive note-taking by Japanese staff when the senior man speaks, as they wish to glean every hint of direction and/or change in official stance on all issues. We note a major cultural difference in so far as the Occidental wishes to hear plain language, not broad generalities.

Figure 2. Single and Double Loop Definitions (Hampden-Turner)



To illustrate some of the conflicts in organizational learning Argyris (1992) postulated the single vs. double loop learning system. This definition was taken up by others, such as McGill and Slocum (1992), and also, aspects of the work of Hampden-Turner (1990) might be interpreted similarly.

In Figure 2 we indicate that overly strong pursuit of goals along either of the two axes will be unwise: that is, adherence to standards without upholding good performance criteria, or vice versa. For instance, there is a global surge to gain the ISO 9000 series of quality certifications (or in the U.K., BS 5750). Implicitly one considers that the provision of audit trails, and the necessary in-house research on the required paperwork will raise quality awareness: but it does not follow that "awareness" is the same as the "achievement" of high quality standards. Almost as parody we note that a bureaucratic environment is one which follows rules (thus lies on the "standards" axis). Contrariwise, a political environment lies on the "performance" axis, since it stresses, not the "what" but the "how". We suggest that over emphasising either of these (useful) activities in an organization may be damaging – as is a random mixture of the two. It is further argued that the pursuit of simple strategies leads to "single loop learning" – wherein one is getting better at the tasks but not really developing. Proponents of the theme would argue that major advances in the firm will only occur through "double loop learning". Good examples of "double loop learning" are seen in Garfield (1992).

We did not hear of examples of "double loop learning" in our interviews. But there were foundations in place in some firms for training courses. In one case this was directed by the RHQ in which there was to be cross-functional divisional learning. CEOs in the RHQs generally recognized the need for bureaucracy and formal meetings. They also recognized the need for cross-boundary meetings where representatives from many countries could express themselves to raise the common consensus of performance. Some said there were too many meetings, but in attempting to merge the European offices into a new structure they fell foul of old bureaucratic structures, and had to maintain too many meeting groups. We would recognize here the potential for the RHQ to act as a catalyst for double loop learning, or indeed for deutero learning (the learning to learn activity). Thus the RHQs could facilitate vertical and horizontal learning between and within divisions and holistically between and within the Japanese HQ and its foreign outposts.

Some of the Japanese managers mentioned during our RHQ interviews that there was a strong management pressure from their HQ in Japan, and that they were acceding to this pressure, notwithstanding the local needs in each European country. To some extent this comes about through earlier changes in their organization structure to form Business and/or Product Divisions with a global remit so now the needs of the local managers in a country, even on a pan-Europe base, are subsumed under strong functional management from Japan. In these

cases the learning mechanisms are “vertical”, only between members of the business division in the field and its members in the Japanese HQ. Although such learning might incline slightly towards the double loop type it is basically a complex form of single loop learning. To transform this form of global organization to the transnational form requires sympathetic management – but above all it needs to establish the double loop learning mechanisms. We consider the role of the RHQ and its management to be the key to this transformation.

Networking in Firms

We recognize that all human endeavours are founded on interactions between individuals. These are rooted in cultural differences which we will consider under two headings:

- how people deal with other people
- how they deal with time

In the European context there is increasing emphasis being laid on how individuals in the (small) European countries relate to others from very different cultures – for example, from the North or South America, from Japan, and/or from other Asian countries, as new investments, alliances or joint ventures are investigated. Japanese managers of the RHQs in Europe recognize the importance of these aspects but, as yet, have not found a unifying mechanism.

How People Deal with Others

It might be seen (logically) that it is better to communicate and negotiate compromises to reach towards common goals than to over-compete for a too-large share of restricted resources. To get this state we need to have well-trained persons in the firm. To this end Kanda (1992) suggested four levels of “training” that should lead all employees of a firm to a common understanding and a high level of networking ability. These stages are applicable to all levels of the work force from the CEO to the most junior operator:

- **Knowing how** – being trained in the best way to use the tools of one’s trade – be it a machine on the shop floor, a telephone, or a personal computer for e/mail use.
- **Knowing what** – to understand the need to deliver on time, first time with the right quality, using the best tools, according to the needs of the customer.
- **Knowing why** – to understand broadly the reason for one’s tasks and how they fit with the overall mission of the firm and its aspirations.

- **Knowing who** – to be able to communicate one's ideas or one's worries, or to enhance one's own skills and those of others through the exchange of data to a peer group, or even more widely, for the good of the Firm.

With respect to *Knowing who*, we note that many Japanese firms have several subsidiaries operating nationally or even globally, so we consider that the sharing of values and issues between all involved in their processes is important. Bartlett and Ghoshal call this "necessary socialization". The regular global movement of Japanese staff is well known and documented. Kidd (1983) noted the easy manner by which some Japanese staff enter conversations in their new employ through *Knowing who* – Kidd at the time called this "potential *nemawashi*". But this (*nemawashi*) is more than just being able to "talk round the issue" with colleagues, it relies on the Four-Knows being in place and operating. We consider this ability is not restricted solely to Japanese staff – with suitable training schemes all staff can benefit. Of course the concept of "training" is culture-bound, as is the concept of sharing data with one's colleagues. Once again we must note the central rôle of the RHQ in creating and managing comprehensive training schemes.

It is vital however to avoid any stigma attached to "training". For instance, in the U.K., the person being offered training sees the offer as a slight on his/her ability, and does not see the training as an opportunity for advancement. In this case, the CEOs and their subordinates must be subtle in their persuasion.

We will find networking persons, by co-operating with others and by knowing with whom to network, will be able to support community membership within the "neutral" organization. Specifically they will be able to

- integrate a firm across traditional vertical, horizontal or spatial boundaries.
By using electronic interlinks they will also escape from temporal traps that prevent face to face meetings (or telephoning) when the respondent is unavailable. These "electronic amplifiers of management power" work very well when the contacts are in very different time zones (cf. Europe – Japan).
- integrate the "deal makers" across spatial boundaries.
In all organizations there are many persons who can "get things done" by manipulating the bureaucracy. Networking puts these people in contact with a wider clientele.
- reduce the organization's need and reliance on the CEO.
If a team is empowered by the CEO, he or she need not be intimately involved in all its deliberations. Responsibility can be delegated and used well by the networking group.

Garfield (op. cit.) stresses these points, Nohria and Eccles (1992) provide an academic perspective and Grenier and Metes (1992) offer good practical advice.

Some of these aspects were noted by Kidd (1983) following our interviews during 1980.

Specifically in the RHQs we heard of issues concerning each of the three points above which may be predicated on the Four-knows training. For instance the attitudes of the CEOs to the use of confravision (TV-meetings) was polarized – one firm used TV linkages to Japan for about 4 hours each day, while another firm (also with a full installation) used it infrequently. Few used this medium for conversations within their European operations – often due to cost, and even in the recent past due to technical limitations in several countries. Electronic mail was infrequently used. In contrast, we heard often the CEOs suggest that inter-personal meetings were to be supported as the best medium of interchange and networking: (Norhria and Eccles (op. cit.) suggest that face-to-face meetings should be undertaken prior to the more restricted electronic form). The CEOs themselves often travelled to Japan to attend senior management meetings, suffering the disruption of jet-lag six to twelve time per year. Yet at the same time, these CEOs were very concerned at the cost of a pan-European get-together without a financially accountable need – such are the pressures now the “bubble economy” has burst.

Naturally, the second and third points are highly dependant on attitudes in the local culture. Here we noted the CEOs had some difficulty in making adjustments when moving between countries and the local managers therein. Some local managers would be quite outgoing (thus be happy to use “deal makers” to further their firm’s progress), others would be more introspective and thus invoke the third point – that the CEO is still needed to exercise authority, albeit arising from the RHQ – which is a neat way of shrugging-off local responsibility. The work of Haiss (1990) is noted later on this point.

Relationship with Time

There are considerable differences between cultures in their views of “time”. Some tend to support persons who are essentially linear in their view and use of time (monochronic) – they would carry one planned activity to the next with little free time between. Other cultures are called synchronic (or polychronic) wherein its members tend to carry multiple threads of activity running in parallel, whilst not being strongly scheduled between tasks.

In general the sequential or linear person will be unnerved by turbulence in their perception of the “right” sequence of events. It is not easy for these persons to keep a number of ideas, or activities, at the forefront of their mind as time passes – as would be normal for a synchronic person. For the latter it is the achievement of the end goal that is important, not exactly how and when each stepping stone has to be crossed, some stones may even be omitted.

This aspect was noted by Kidd and Teramoto during the interview phase of their 1991 survey, but it was not reported. The story unfolds as follows:

Some of the U.K. managers were stating their Japanese senior managers (usually their CEOs) were withholding information from them. In response, to us, the Japanese senior managers mentioned two things – first the U.K. managers generally did not speak Japanese so were excluded from conversations with more senior managers from Japan about the long term future of their subsidiary. And, second, the conversations in Japanese usually concerned many potential future states – of growth, of mergers, of modifications to the status quo, and so on. In other words, the Japanese managers were considering and balancing multiple streams of data, they were being synchronic. The Japanese managers recognized their own use of multiple “potential” futures, yet, when pressed by their U.K. managers, they had proffered only a single, simple future scenario. Unfortunately, if this scenario was not realized, the U.K. managers were anxious, and demanded of their Japanese seniors, “what is going wrong? You told us one thing, and now something else is happening!”

Because U.K. managers tend to be linear in their time management, the Japanese synchronic managers had made a single (best) guess at the future – and because this scenario had not occurred, they, the Japanese, felt they had “lost face”. Rather than letting this occur again, they became more reticent to offer forecasts. Thus the U.K. managers, wishing to grasp at a (linear time-based) straw, felt they were being excluded from the process of management by being deprived of knowledge of the future.

There is no reason to believe the Japanese and the Europeans have altered their day by day use of time: the Japanese remain synchronic and the Europeans remain linear. Several examples of time management are given in Trompenaars (1993).

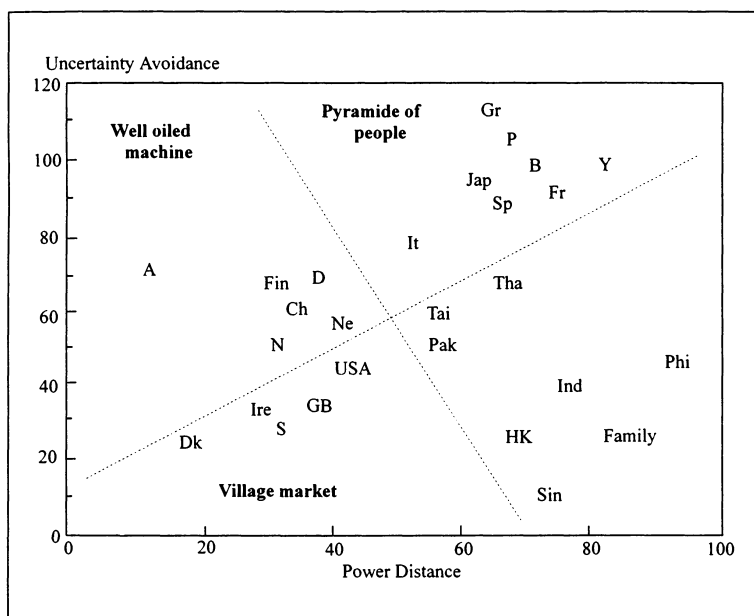
The Psychology of Cultures

We have discussed cultural aspects at length elsewhere: see Kidd and Teramoto (1991). However this point is still raised by the Japanese CEOs and the non-Japanese managers in the RHQs. We do not wish to dwell here on the subject, but we should note the following representation of multi-country differences.

We have taken a sample of Hofstede’s data of 1991 and mapped these onto two dimensions: Power-Distance (PDI) and Uncertainty-Avoidance (UAI), in Figure 3. These dimensions refer to organizational attitudes in firms. Furthermore the Power Distance scale equates to the propensity to concentrate authority on fewer individuals (more concentration at higher PDI values); and there is a greater structuring of activities at higher UAI values which suggests a greater

acceptance of bureaucracy for nations with high UAI scores. These latter findings come from the "Aston" studies which commenced in 1961 which are discussed by Pugh and Hickson (1976). The descriptions also concur with the work of Haiss (1990), who notes the ability of an organization to learn is to some extent positively co-related with higher PDI values; he also notes gross differences in organizational needs according to national cultures. Specifically in Europe, the Anglo-speaking community do not carry the same attitudes as do the Germanic group, and the Japanese hold a further set of attitudes.

Figure 3. National Differences in Culture (Hofstede)



Hofstede (1991, pp. 142 et seq.) notes research at INSEAD during the 1970s. They found that manager/students performed case analysis in differing ways according to their various cultural backgrounds. One culture group suggested the solution was for the staff involved (in the case study) to take their conflicts to their superiors for resolution: they described a very hierarchical system with

well structured activities (the "Pyramid of People"). Other culture groups at INSEAD described their solutions differently – there was the "Well oiled machine" solution in which there is less hierarchy, but activities are so well codified that, in theory, there should be no circumstance in which the superior manager should be bothered by "trivia", as all contingencies are covered by the rules. In the "Village market" solution we find there is no hierarchy and no rules, just a pragmatism that tends to treat each case afresh. This solution also tends to consider the issues to be about the relationships of people and their management in human relations terms. Hofstede suggests the term "transactional analysis" would be an appropriate description nowadays for the last description, but it was not a current term in the 1970s.

We suggest this analysis should indicate to the CEOs of the Japanese RHQs in Europe that there is ample opportunity for conflict between natural organizational styles and behaviours if, and when, Euro-Asian ventures are entered into.

Conclusions

We draw only two conclusions at present from our interviews at the Japanese RHQs in Europe. Both relate to the development of the overall organization learning – through teamwork and through networking.

Team Building

We see the need to create teams of senior staff from different nationalities who (probably) will have worked in several countries. Yet there is a constant battle, as it were, to get the right fit between individuals and the corporate culture. This is difficult when individuals come from different countries, being educated at home, at school, and in their previous employment, since all these factors impress upon them a psychological programme within which to work. It becomes especially difficult if there is to be a "merger" of corporate styles, which must occur in strategic alliances, or joint ventures, or if one firm is taken over 100% by another from an "alien" culture. Unfortunately in multi-culture teams we see often a strong (backwards) link to the individual's heritage. It is this aspect which keeps firms at the global stage, wherein all decisions are targeted at what is best for the local firm, (*in our case*), back in Japan.

If managed well, cross-cultural teams will create more embracing and better results than a mono-cultured organization. We see the CEOs in the RHQs being the focus here: they are best able to decide on the "fit" of persons throughout Europe and developmental roles which have to be played by the managers in the RHQ and in the subsidiaries. Otherwise the strong divisional line, running from

the field operations in Europe to the HQ in Japan will maintain the mono-culture attitudes and thus anchor the firm at the “global” stage.

The Centrality of Networking

All considerations of networking emphasise the central role of the RHQ in which the CEO and his local managers would be facilitators of (regional) learning schemes for their staff in Europe. We consider that this model may become the basis for similar learning schemes in their other RHQs – in the U.S. and in SE Asia. The training will encourage:

- *Networking* – both face to face or via electronic means. This has to be taught and learned by some mechanism. Often, like many organizational innovations, it spreads by diffusion. But time is too short, and cultural norms may hinder the diffusion process. The CEOs in the RHQs have to take a proactive part in establishing double loop learning. This will support other networking aspects of the organization, which, in turn, will develop dynamic deutero learning.
- *The management of time* – has deeper and more subtle aspects than those addressed by the traditional Time Management courses. It is vital to address the issue with respect to the individual’s natural inclination to linearity or to synchronicity. Forcing a person into the wrong role will wreck havoc. Creating understanding of the other’s needs will reap benefits.
- *The management of one’s environment* – is perhaps akin to recognizing the Japanese persons’ natural affinity towards the acceptance of space as part of the whole. The Occidental may place too much emphasis on that which seems to be present, and try to use inner-direction control, rather than see the whole, and learn to be outer-directed.

Future Outlook

We were surprised to hear from the current cadre of CEOs in the Japanese RHQs during the interviews of 1992 and 1993 exactly the same sentiments that we heard in our 1980 interviews – that they were observing for the moment, not acting – hence a “carefully carefully” attitude. As there were few Japanese firms in Europe in the early 1980s, their body of corporate knowledge was slight and they knew they were “juniors” at playing the expatriate manager game.

Several of these “early learners” have returned to Europe in senior management positions. They are now carefully considering their options in the “new Europe” – essentially considering how they may consolidate their local operations within a global viewpoint, though they are not yet making a move towards

being a “transnational” organization. This is not a novel finding: we note a quote from the literature of Sony (1992):

“Sony’s goal in the Eighties remained to act as a truly European company increasing self-sufficiency under our Global Localisation policy. This philosophy of “think global, act local” allowed us to explore and develop the unique features of each country while at the same time benefiting from the strengths of a global enterprise”: Akio Morita, Chairman of the Board.

Now, in the Europe of 1994, there is a harmonization that all Member States are working towards: the lack/loss of borders are creating new opportunities and new problems, and there is a global recession. While the latter affects all firms in Europe, there is a need for major players to take care in re-organizing their European operations. It is on this aspect we consider the role of the Japanese RHQs to be vital. If they convince their HQ managers in Japan, as well as their diverse European managers, to uphold schemes of double loop learning these firms will progress rapidly towards being transnational. But they necessarily must proceed very carefully at present, step by step.

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In 1992, in alphabetic order, we interviewed:

Fujitsu, Hitachi, Mitsubishi, NEC, NSK, Oki, Panasonic, Toray and Toshiba and in 1993:

Cannon, Epson, Konica, Omron, Ricoh, Sharp and Sony.

Section 2: Culture-bound Aspects of Japanese Management

Michael Axel

Toward an Analysis of Japanese-style Management: A Psycho-cultural and Socio-historical Approach

Abstract

- Japan's exceptional economic success and the shaping of the Japanese management system are yet to be conclusively explained. Apart from a good number of "contributory influences" one crucial factor is Japanese culture, in particular the inclination of the Japanese to act collectively. However, what is still needed is a conceptional framework that describes the features shaping Japan's culture.
- In this study an attempt is made to develop a concept that enables the essence of Japan's cultural features as they affect and influence its economic development and management system.

Key Results

- The Japanese management system is shaped essentially by the features of Japanese culture. These features can in turn be traced back to the family system and child-rearing patterns in Japan. It is not possible to come to an understanding of the Japanese management system without knowledge of this connection.

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Introduction

Statement of the Problem

Japan's phenomenal economic development and the international competitiveness of Japanese enterprises is usually explained by particular attributes of Japanese management. There is, however, no explanation for the question how and why Japan developed a management system which in many respects is the exact opposite of Western practice and standards (Murakami 1990, p. 13). Sullivan and Peterson (1989) have identified seven factors used to explain the so-called "Japanese miracle":

1. economic pressures,
2. institutional structures and functions,
3. interests of powerful elites,
4. convergence theory,
5. created organizational cultures,
6. national cultural influences,
7. social relations and values (groupism).

According to Hazama (1977a, 1978), Iwata (1982), Tsuda (1979), Hayashi (1988) and Yang Tien-yi (Kan Toshio) (1989), the Japanese management system is based on the special inclination of the Japanese to act collectively. Nevertheless, as Sullivan and Peterson (1989) point out "the sources of this strong group orientation are not clear." (p. 261).

In this paper an attempt is made to understand Japan's culture in conceptual terms in order to find systematic access to Japanese management practice.

Method

It is generally accepted today that the Japanese management system has been influenced by Japan's cultural features, especially the inclination of the Japanese to act collectively (Hamaguchi 1985, Kumon 1982). However, the background of this inclination as well as of other cultural features is still unclear. Furthermore there is a lack of plausible method to infer the central features of the Japanese management system from the Japanese cultural background. In the context of the discussion concerning the transferability of Japanese style management, Kagono (1990), Ishida (1986), Kono (1982) and Yoshihara (1989) propose the following approach: These authors distinguish in Japanese management various structurally interrelated levels. Three features make up the core of the manage-

ment system: (1) lifetime employment; (2) the principle of seniority, and (3) company-based labor unions, and/or an understanding of the enterprise as a community. This fundamental basis of the Japanese management system is closely bound up with Japanese culture. The basic features of Japanese culture are (1) maintenance of permanent vertical emotional human bonds/*ningen kan-kei*, (2) group orientation/groupism/*aidagara*, and (3) emphasis on harmony/*wa* (Kagono 1990). These three cultural features emerge from the child-rearing practices in the Japanese family structure. Therefore, in order to be able to understand these three features of Japanese culture and assess their influence on the Japanese management system, it is necessary to have some knowledge of primary socialization in Japan.

Primary Socialization in Japan

Although the differences between the child-rearing practices and the family system in East and Southeast Asia and their counterparts in the West are substantial, little is known in the West about the conditions prevalent in Asia. According to J. Hsu (1985, pp. 600 et seq.), the following aspects differ between Asian and Western families: definition of family, financial obligation, core relationship, emphasis on familism, orientation, spouse, parent-child relationship, decision-making, role expectations, ideology, goal, boundary, disclosure of information, expression of love, and expression of anger. What is of particular significance is the difference in the core relationship of the family. J. Hsu (1985) and F.L.K. Hsu (1965/1983, 1975) note that the Western family system is dominated by a father-mother relationship characterized by the features of discontinuity, exclusivity, sexuality, and spontaneity. The exclusivity and sexualized intimacy dominating the relationship between the spouses in the Western family system leads to a situation in which the children in this family system are relatively marginalized and isolated. In this system children are reared in such a way as to promote them in developing their individuality, rapidly acquiring independence, and establishing their own independent household at an early point of time.

The relationship dominant within Asian families is invariably one between the parents and the children, although there are salient differences in East and Southeast Asia in the shape taken on by this core relationship.

Japanese families are dominated by the mother-son relationship (Hsu 1975, Kitahara 1989, Kawai 1987/88, Sofue 1971, Wagatsuma 1977, Tanaka 1986); according to Hsu (1975), this is defined by the following characteristics: discontinuity, inclusiveness, dependence, diffuseness, and libidinality.

The mother-son dyad shaping the Japanese family system is characterized in particular by the feature of dependence. In contrast to Western child-rearing

practice, which is marked by forced individuation of the children, and the Chinese or Korean pattern of raising children, which is determined by transferring child dependence from the mother to the father (Dien 1992), the close emotional ties between mother and son are not severed in the Japanese family (Tanaka 1986).

The mother-child relationship typical in Japan and the consequences it entails are described by Naka and Kawakita (1964) as follows:

1. Mothers are too keen to take care of their children, thus indulging a tendency towards overprotection.
2. Undesirable habits or behavior deviations are often caused by this overprotection.
3. Most of the overwhelming emotional reactions of the child are evidently produced when it is confronted with the birth of a new sibling. This family ordeal tends to bring about regressive behavior especially in the elder child.
4. Boys are more overprotected than girls. Girls are more often neglected in respect to developing malnutrition (after the war).
5. Male children have more emotional disorders. This finding may indicate that their overprotections "spoils" the boys (p. 302).

Personality and Culture in Japan

It is not possible to infer correctly and objectively the link between primary socialization in a society national character, and the central features of that culture. All the same, it is in my opinion possible to demonstrate plausible contexts that may contribute to a deeper understanding of the culture under consideration (Johnson 1992).

The Japanese National Character

The basic difference between family dynamics in Japan and the West is the excessively close mother-son relationship encountered in the former (Sofue 1971, Kitahara 1989, Tanaka 1986). This excessively close relationship leads to a situation in which Japanese show a tendency to develop a "close mother syndrome" (Kitahara 1989, p. 64), an "over-dependent and immature personality structure" (Naka and Kawakita 1964, p. 303), or a "mother complex and a dependent personality" (Sofue 1971, p. 285; see also Tatara 1974). The Japanese national character is, in Kawabata's view (1987, p. 92), marked by the following features:

1. lack of strong will and maintenance of the ego identity with a subjective attitude,
2. embeddedness in a collective ego without clear ego boundaries,
3. attachment in the forms of dependency on and need for ... (a nurturing parental figure),
4. passive ego autonomy in which there is a tendency to depend on and react to situational dynamics.

In my view, the second feature deserves special attention. According to Hamaguchi (1990), the Japanese lack an individual identity sharply delineated from their social context, and tend, rather, to live in a sort of symbiotic relationship with their interpersonal environment. "That is to say, a Japanese contextual does not have a hard shell of personality or definite identity as an "individual", even though he does have some membrane to separate him from the other people belonging to the same "context", in which respect he is also different from the collectivist. The contextual's characteristic of lacking "personality" can also be indicated by the fact that he does not possess the invariant "I-ness". His identity changes according to what context he belongs to or the kind of people he is with" (Kumon 1982, p. 19). The individual personality of the Japanese is compared by Mori (1977) with a "shell-less egg" and by Kumon (1982) with an "amoeba" (Greek "change", "alternate").

Some Features of Japanese Culture

Three basic features of Japanese culture are: (1) maintenance of permanent vertical emotional human bonds/*ningen kankei*, (2) group orientation/group-ism/*aidagara*, and (3) emphasis on harmony/*wa*. These three core features are directly linked to the Japanese method of child-rearing.

(1) *ningen kankei*: The mother-son dyad characterized by a strong mutual dependence determines at the same time the father's position in the family and shapes relationships to persons of authority outside the family (Hsu 1965/1983, p. 229).

In the Japanese culture marked by the mother-son dyad, persons of authority have the function of potential opportunities to substitute for the son's non-concluded relationship to his mother (Muramatsu 1951, p. 198).

The mother-son dyad serves as a model on which to pattern fictive parent-child relationships between adult individuals not related to one another. These fictive parent-child relationships are designated by the terms *oyabun* and *kobun*. *Oyabun* refers to a person with the status of a parent (*oya*) and *kobun* designates a person with the status of a child (*ko*).

The basic elements of this relationship consist in the fact that the *kobun* receives benefits and help from his *oyabun* or that the latter provides him with advice in making important decisions. Conversely, a *kobun* is always ready to help when requested to do so by his *oyabun*. Nearly all Japanese are involved in *oyabun-kobun* relationships, regardless of their profession or status (Nakane 1985, p. 65).

One thing that is essential to an evaluation of the *oyabun-kobun* relationship is that it is based not on any rational, specified contract but on the emotional ties between those involved. The emotional tie between the fictive parent and the fictive child rests on the *amae* concept first described by Doi (1982): "The concept of "amae" is best translated as "indulgent dependency", which is an integral part of the Japanese social fiber and not easily understood by Westerners" (Johnson 1992). Whereas the noun *amae* stands for a special form of a dependent relationship experienced as positive, the verbal form designates a dynamic, intimate interaction (Kumagai 1981):

amaeru: for an individual to indulge himself in love,
amayakasu: to defer to the other in love.

The interplay of *amaeru-amayakasu* gives rise to the formation of a specific Japanese human sentiment linking the persons involved, which is designated as *ninjo*. Closely associated with the term *ninjo* is the social obligation termed *giri* which results from a kindness received (*on*, *on-jo*). The interaction between *on* and *giri/ninjo* results in the establishment of a mutual, emotionally binding relationship.

The interplay of *amaeru-amayakasu*, or *ninjo/giri-on*, gives rise to the development of a form of interpersonal relationship that, in current theory on Japanese ethics, is termed "space between persons" ("inbetweenness") or "interpersonal principle" by psychologists, psychiatrists, and sociologists (Watsuji Tetsuro, Kimura Bin). This form of interpersonal relationship designates a "human mode of existence in which one is aware that within interpersonal contexts the relationship per se is the self, and not any links or extensions of an independent ego. East Asians, including the Japanese, regard this "being qua intersubject" as the natural mode of existence. This is also clearly demonstrated by the fact that in Japanese "man" (*hito*) is designated as *ningen* (literally: "person" and "between") and in Chinese the expression "man" (*jen*) also includes interpersonal relationships (Hamaguchi 1990, p. 143). Hamaguchi (1990) characterizes the Western mode of existence as that of the "individual" or the "individual subject", whereas he sees the Japanese or East Asian counterpart as that of the "intersubject" or the "relational subject". The ego-consciousness of the "intersubject" consequently includes others. It is less something definitively contoured than an amorphous life-space the formation of which is fluid in that it is based on interpersonal contexts (Hamaguchi 1990, p. 143).

(2) *Groupism/aidagara*: In the Western perspective, the most striking feature of Japanese culture, or Japanese social behavior, is the inclination of the Japanese to act collectively (Lifton 1962, p. 183).

Japanese differ from Westerners not only in their general proclivity for group formation but also in the special quality of their group dynamics. The significance of the entirely different organization of groups dynamics in Japanese groups has, in my opinion, been entirely neglected by Western researchers.

The Western individualist, whose identity is generally faced with a latent danger in being forced to separate from the maternal (Kawai 1987/88), may lose this identity in unstructured group situations: he plunges into the void. A feeling of anxiety associated with loss of identity is the central aspect of the experience of the Western individual in unstructured groups (Diamond and Allcorn 1987). In order to gain control of the anxiety of individual group members engendered by loss of identity, groups in the West elaborate collectively shared defense mechanisms (Takahashi 1991). In contrast to Western individualists, the Japanese can experience belonging to a group without any fear of loss of identity (Yamaguchi 1986, Kumon 1982).

The specific quality of Japanese groups according to Hamaguchi (1985, 1990) and Kumon (1982) cannot be captured by concepts stemming from the Western cultural sphere (Hane 1982, p. 34).

According to Hamaguchi (1990), "intersubjects" fashion from relationships an "inter"-network that is designated in Japanese as *aidagara*.

union of individuals → group,

union of "intersubjects" → *aidagara* (context).

The group (*aidagara*) that develops through a union of *ningen* gives rise to an "array-like" association/configuration (*ba*). Such associations form the core social unit of Japanese society which is referred to as *ie* (Kumon 1982, p. 22).

(3) *Harmony/wa*: In the year 604 BC, the regent, Prince Shotoku, promulgated a constitution consisting of 17 commandments; its initial and supreme precept was harmony (*wa*). According to Tai (1989), *wa* has two meanings for East Asians: "it means both a union of human beings with the natural world and the maintenance of congenial relations among individuals" (p. 17). The Japanese category *wa* is closely associated with the individual ("shell-less egg"), the dyadic (*ningen*), and the collective (*aidagara*) self-orientation of the Japanese and East Asians.

The category *wa* goes, according to Hane (1982), Tai (1989), and Maruyama (1984), beyond the understanding of Westerners, which rests on individualism. Following Rohlen (1975) and in my view, the category *wa* can be interpreted as teamwork, high morale, group cohesion, or group vitality via formation of a "group-self", or "collective self".

The Preindustrial Japanese Family System

Today's Japanese management system, and the present structure of Japan's economy, can be understood only against the background of the historical development of the Japanese family system (Horie 1966, Hsu 1975, Murakami 1984). It is difficult to analyze the development of this family system, since during Japan's 2000-year history several different family systems have existed parallel to one another, some of which have gone into decline or changed, while others continue to exist.

The oldest traditional Japanese family system is that practiced by the Yayoi Culture (c. 300 BC – c. 300 AD). Artificially irrigated rice cultivation was introduced in this period. The family system of the rice farmers was a matriarchal family structure (Ienga 1990). The consanguineous mother-child relationship was the foundation on which the matriarchal family structure was based. An essential feature of this family structure was a form of conjugal community that required the husband to live in a community separate from his wife (men's lodge). The farming villages were organized not along the lines of family units but in the form of gender- and age-based communities which shared living quarters. These communities were not based on kinship. The following gender- and age-based groups existed within the village: (1) from infancy up to about the age of seven years, (2) childhood from about seven to approximately the age of physiological puberty, (3) adolescence and early maturity, (4) middle-age – after marrying, (5) the group without work – after retirement, and (6) old age. One of the most important customs in this type of village community was a so-called fictive or social parenthood (*kari-oya*), an elderly member of the village community assuming fictive parenthood for a youth. "In public life, the social parent has more power to compel and to protect than does the blood parent" (Hori 1974, p. 3). The atmosphere in the peasant family and village communities was egalitarian, warm, humane, democratic, and emotional (Kawashima 1985). This family system, which developed in ancient Japan, displays strong points of similarity with the family system in Polynesia and Southeast Asian; in certain regions of Japan it continued to exist into the postwar era (Matsumoto 1949, Norbeck 1953).

Beginning in the third century AD, several waves of immigration from the Asian continent led to the subjugation of the native population, giving rise to class differences. The family system of the new class of rulers (Uji clan system) differed strikingly from the family system of the subjugated population and was based on patriarchal principles. The Uji family system is characterized by the principle of consanguinity, the absolute power of the family head, marriage of women into a man's family, the Confucian family ethic, and a hierarchic structure of family organization (Horie 1951, Ienga 1990). The Uji family system strongly resembles the practiced in Korea (Ariga 1956). The latter is

organized along patriarchal, patrimonial, and patrilocal lines. The Uji family system of the ruling class lost more and more of its significance as the Ritsuryo order declined, and finally vanished in the 16th century (Murakami 1984). With the decline of the Ritsuryo order and the rise of a *noblesse d'epée*, or samurai class, in the 11th century, a new family system began to develop ("*ie*-cycle", Murakami 1984). This system joined elements of the Uji family system with the family system of the subjugated peasants. The new system developed in the context of the colonization of Japan's northeastern regions.

According to Nakane (1967, p. 1), the correct translation of the Japanese word *ie* is not "family" but "household". What this expresses is the fact that the persons living in a household were not always consanguineous kin. In Japan this renders impossible ancestor worship of the type practiced in China and Korea, since there is no way of guaranteeing the purity of a line of ancestors. According to Ariga (1956) and Horie (1966), the Japanese notion of *ie* corresponds to the concept of the legal entity in Western legal systems. The *ie* represents an undying unit, a space, a field, that exists independently of its individual members. The latter are bound by loyalty toward the *ie*, which is merely represented by the actual head of a household. The *ie* has a group spirit, or group tutelary (*kami*), of its own.

The Japanese family (household, *ie*) or the Japanese family organization (*dozoku*) is characterized by the following four features (Murakami 1984, pp. 302–312):

1. *Membership qualification: kin-tract-ship*

The Japanese family is not based on the principle of consanguinity but is formed through imitation of kinship relationships. New family members are "adopted", a process in which consanguineous factors play no part. This distinguishes the *ie* system fundamentally from the Chinese or Korean family system. Hsu (1975) refers to the relationship entered by members of the *ie* as "kin-tract-ship", the term of course being made up of the words "kinship" and "contract". This type of tie is based on the interaction of *on-ninjo/giri*, through which a fictive kinship relationship is constituted.

2. *Perceived collective goal: stem linearity*

The goal of the *ie* is not to achieve a given result; it is the "eternal continuance and expansion of the group" (Murakami 1984, p. 306). One means of achieving this goal is the manner in which hereditary succession is regulated (primogeniture).

3. *Form of role structure: homo-functional hierarchy*

The homo-functional hierarchy is a structure which aims at collectively fulfilling a function by assigning a specific part of this function to each individual stratum within the hierarchy.

4. *Degree of autonomy: near-independence*

The *ie* is a self-sufficient, autonomous organization that does not depend on the outside.

Since its rise in the 12th century, the *ie* has developed into Japan's most important social unit (Nakane 1967). To be sure, the diffusion of this family system was restricted to the samurai, merchant houses, big landowners, and the peasants in the northeastern regions of the country (Ueno 1987). Parallel to the *ie* family system, a large part of the peasant population, in particular in more remote regions to the south-west, continued to live in community-oriented villages with groups based on gender and age. Only in connection with the process of mass population migration and urbanization associated with industrialization did this family system begin to lose its significance.

The Development of the Japanese Industrial Management System

The development of today's industrial management system in Japan, with its four core elements of (1) lifetime employment, (2) the seniority principle, (3) company labor unions, and (4) company-based social policy, was neither planned nor did it develop in a straight line; rather, it proceeded in several phases, as a learning process. According to Tsuda (1979), Sumiya (1966), and Hazama (1977), three phases of this learning process can be distinguished: (1) The introduction of the Western-style factory system: the government factories, (2) the development of private enterprise and turmoil in labour-relations, and (3) the development of "family-ism" in management (*kazoku-shugi*).

Ad (1): The first attempts to found modern industrial enterprises were undertaken by various feudal lords as early as the end of the Togukawa period. Beginning in 1868, the new government forced the build-up of modern industry by founding numerous new state-owned enterprises. Aside from producing strategically important goods, these new state industrial enterprises operated in particular as model factories. These model factories were intended to ensure a rapid proliferation of Western technology in Japan. Personnel management in the model state-owned industrial enterprises was geared on the one hand to the traditional bureaucratic practice of the Togukawa period and on the other to the personnel policies of major Western companies. "Labor conditions in the early period of operation were relatively good, because they were originally set up for the foreign experts" (Hazama 1977, p. 408). The state industrial enterprises were able to function as model factories aimed at providing impetus to Japan's industrial development. Yet the Japanese government was unable to run its

industrial enterprises profitably. This circumstance finally led to the sale of the state-owned factories to the private sector.

Ad (2): The private owners of the former model state factories attempted to improve productivity by introducing drastic rationalization measures. An attempt was made to step up productivity in particular by modifying personnel policies. Working conditions deteriorated dramatically as a consequence of the new personnel policies. "The company profited at the expense of the workers" (Hazama 1977, p. 410). In connection with a demand surplus for manpower in the labor market, the poor working conditions led to high levels of manpower fluctuation between factories. "In considering the labour-relations in the period following the Sino-Japanese War ... the first thing that draws one's attention is the extremely high rate of labour mobility at that time" (Sumiya 1966, p. 500). Japan's industrialization was stimulated essentially by the two successful wars waged against China and Russia. However, the war-related business boom was quick to collapse, in particular after the war against Russia. This led to a further deterioration of working conditions. The consequence was mass strikes, unrest, and violence. "... closely following the war's end there occurred in succession violent labour disputes in such places as shipyards and the Army and Navy arsenals. These disputes were no longer of an accidental nature ..." (Sumiya 1966, p. 506).

High rate of fluctuation and tense industrial relations also had a negative impact both on product quality and further industrial development. The growing complexity of industrial output following the Russo-Japanese War required better and better trained workers; and the high training levels required in connection with progress in industrialization could be achieved only by inducing workers to remain with a company for a longer period of time.

In my opinion, the psychosocial situation of the workers in this phase deserves particular attention. The great demand for manpower that developed in connection with forced industrialization could be met only by hiring rural workers. The textile industry of this period for the most part employed young, unmarried rural women who, in a number of years, as a rule returned to the countryside and married. More difficult, on the other hand, was the situation for the formerly rural male population now living permanently in the cities. When these persons moved from the country to the developing industrial centers, the social structure based on agrarian roots began to crumble. "The workers entered the firm from the background of village life totally steeped in permanent group relationships, with duties and mutual dependencies dominating every aspect of their lives" (Hirschmeier 1977, p. 26). The loss of the agrarian psychosocial context triggered in this population group a state of psychological disorientation leading to a rapid rise of diffuse anxiety disorders (*taijinkyofusho*, Russel 1989). Doi (1982) traces the increase of such anxiety disorders in this phase of industrialization, marked as it was by impersonal contractual relationships and

high levels of fluctuation, back to a lack of any possibility for *amaeru*. The government then propagated the ideology of the family-state as a means of addressing this problem (Ishida 1967, p. 4). The marked need for ties on the part of the uprooted former rural population now living in the cities led in this period to an epidemic development of so-called “New Religious Groups” (Ishida 1967, Yasumaru 1981). In an anonymous, uprooted society; in a situation in which, in an urbanized environment, the individual no longer knew his neighbors and was no longer bound by blood ties, marriage, or even shared interests, the new religious groups offered those affected a new group environment. This was enhanced by stressing the interpersonal responsibility shared by group members. The religious movements were organized along the lines of the traditional *oyabun-kobun* system (Köpping 1974, p. 119). The common denominator of the various “New Religious Groups” is that they created in the new, anonymous industrial towns a psychosocial context (*aidagara*) with which the former rural population was already familiar and of which it had an existential need as a means of achieving a psychosocial equilibrium (Hsu 1975, with the assistance of Professor Esyun Hamaguchi, pp. 161–179).

Ad (3): The situation described for the second phase of Japan’s industrialization required a modification of the personnel policies hitherto pursued. Instead of impersonal, tense industrial relations, the employers began to emphasize traditional, fictive parent-child relationships. “In this new endeavour the factor most emphasized was the sense of gratitude towards the parent (*on*), and the feeling of warm intimacy within a family” (p. 509). “... From here on, however, the employer’s warm feeling was to be stressed” (pp. 509 et seq.). “... Thus, an entirely new form of labour relations – represented by such terms as family-ism (*keiei kazoku-shugi*) and the principle of warm-heartedness (*onjo-shugi*) – rapidly came to take shape ...” (Sumiya 1966, p. 512). In parallel to their propagation of the new management ideology, the employers began, in concrete terms, to modify their personnel policy. The shape assumed by the new personnel policy entailed both creation of numerous in-company welfare arrangements and a new hiring policy (*kogai*, “reared from juvenile”). The purposeful implementation of traditional agrarian organizational patterns (*ie-dozoku* system, “age-grade” system) on the shop floor made it possible for the employers, not unlike the New Religious Movements, to create a surrogate for the vanished base agrarian unit. According to Ishida (1967), the workers at that time were in need of a base unit on which they could rely and with which they could fully identify as a means of diminishing their anxiety. The new management system that developed after the war against Russia (*kazoku-shugi-keiei*) is, in the view of Iwata (1982), based primarily on the marked need for ties displayed by the Japanese, and it is keyed to providing psychic stabilization for employees (Hazama 1960, 1978).

The Japanese Management System

The essence of today's Japanese management is "managerial familism" (Inohara 1990).

According to Murakami (1984, p. 357), the central features of today's Japanese management system, that is, (1) lifelong employment, (2) payment and promotion based on length of employment, (3) company labor unions, (4) company social policy, (5) group consciousness and team spirit, (6) decision-making on the basis of consensus/harmony, (7) job rotation, and (8) the system of industrial associations, are directly linked to the *ie* family system that developed in the 12th century.

The standard version of the ie

1. Kintractship
2. Eternal continuation of the *ie*
3. Homo-functional hierarchy combined with efforts to maintain group homogeneity
4. High degree of autonomy

The Japanese management system

Lifetime employment (Inclination to recruit new graduates).
Eternal continuation of the firm.
(Inclination to avoid the dissolution of the firm at any cost or the unemployment of its workers.)
Seniority Wage and advancement system.
High inter-job mobility within each firm.
Intra-firm welfare system.
Company-based labor union.

(Murakami 1984, p. 357)

The significance of the *ie* family system for the shape displayed by today's Japanese management system has been presented by Horie (1966), Hazama (1960), Okada (1952), and Kawamura (1993). Yet the influence of the second Japanese family system, the "community-oriented age-grading system" on today's Japanese management system has thus far hardly been addressed as a problem. According to Ueno (1987), the strict division of labor between the sexes in Japan, the hiring of groups of new employees without any vocational experience, the existence of company-run bachelor dormitories, the paramount importance of male working groups as opposed to families, and the egalitarian democratic organizational structure of Japanese enterprises can be traced back to this family system.

Results

Hsu (1975), Hamaguchi (1985), and Maruyama (1984) criticize the approaches taken by Western researchers in their attempts to explain culture, economic success, and Japan's management system on the assumption that concepts developed in the Western cultural sphere are applicable here. Hamaguchi (1985) refers to the scientific paradigm implicit in Western Japan studies as "methodological individualism". In Hamaguchi's (1985) view, research based on this approach cannot lead to an understanding of Japan. He therefore calls on Western researchers to find a substitute for their inadequate implicit research paradigms: "... my preliminary conclusion is that the paradigm of Japan studies has to be transformed from methodological individualism ... to something that has its roots in the emics inherent to Japan" (1985, p. 196). The difficulties facing Western researchers in attempting to expand their research paradigm must, however, not be underestimated. Maruyama (1984) writes in this context: "Kimura (1972) and Maruyama report their frustration in trying to help European and North American theorists overcome the dimension reduction (= methodological individualism). It is like attempting to explain some colors to colour-blind persons" (p. 103).

Hence, according to Maruyama (1984), any attempt to define the essence of the Japanese enterprise as a configuration made up of the elements of *Gemeinschaft* and *Gesellschaft* (see Hazama (1977) is therefore insufficient, since these two types of organization are based on Western individualism. Japanese management, on the other hand, is based on an entirely different principle, that of the intersubject (*ningen, kanjin, aidagara*). To define the essence of Japanese enterprises it is necessary to consider in addition the element of *aidagara*.

Gemeinschaft + *Gesellschaft* + *aidagara* = *aidaschaft*

According to Maruyama (1984, p. 103), the essence of the Japanese management system is captured by the concept of "*aidaschaft*". With reference to Kimura (1972), Hamaguchi (1985), and Iwata (1982), Maruyama defines "*aidaschaft*" as follows:

Aidaschaft = "*The individual feels mentally connected to others in the group, works with others without rigid division of labor and with flexible unwritten adaptability to changing situations, and feels responsible for the success or failure of the entire group*" (Maruyama 1984, p. 103)

This study must be understood as an attempt to understand Japan's culture, economy, and management on the basis of a system of concepts developed in the Japanese cultural sphere.

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Daniel Dirks

The Quest for Organizational Competence: Japanese Management Abroad

Abstract

- Structural approaches to the globalization process of firms tend to neglect cultural diversity as a momentous variable.
- Despite their questionable history of internationalization, Japanese companies appear to have access to an organizational concept facilitating multicultural integration.

Key Results

- The organizational challenge of corporate globalization is linked to the issue of cultural diversity, with a Japanese theory of organization contributing insights into possible solutions.

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Introduction

Managers and researchers alike have been proclaiming the age of globalization, and though still largely a “term in search of a definition” (Bartlett and Ghoshal 1989), it appears that companies involved in this cross-border endeavor have a fairly sound understanding of what it takes to become a “global player”. Hence, strategic choices made will have to deal with the basic conflict of integrating, coordinating, and controlling activities spread around the globe versus catering to local and/or regional needs that confront the company’s subsidiaries.

Ghoshal and Nohria (1993), conceptualizing the multinational company (MNC)’s structure as a “nexus of the relationship between its different national subsidiaries and its headquarter”, have recently (re-)introduced the concept of “fit” between an organization and its environment as “one of the relatively few simple and robust findings in organization theory”.

Applying the idea of “fit” to the arena of the MNC, four basic patterns of MNC structure can be identified, each being a different conglomerate of the three basic headquarter-subsidiary governance mechanisms (centralization, formalization, normative integration):

- *structural uniformity*, i. e. a strong, uniform attempt for overall integration across the whole company with an emphasis on one of the three mechanisms or a combination thereof,
- *differentiated fit*, i. e. an adoption of different governance modes to fit each subsidiary’s local context,
- *integrated variety*, i. e. an adherence to the logic of differentiated fit, but overlaying the respectively structured relationships with an integrating mechanism (again, a choice between centralization, formalization, and normative integration),
- *ad hoc variation*, i. e. a situation without any dominant integrative mechanism nor any explicit attempt or pattern of differentiation.

Multinationally active companies are faced with a range of different contexts in terms of the respective environment’s complexity and the local subsidiaries’ resources, a fact reflected in a variation of the MNC’s different headquarter-subsidiary relationships (Ghoshal and Nohria 1989). To be successful, such variation will further have to effectively and flexibly balance the costs and benefits of differentiation vs. integration, since growing organizational complexity, associated with growing differentiation, may also lead to a significant increase in administrative costs.

Figure 1 summarizes the basic “fit” postulate, classifying the different environments according to the intensity of responsiveness/integration forces and ascribing the proper structural response patterns to the four resulting clusters.

Figure 1. Structures of Headquarter-Subsidiary Relationships in MNCs

Forces for Global Integration/ Structural Integration	Strong/High	Global environment <i>Structural Uniformity</i>	Transnational environment <i>Integrated Variety</i>
	Weak/Low	International environment <i>Ad hoc Variation</i>	Multinational environment <i>Differentiated Fit</i>
		Weak/Low	Strong/High
		Forces for Local Responsiveness/ Structural Differentiation	

Source: Ghoshal and Nohria (1993), pp. 27, 31

“Fit” structures that are achieved according to this framework will, it is contended, lead to improved subsidiary, and hence overall performance. For all of its charm, due to its simple yet powerful reasoning, the theoretical argument leaves aside an important ingredient of organizational adaptation to varying environments, i. e. the ability of an MNC to adequately sense and understand changes in those environments and to successfully respond in line with the “fit” model argued for.

What seems far less clear, moreover, is *how* to construct globally structural governance modes. Elaborate policies and strategies call for efficient and effective implementation, and the ability of an organization to operationalize these plans is put to a test. In fact, Bartlett (1986) had earlier pointed to the importance of an organization’s “administrative heritage” for developing structural responses to important business contingencies (e. g. environmental factors). In other words, the history of a company’s internationalization process as well as management’s cultural background, its norms, values, and practices, profoundly influence strategic decision-making and structural implementation.

Therefore organizational issues as a result of corporate and managerial cultural orientations do matter. These orientations within MNCs are, however, far from homogenous, complicating the achievement of structural “fitness”. *The central thesis of this paper is that developing the MNC’s ability to advance to a truly “global” or “transnational” stage is a function of institutionalizing efforts to incorporate culturally-linked diversity into the organization.* This implies that cultural diversity must be accepted as a given quality of MNCs. This paper further hypothesizes that as companies internationalize their organizations, they will systematically need to address their propensity to become “multicultural”,

an organizational situation characterized by a high degree of heterogeneity and, thus, complexity. The search for simplicity in organizational design may otherwise prove fruitless.

The Japanese Experience

Strategically, Japanese MNCs have lately come to embrace a more “regiocentric” approach with the creation of semi-autonomous networks in Asia, Europe, and North America (Tanaka 1993). It thus appears as if these companies have come to play the “global game” with more ease and experience, which in itself must be seen as a remarkable advance from the earlier, “reluctant” days of internationalizing (Trevor 1983).

However, a case can still be made with regard to the continuation of ethnocentric behavior within Japanese business organizations. Studies illuminating the headquarter-subsidiary mode or the integration of foreign personnel into internal communication and decision-making processes are, unfortunately, comparatively rare and often somewhat outdated, originating from the early days of the massive Japanese foreign direct investment (FDI) advance throughout the 1980s (Kumar and Steinmann 1985, Park et al. 1985).

More recent findings remain either vague on the issue of intra-organizational procedural qualities (Park et al. 1992) or present a rather bleak picture (Hayashi 1988). Yoshihara's (1989) characterization of a relatively unproblematic transfer of Japanese management techniques on the production side (“blue collar bright sides”) against considerable friction and disappointment on the administrative part (“white collar dark sides”) continues to exist fairly undisputed.

In summary, the accusations brought forward by non-Japanese employees in Japanese MNCs' white collar sector (usually employed at the local subsidiary level) encompass:

- *general leadership style*
 - incomprehensible concept of “leadership”
 - inability to deal with conflict situations
 - vague or equivocal policies and strategies
- *communication and decision-making process*
 - “dual system”, effectively barring locals from participating
 - exclusive information held by the Japanese side
 - “consensus management” not applying to locals
- *individual Japanese managers*
 - frequent personnel changes
 - “closed” mentality, arrogant

- avoidance of close contact with locals
- no respect for local customs
- headquarter's behavior
 - inadequate support
 - little understanding or effort to understand the local situation
 - belated or insufficient reaction to local initiatives

Though these findings certainly do not apply to all Japanese MNCs, and in the majority of cases far from all of the above will hold true at the same time, more positive examples of managerial and organizational “geocentrism” appear to be exceptional enough to warrant closer scrutiny. The general opinion, however, about the intercultural work environment inside these Japanese companies is less sanguine.

Culture in Organizations

Although many have lamented about the difficulty to conceptualize culture, and definitions attempting to cover as many of its multifarious facets as possible abound, culture as a phenomenon influencing the management of multinational organizations continues to be respected as a sizeable variable (Hofstede 1991, Hampden-Turner 1991). Local, regional, and national differences on the one hand, intra-organizational cultural distinctiveness among the various units within one and the same global company on the other lends credence to the applicability of the term “multicultural” to the MNC. In this sense, culture adopts a complementary role next to the MNC's more formal systems and structures, mutually influencing, reinforcing, and transcending each other to become what has been referred to above as the organization's “administrative heritage”.

The environment's role in shaping the MNC's internal structure and, more specifically, the governance mode of headquarter-subsidiary relations has already been highlighted. Apart from structural and, thus, measurable differences between countries, such as legal and political systems, economic and social conditions, language, etc. culture also influences the extent of the apparent “environmental gap” through a psychological dimension (Fayerweather 1982). It appears that a very concrete, yet somewhat covert, issue continues to exist unresolved, causing Hymer (1975) to note that “ethnic homogeneity increases as one goes up the corporate hierarchy; the lower levels contain a wide variety of nationalities, the higher levels become successively purer and purer.”

Easier communication and a competency or fluency in the national customs (of headquarters' location) are usually cited as an explanation for this purity. However, explicit and, perhaps even more pervasive, implicit attitudes vis-à-vis

the "other", i. e. foreign employees, competitors, customers, etc. do influence the way an MNC is organized in terms of its formal structure and its management behavior.

An MNC's relative advantage of internally transferring resources (essentially capital, technology, people) is thus not merely a technical issue, subject only to strategic considerations. Abo (1989) has pointed out that even something as seemingly "hard" such as technology carries "human-related aspects" based on national differences, resulting in a "number of problems with the international transfer" of technological, competitive advantages, problems understood to relate to the issue of organizational behavior.

Organizational behavior, however, extends beyond the cross-border transfer of internal resources. As a concept, it usually embraces information and communication processes and decision-making within an organization. Among recent developments in international management research, behavioral aspects in organizations have been rated accordingly as one of the prominent areas studied, culture being the main focus of attention (Ricks et al. 1990).

Cultural diversity within a multinational company essentially becomes apparent in the interaction of people from different cultural backgrounds. Here, intense research efforts to describe cultural differences and potential pitfalls in (intercultural) communication and management processes, prescribing necessary personal traits and human resource development measures in order to alleviate some of these problems, are almost legion. And yet, far from being resolved, cross-cultural themes continue to dominate the practical and theoretical debate.

A Japanese Approach to Organizational Effectiveness

Organizational deficiencies, particularly those related to the efficacy of information, communication, and decision-making processes, form the basis for theoretical advances collectively labeled "organizational development" (OD) or "organizational learning" (OL). A huge body of contributions, far beyond the reach of this paper for any meaningful recapitulation, has meanwhile emerged. The main thrust of the various models offered lies in their attempt to adequately deal with complexity as a prominent feature of a company's environment and the firm's interior design of structures and processes, respectively. Sensitivity in monitoring external developments, profoundness and accuracy in processing information throughout the organization, and flexibility in managerial action all form part of what may be considered "organizational competency".

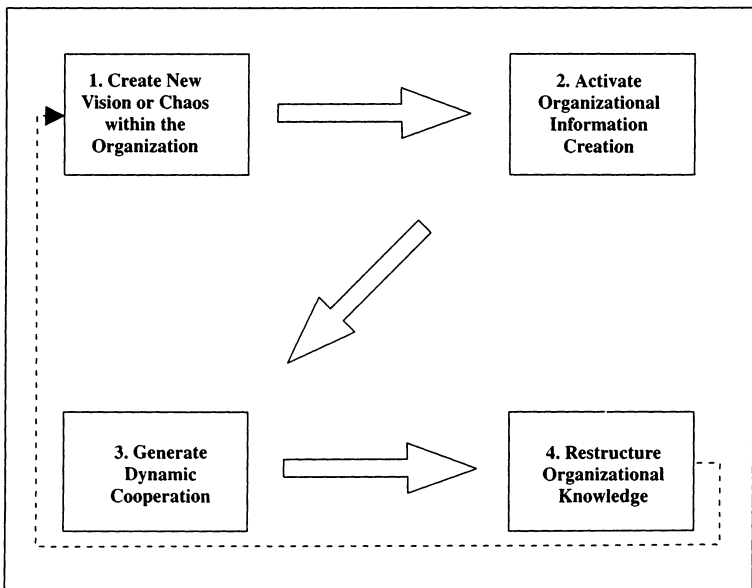
Ironically, despite the negative evaluation of Japanese organizational behavior abroad, it is an "emerging theory of the Japanese firm" (Daniel and

Reitsperger 1991) that features a combination of broad skill development, information-processing capacities, and decentralization, all hallmarks of the OD postulate. Building on the distinctive use of information, this approach is associated with Nonaka and his colleagues.

"The information creation paradigm, in contrast, stresses the process of creating meaningful information through personal interaction. The quality of information becomes more important than the quantity. Inductive, synthetic, and holistic methodologies become more useful than the deductive, analytic, and reductionistic ones used in information processing." (Nonaka 1988)

As a team approach, it advocates the fostering of interdisciplinary perspectives and ideas and their task-oriented close and dynamic cooperation, stimulating innovative information creation and problem solving. Figure 2 presents a model of this process, beginning with the creation of a new mission or vision, proclaimed by top management and providing guidance and inspiration for organizational members.

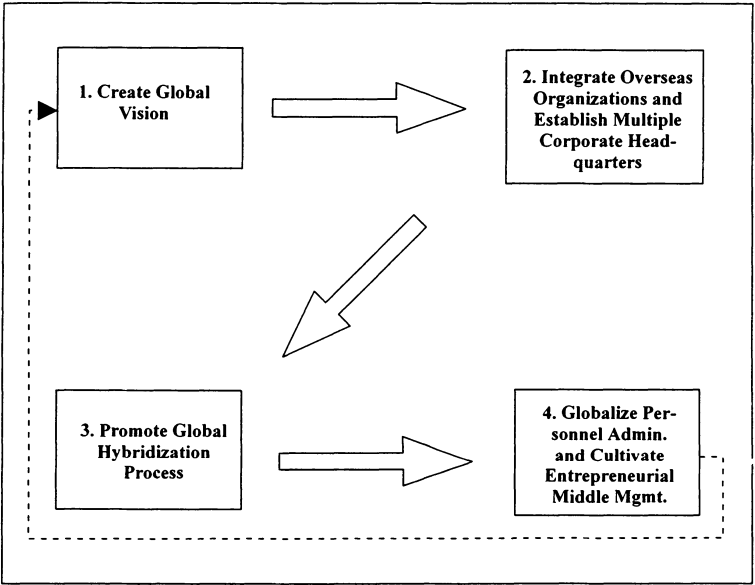
Figure 2. Nonaka's Model of Organizational Learning



As a vision, the new course will usually not be an elaborate policy that lays out a detailed plan. Instead, the initiative's main purpose is to invalidate traditions, long-held beliefs, and routines that have been prevalent throughout the organization by setting new, challenging goals. At the same time, such a proclamation will leave ample room for interpretation and participation in the translating process from a vision into a specific course of action.

This task is given to lower-level echelons ("middle managers"), who will then have to initiate the necessary environmental screening and organizational re-orientation activities. Searching, processing, and applying data (the "information creation process") is furthermore based on team- or project involvement of employees across hierarchical levels and business functions and facilitates the dissemination of new information acquired, leading to a restructuring of organizational knowledge.

Figure 3. Globalization Process of Japanese Companies



The organization has thereby reached a new equilibrium at, it is hypothesized, a higher level of competence due to substantial learning effects during the preceding process. After a period of stability, a new OD cycle may be instigated. A learning organization is thus one that is capable of systematically and continuously progressing through activities of information creation, processing, diffusion, and problem-oriented usage. What is of interest here is the model's application to the globalization of Japanese companies (Nonaka 1990) (Figure 3).

The dynamics of this process are similar to the one described above. A "global vision" provides guidance and meaning for local subsidiaries and encourages information-creating activities. An accompanying structural reorganization, however, evolves as a necessary condition for achieving desired cooperation effects. As a regiocentered strategy, it is aimed at establishing several regional headquarters which, due to their elevated status in the corporate hierarchy, are to fulfill a threefold purpose: 1) assisting local subsidiaries through a provision of centralized functions (e. g. finance, logistics, etc.); 2) coordinating intra-regional affairs; and 3) helping to enhance an overall corporate global perspective.

The ensuing "global hybridization" of distinctive business practices and diverging viewpoints, part of the information-creation paradigm, depends on the ability to promote cross-border (and cross-cultural) interaction. This, however, is a function of the willingness of organizational actors to engage in such activities. Here, the model offers an administering of corporate-wide personnel development measures (e. g. global job rotation to create a cadre of internationalized managers) and a fostering of an entrepreneurial awareness among middle managers geared toward engaging in information-creation programs irrespective of corporate or national boundaries.

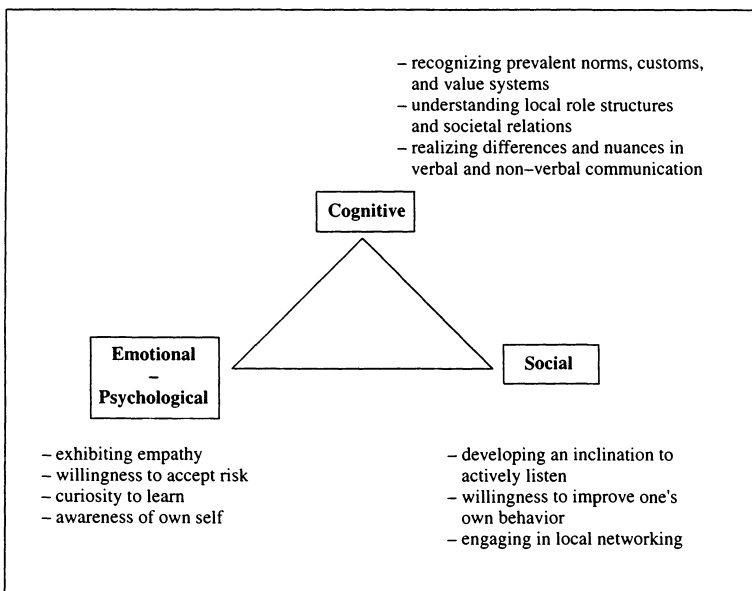
Although selected cases as support for the validity (and feasibility) of this model are presented, these examples remain curiously vague about the details of the actual processes' unfolding, of barriers and problems encountered, or of necessary facilitating measures. While endorsing the model's procedural, dynamic perspective, at least two dimensions need to be clarified:

- The *individual manager*: what social, cognitive, and psychological qualities are necessary to effectively participate in this type of cross-cultural information network?
- The *organization*: what are possible organizational methods for achieving effective cross-cultural interactions between MNC employees?

Management of Diversity

Several contributions have substantiated the individual manager's role in an MNC (Edström and Galbraith 1977, Nonaka 1988, 1990). That the participants in intercultural work settings have an important influence on the shape and outcome of this encounter is almost a truism. Demanding a more profound analysis, though, is tantamount to asking what conditions individuals must or should fulfill in order to effectively interact cross-culturally.

Figure 4. Intercultural Competence for Managing in Diverse Environments



The author, a member of a bi-national (Japanese-German) research team, has endeavored to probe into the interaction structure of Japanese and German (white collar) employees of Japanese companies in Germany. Eleven Germans and twelve Japanese in five companies, representing different functions and a variety of hierarchical levels – from top management to assistant of department head – were interviewed intensively about their experiences in working with

people from the other culture. Figure 4 presents some results, whereby “competencies” need for intercultural interactions have been identified through the interviews and clustered into three categories.

Apparently, such interactions are characterized by an adjustment process embracing a range of cognitive as well as emotional and social factors. They largely confirm contemporary theories underpinning, for example, intercultural training designs (Brislin 1981, Triandis 1989), though in practice these pre-departure preparatory courses continue to be rarely offered, not to mention the scarcity of training programs accompanying a stay abroad or offered after repatriation.

In addition, and mindful of their preliminary nature, a few more notable results can be stated:

1. Although there is an indication that participants develop a sense of ease or fluency concerning intercultural interactions over time, no deterministic process of a clearly delineated adjustment exists. There is certainly no “end” in terms of completely overcoming the (latent, sometimes eruptive) elements of uncertainty, misunderstanding, and even distrust in these interactions. In return, actors tend to adopt coping strategies (ranging from “always asking about every minute detail” to “avoiding contact wherever possible”) to alleviate some of the interculturally derived stress.
2. Concentrating too heavily on (however) acquired notions of “the” Japanese or “the” German is dangerous. It severely complicates the ability to accept the other as an individual in his or her own right. On the other hand, knowing little to (almost) nothing about the other’s background – as was common among our German interview partners – means that wheels need to be reinvented: despite the intense research efforts of “Japanists” over the past 20 years, little has trickled down to even the non-Japanese employees of Japanese companies.
3. Successful intercultural interactions – in terms of mutually beneficial outcomes – appear to depend on the participants’ ability to reflect, individually as well as jointly, on the characteristics of their *common* interaction.

Reflective behavior is a point central to the notion of organizing for successful, “geocentric” MNCs: an attempt to deal with and make use of their inherent cultural diversity.

Organization of Diversity

A model calling for a transnational company to effectively stimulate organizational learning through a process of information creation, multidimensional cooperation, and knowledge reformation, is in line with a modern economic theory of hierarchies: a decentralization of information and its processing as subject of a “theory of teams” (Radner 1992). Thus, it is economically rational to decentralize incentives and control, i. e. allowing for more self-organization within a context of growing complexity faced by those firms internationalizing corporate activities. Nonaka’s concept of a flexible, group- or team-based organization, its members comprising functionally, hierarchically, and culturally divergent backgrounds, may thus be considered a suitable design for the transnational learning organization.

However, this framework has evoked considerable criticism for being full of “high philosophy, grand themes, and sweeping metaphors”, leaving the “gritty details of practice” untouched (Garvin 1993). The indication is evident: effective organizational learning and intercultural adaptation rarely emerge by themselves. There appears to be a need for initiating, nurturing, and evaluating this process, eventually leading to its institutionalization as a permanent management theme within the organization.

This insight, however, is not exactly new. Earlier OD models had proclaimed a similar need for conscious strategies and methods to facilitate the general problem solving capability of firms. For intercultural work settings, these methods need to address the following questions (Morris and Sashkin 1976, Adler 1983):

- How can interaction processes, leading to a diminution of (possible) friction and an enhancement of organizational effectiveness, be created?
- How can a balance be found between individual cultural rationalities and the need for overall organizational integration mechanisms?
- How can a variety of perspectives (i. e. culturally based values, norms, ideas, etc.) be made mutually stimulating and supportive, further benefitting organizational competitive advantages?

Acknowledging that in complex environments results of individual actions cannot be predicted by employing simple input-output, cause-effect schemes, OD models have attempted to carefully manipulate the context of organizational activities. A prominent example is the standardized use of the “problem-solving process”, a dual-goal instrument attempting to facilitate the solution of imminent, task-related problems and, through its team-based orientation, to foster group cohesiveness (Figure 5).¹

Figure 5. “Problem-Solving Method” and Organizational Learning

Phase	Task	Organizational Learning
1. Diagnosis	Identifying and analyzing a problematic situation	1. Create new strategic vision
2. Solution menu	Generating alternatives for action in order to solve the problem	2. Activate information creation
3. Selection of solution and action planning	Selecting a preferred course of action, planning for its implementation, and establishing performance criteria for its evaluation	3. Stimulate dynamic co-operation
4. Implementation	Implementing the agreed upon plan	
5. Evaluation	Studying the consequences of action; generalizing evaluation results concerning the action and the process in toto to achieve learning benefits	4. Transformation of accumulated information into organizational knowledge

Although originally developed for domestic application, this method is closely related to the organizational learning paradigm advanced by Nonaka (as indicated in the right column of Figure 5). As a form of institutionalized “self study” (Torbert 1983), and through its iterative design, it is a potential analytical tool for intercultural work situation, i. e. a process that receives and interprets feedback on intercultural interactions with a view toward practical solutions.

Figure 6 provides an example of such a diagnosis and action inference session. In this case, German and Japanese employees of Japanese subsidiaries in Germany have analyzed their work situation employing the “problem-solving method”.

About ten Japanese and an equal number of German participants were first asked to identify and analyze typical problem situations in their personal work environment. In this first round, the two groups were separated from each other to assure an open flow of opinions unhampered by any language problems. In a second session, both groups then jointly presented their results and evaluated respective propositions. A conspicuous difference, however, exists between the usual (solution-oriented) application of this method and the procedure here: the action phase is missing due to the fact that participants came from different

organizations. Thus, we are dealing with an abbreviated version of the instrument, with an emphasis on analysis and mutual awareness building.

Figure 6. “Problem-Solving Method” in an Intercultural Context (Example)

Phase	Task	Examples ("G" = answers given by Germans; "J" = answers given by Japanese)
1. Diagnosis	<ul style="list-style-type: none">– identifying typical problem situations of intercultural cooperation– analyzing obstacles negatively influencing cooperation	<ul style="list-style-type: none">– lack of access to information (G)– no clear feedback from Japanese (G)– management is too strongly committed to parent company (G)– Germans shirk responsibility (J)– high egotism and selfishness (J)– low flexibility and inadequate team orientation (J)
2. Solution menu	<ul style="list-style-type: none">– generating possible solutions	<ul style="list-style-type: none">– mediation through an interface (G)– joint Japanese-German top management (G)– intercultural training (G)– improving own assertiveness (J)– more detailed job description (J)– intercultural training (J)
3. Selection of solutions and action planning	<ul style="list-style-type: none">– assessing possible solutions in terms of their feasibility and/or desirability	G: most important = “interface” J: most important = “improvement of personal assertiveness”

Concluding Remarks

Not everything, of course, can be solved through a procedural instrument as described above. OD theory is based on an understanding that management continues to set the stage, notably deciding on the basic strategies and the contextual frame inside which intercultural cooperation can proceed. In terms of a company’s globalization process, this encompasses not only the promulgation of a broad mission but also the willingness to promote a truly global hybridization process through the allocation of necessary resources for the cultivation of, for example, a transnational human resource development program or a joint, company-wide collaboration in R & D. This readiness is a prerequisite for any attempt to achieve organizational competence by fostering intercultural cooperation and mutual learning efforts.

While Bartlett and Ghoshal's (1989) vision of a "transnational mentality", a "matrix in the minds" of managers active across borders, evolves as a necessary condition for building the organizational capability for dealing with the complex process of internationalizing activities along the organizational value-adding chain, the actual realization of an effective multicultural company seems to depend on competencies related to more procedural qualities of organizational behavior: efficiency and effectiveness of information and communication management, responsiveness to external and internal development, and learning to organize the mutual acculturation process.

Japanese companies, it appears, have ignored their domestically developed ability for organizational learning when moving abroad. Reconsidering this remarkable negligence, Japanese MNCs may evolve as a new type of multicultural organization in the not so distant future. It will be worthwhile monitoring this development closely.

Note

- 1 Far from remaining solely a theoretical blueprint, companies like Xerox have adopted this technique due to its practical orientation and its simple, yet profound, approach to organizational problem solving; see Garvin (1993) for an illustration.

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Frank-Jürgen Richter/Yoshiya Teramoto

“Interpreneurship”: A New Management Concept from Japan

Abstract

- In Japan a new type of entrepreneur is changing the traditional styles of management. Entrepreneurial firms are entering corporate networks in order to exchange and to develop knowledge resources.
- This article identifies and discusses the principal factors of “interpreneurship” as a new management concept. Japanese style interpreneurship is further compared with the Schumpeterian view of economic change.

Key Results

- As a consequence the framework of “interpreneurship” seems to be able to become a new wisdom of how to generate innovations in turbulent environments.

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Introduction

Today a new type of entrepreneurship is introducing innovative attitudes in the traditional world of Japanese business. This new Japanese-style entrepreneurship is related to high-tech startups and the extraordinary economic growth. The emergence of creative entrepreneurs in a world of life-time employment is about to change the traditional structure of Japanese management practices.

Japanese entrepreneurial firms are increasingly joining forces in temporal limited projects to perform joint product developments or joint marketing activities. They are creating "linking values" with one another forming huge networks of cooperative relationships (Teramoto 1990). The cooperative agreements help the firms to learn the partners' knowledge and to mobilize new knowledge resources. The driving force for entering corporate networks are visionary entrepreneurs who perceive inter-firm partnership as business opportunities. Under certain circumstances, entrepreneurial activities change the character of whole industrial branches.

The Schumpeterian legacy of such entrepreneurial networks seems to be self-evident. Schumpeter's theory of entrepreneurship turned its attention from equilibrium to a concern for economic change. His work emphasized the role of "heroic" entrepreneurs in creating and responding to economic discontinuities (Schumpeter 1934). The variety created by innovations opens up new opportunities. Schumpeter's approach describes how individuals can take the highest possible profit by creating industrial organizations. In this sense, entrepreneurship means a zero-sum game situation and remains almost wholly confined within a Darwinian mould. On the other hand, the generation of collective knowledge within networks ensures the success of technological innovations. Change triggered by individuals is replaced by an economic transition which is stimulated by the interplay of entrepreneurs.

It is the aim of this paper to illuminate the new Japanese-style entrepreneurship and to search for a theoretical explanation of its emergence. This type of entrepreneur shall be called "interpreneur" to express its individual creativity as well as its interweaving with a set of organizations in a network context. The concept further holds that the organizations led by interpreneurs have shared futures and that they are not absolutely discrete entities. The behavior of interpreneurs is accordingly called "interpreneurship". Interpreneurship will be described by comparing it with Schumpeterian entrepreneurship and with approaches of intra-organizational entrepreneurship, normally referred to as leadership or intrapreneurship. Finally, the paper explores the effectiveness of learning strategies of entrepreneurial organisations.

Historical Grounds of Entrepreneurship

In the past, there have been many different views on the meaning of the term "entrepreneur". The fact that entrepreneurship is increasingly important in influencing the economy has made entrepreneurship a frequent subject of study in economic sciences. Entrepreneurship is perhaps the phenomenon which is most emphasized yet least understood by economists.

The Schumpeterian View

Although Schumpeter's concept of entrepreneurial change lay dormant for several decades, it recently found its way back into academic discussions. Born in 1883 and educated by economists of the "Austrian School", Schumpeter focused on three basic assumptions. First, capitalism is a system of continual change, second, the system's central figures are entrepreneurs, and third, change arises because of entrepreneurial innovation (Schumpeter 1934).

Schumpeter compares his entrepreneur with the "capitalist" whose role is to accumulate, and the "technologist" whose role is to invent. The entrepreneur's role, however, is to innovate. The defining characteristic of entrepreneurship is the doing of new things. It is defined in terms of non-routine activities. Hence, entrepreneurship is not reactionary in nature, but it adds a creative meaning to the image of a calculating capitalist and a skillful technologist which had dominated until Schumpeter's time.

Schumpeter's economic contribution can be seen in his focus on the progress of growth. Schumpeter saw entrepreneurship as a form of economic change that can never be stationary. Through the process of change, entrepreneurial roles are relinquished over time, thus making way for new ones. Because entrepreneurship creates wealth as it destroys existing market structures, Schumpeter describes it as a process of creative destruction. He argued that static equilibrium models are largely irrelevant to economic development in market systems, because price competition is not the primary source of innovation.

Intrapreneurship

Intrapreneurship theories contend that visionary individuals are the catalyst for organizational transformation (Pinchot 1986). Leaders are skilled in integrating organizational diversities in order to stimulate change. Organizational change is carried out in order to guarantee better corporate performance (Marsh/Mannari 1986).

Intrapreneurship approaches emphasize the charismatic character of successful leaders. Charisma refers to a special quality that enables leaders to mobilize activity within organizations through specific actions combined with personal

characteristics. Such a kind of intrapreneurship is a vital aspect of managing large-system change. Charismatic leaders, however, need to be more than just charismatic. Charismatic leadership has to be bolstered by instrumental as well as institutional leadership to be effective (Nadler/Thushman 1990).

The literature on leadership also focuses on middle managers in entrepreneurial settings (Fulop 1991). These managers contribute to the incremental processes of innovation and act therefore as quasi-entrepreneurs. The entrepreneurial heroes of today are no longer just top managers. Rather they are the people doing the real day-to-day business such as research and development, manufacturing and marketing. In this sense, Nodoushani talks about the "end of the entrepreneurial age" (Nodoushani 1991). Or in other words, everyone in a company is able to participate in the process of entrepreneurship.

Emergence of Networks

The theoretical foundation of the interpreneur is based on the network approach as developed by organizational scientists (Laage-Hellman 1989, Teramoto 1990). Industrial networks are intermediate forms of governance structures between market and hierarchy. They link firms taking part in cooperative activities. The firms exchange resources and make joint efforts in knowledge creation.

Networks are always in the midst of change. Whereas some companies decide to exit the network, others newly join it. When entrepreneurial firms link up in networks, they enlarge their sphere of commerce. They search for external sources of innovative knowledge and enter alliances with like-minded firms. The corporate leaders of networking organizations surmount the traditional idea of entrepreneurship and intrapreneurship because they emphasize the social dimension of economic behavior. Entrepreneurial action is worthless if not linked to the contextual conditions of management.

The interpreneur is an entrepreneurial individual who has the entrepreneurial strength to create innovations and the coordinating capability to lead people. He shows a strong commitment to the environments which surround the entrepreneurial setting. He also tries to integrate the environment into the firm's scope of action. Hence, he is a creator, maintainer and promoter of industrial networks. In order to propose a more general understanding of the new concept, the individual characteristics of the interpreneur and the underlying properties of "interpreneurship" shall be theoretically derived from their dichotomy with the traditional approaches of entrepreneurship and intrapreneurship.

Differences between the Concepts

The concept of interpreneurship is rooted in the tradition of entrepreneurship and intrapreneurship models. The strongest difference, however, is the tight link of the interpreneur with his business environment. He enlarges his entrepreneurial initiatives and shares his business interests with like-minded individuals and organizations. The differences between interpreneurship and the traditional approaches can be seen in three dimensions and are as follows.

Figure 1. Three Dimensional Comparison

	Entrepreneur	Intrapreneur	Interpreneur
Organizational boundary	open	closed	permeable
Evolutionary perspective	darwinistic	egocentric	altruistic
Type of innovation	technological	cultural	social

Organizational Boundary

In Schumpeter's entrepreneurial settings, firms are seen to be open to their business environment, from which they receive their vital resources. The entrepreneur changes the firm's structures in reaction to environmental influences. Hence, the relations between the system elements are lived short and are subject to frequent shifts. Entrepreneurs perceive the environment as a major source of uncertainty. They adopt their organizations' structures, strategies and cultures to environmental changes. Hence, there is a tension between the organization and its environment.

The intrapreneurship model, on the other hand, is based on the closed systems approach. Leaders act within the narrow organizational boundaries of their firms. They try to optimize the human interrelations of the employees by integrating the existing incentives, capabilities and purposes. Leaders are, by priority, protagonists of self-induced and selfish organizations. They lack the linking dimension to the business environment.

A special type of entrepreneurship, on the contrary, is needed for organizations operating in turbulent environments. The goal of this type of interpreneur is to create a systemic relationship between his organization and the prevailing environment. Shareff argues that the new entrepreneur has to be in a partnership relation with the environment. So called "ecovisions" design mutual exchanges between organizations and their environments (Shareff 1991). Hence, the organizational boundary is neither closed nor open, but rather permeable. Perme-

able organizations allow environmental perturbations to pass through and reach the employees within the organization. As a result, organizations managed by interpreneurs become more flexible than it would be the case for open or closed organizations.

Evolutionary Perspective

Schumpeter clearly admired Darwin and emphasized the importance of Darwin's theory for the understanding of economic change and the destructive role of the entrepreneur. Because success breed resistance to change, the most important task of entrepreneurs is the destruction of the existing economic order. Schumpeter's main emphasis is on economic change caused by the replacement of entrepreneurial firms by others. Only the most robust organizations have a chance for survival. The idea of creative destruction is based on Darwin's principle of selection of the fittest. The whole evolutionary process occurs as a sequence of variation, selection, and retention. Schumpeter's transfer of Darwin's theory on the economic system is based on a long tradition of Darwinism in social sciences.

Leaders, on the other hand, trust in the internal growth potential of a given organization. They try to trigger synergy effects among the different subunits and individuals of organizations. Internal growth seems to be convenient for the late phase of the corporate life-cycles, when the given potential of an organization has to be used in order to preserve a specific competitive edge. During the early phase of start-up companies, however, ignorance of external growth potential can give away chances for rapid corporate evolution. In this phase, a high amount of resources has to be concentrated in order to advance into new technologies.

In the case of interpreneurship, organizations are in an altruistic relationship with their environments. Rather than evolving as single units by adopting to hostile environments or concentrating on internal growth potential, they coevolve with their environments. The organizations actively exchange knowledge resources with firms integrated in a cooperative network. By doing so, however, they sometimes sacrifice evolutionary speed in the short run because they strengthen the competitiveness of the environment. But they receive indirect long-run rewards that compensate for the immediate sacrifice. Simon calls such an organizational strategy "weak altruism" (Simon 1983). Weakly altruistic organizations are finally exposed to more benevolent environments than non-altruistic ones.

Type of Innovation

Schumpeter's entrepreneur revitalizes organizations primarily through technological innovations. Technological innovations create market competitiveness and secure the survival of the firm. Schumpeter put the importance of technological innovations down to the fact that the technological achievements of the first industrial revolution fundamentally changed the socio-cultural mind of mankind.

Intrapreneurship theorems emphasize the cultural transformation of firms. Intrapreneurship can be conceived of not only as technological innovation; it also includes innovation in organizational structures and culture. Organizations are shaped by their leaders and management visions are good opportunities for a transformation of the organizational culture. Hence, one could talk about cultural innovations generated by leaders who are smoothly changing the behavior of their employees and of their organization as a whole.

Because to their interweaving within industrial networks, interpreneurs take advantage of the possibility to trigger social innovations. Social innovations include the renewal of the basic pattern of social interaction. Networks can not be managed by performing demarcation strategies in response to hostile environments. Rather they have to be run in an atmosphere of mutual trust (Laage-Hellman 1989). Hence, interpreneurship demands a shift in the dominating social paradigm and interpreneurs are asked to proclaim this shift. Due to their engagement, interpreneurs shape the public opinion.

Different Approaches of Learning and Self-perception

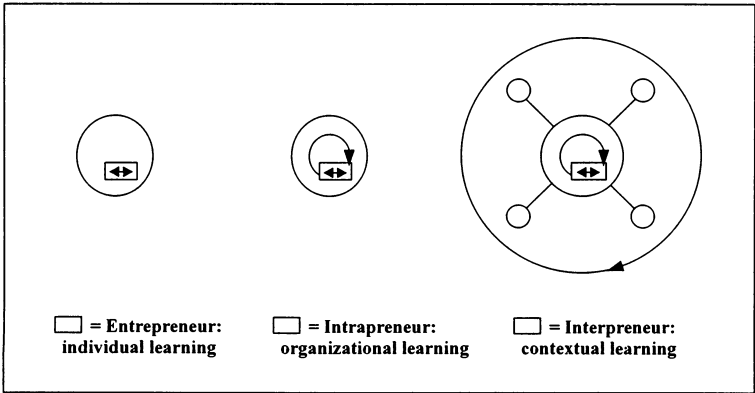
Due to their capability of triggering changes, entrepreneurs and leaders as well as interpreneurs have to learn how to improve the given state of their organizations. They increase their understanding of reality by observing the results of their acts. Or in other words: they learn, through their processing of information, if the range of their potential behavior is changed.

Learning procedures within industrial organizations are already documented in the literature. Argyris and Schön for example argued that organizational learning is a necessary mechanism for the evolution of the firm (Argyris/Schön 1978). They use the concept of organizational learning as a metaphor to describe behavioral and cognitive changes within organizations. Organizations do not literally learn, rather the individuals in organizations link knowledge among themselves and therefore generate new values.

The three concepts of entrepreneurship shall be conceptualized in light of a perspective which regards organizations as learning systems. The fundamental contribution of such a perspective is the recognition that organizational change

can be modeled as a learning process (Zahn/Richter 1995). Schumpeter's entrepreneur, corporate leaders and interpreneurs have all the capability of learning although their focus of learning is somewhat different. They learn either by personal experiences, by interacting within the organizational borders or by grafting knowledge from the surrounding network.

Figure 2. Different Approaches of Learning



Individual Learning

Entrepreneurs are heroic individuals who have particular skills which distinguish them from “normal” employees. They guide their organizations’ growth through their individual learning capabilities. Entrepreneurs take an active role in enacting ideas which apparently seem to be important for the enhancement of the organization. Experiences from acting are stored in their minds, and these experiences modify an organization’s future behavior.

Learning efforts within firms managed by entrepreneurs, however, remain limited, because individual orientation does not permit cooperative learning activities. Their knowledge is not transmitted throughout the organization. Entrepreneurs remain loners and are not able to profit from the synergy effects which could theoretically be gained through wider learning activities. Organizations frequently know less than the entrepreneurs which are leading them. Problems in communication due to the hierarchical difference between entrepreneur and employees make it normal for the whole to be less than the sum of the parts.

Organizational Learning

Intrapreneurs emphasize the learning capabilities of the whole organization. They psychologically help people perform in the face of challenging goals and trigger learning activities of all organizational members. Learning, in this sense, is discovery. Intrapreneurs discover themselves and the knowledge potential of their social environment. Learning takes place when intrapreneurs integrate new ideas into existing cognitive structures and reconcile incongruent organizational experiences.

Organizations learn in ways that are different from and possibly greater than the sum of the individual learning of the organizational members. Organizational learning procedures are in fact composed of many individual learning procedures. Intrapreneurs take the role of learning stimulators and, in this process, serve as examples for the whole organization. Organizational learning consists in the interplay of individual and comprehensive learning elements.

Intrapreneurs as well as organizations as a whole store tokens of knowledge in long-term memory. The memory and the learning system, however, remains limited on an intra-organizational base. Generative processes through which the organization creates environments beyond the narrow organizational boundaries are merely emphasized.

Contextual Learning

A company does not learn only within the closed borders of the organization, but further acquires knowledge from the outside, i. e., by entering corporate networks (Teramoto 1990). The purpose of entering inter-firm partnerships is to get access to the partner's skills and know-how and to transfer them for use in one's own organization. Companies enlarge their learning activities beyond their narrow organizational boundaries and start contextual learning. When entering networks, firms' boundaries become flexible in order to respond better to environmental opportunities.

The learning procedures of organizations are therefore set in the environmental context of a company. Morgan and Ramirez propose that organizational learning occurs when companies act together to solve problems as equal "co-learners" (Morgan/Ramirez 1983). Firms build up knowledge through which relationships with other companies can be enriched and enlarged. Interaction with the network partners creates actual experiences to refer to, thus adding to the knowledge supply. Actions resulting from new knowledge is interpreted using previous knowledge. As the rate at which organizations must assimilate new knowledge continues to increase, grafting from network partners will become a more frequently used approach to acquire knowledge which is new to them.

Interpreneurs are the agents to trigger contextual learning. On the one hand, they play an active role in cooperating with network partners and therefore in grafting knowledge from beyond the organizational boundaries. On the other hand, they distribute the acquired knowledge within the organization. Due to the distribution of knowledge, the interpreneur and the employees develop new knowledge by piecing together items that they obtain from outside with items that are already known.

Empirical Evidence of Interpreneurship in Japan

From Entrepreneurship to Interpreneurship

Japanese entrepreneurs such as Matsushita's founder Ikijiro Matsushita, Honda's Soichiro Honda and Sony's chairman Akito Morita can be regarded as outstanding exceptions. The common characteristic of these entrepreneurs is that they founded their companies virtually from scratch. They crucially influenced the growth of the Japanese economy and they even created whole new industries. These entrepreneurs are characterized by vitality, vision, creativity and confidence to act on new opportunities. Behind their success lies the hard work of enterprising persons and the unerring instinct for market demands.

In general, however, Japanese entrepreneurs do not represent the Schumpeterian ideal of charismatic heroes having the ability to change the structure of the economy. In Japan, innovations effected by solo business persons are less unambiguously traceable to their own actions than are the innovations in Western firms (Marsh/Mannari 1986). Japanese entrepreneurs are even described as engineers who guide their companies with their technological genius but who lack the charismatic seduction of intrapreneurship (Yasumano 1993). Engineers are seen as a functional alternative to entrepreneurship in Japan's economic growth. There is no doubt, on the other side, that Japanese culture is deeply rooted in entrepreneurial visions (Shimazaki 1992). Entrepreneurial visions are the driving forces behind corporate evolution.

There is, however, a new type of entrepreneur in Japan, who is different from Schumpeter's theoretical description. This entrepreneur develops his abilities within small businesses. Japanese small businesses are playing a great role in shaping the Japanese economic structure. The world of Japanese business, according to conventional thinking, consists of huge corporations whereas start-ups by entrepreneurs are seldom mentioned. Due to the creative economic visions of entrepreneurial individuals, start-ups are a major source of employment and of economic growth. Though the number of newly established firms is increasing since the second half of the 1980's, there are not so many successful small venture firms. The successful firms are, indeed, pursuing a network strategy.

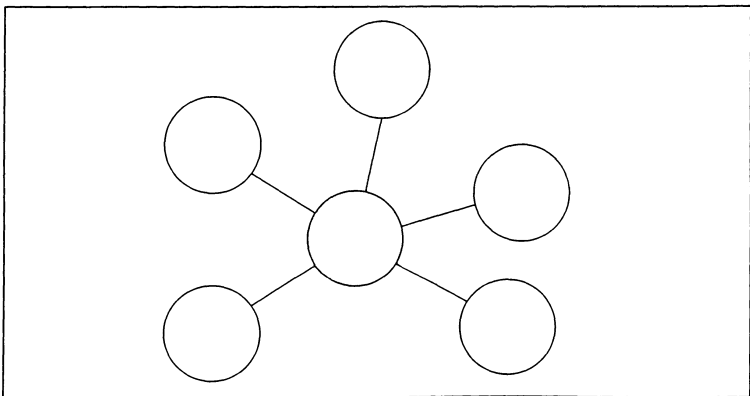
A particular phenomenon of Japanese small business are the so-called *igyoshu koryu* (Stam 1992). Entrepreneurs meet regularly at meetings and seminars sponsored by local authorities. Out of these meetings networks of firms emerge and form alliances for joint activities. In order to overcome the shortage of intra-organizational resources, Japanese small businesses try to create corporate networks for developing new technologies. The following section illustrates an example of a Japanese interpreneur managing his firm within a network of small venture firms.

Case Illustration: Suzuki Sogyo

Although Suzuki Sogyo was established as a trading company, it was reborn as a high-technology company in the 80s. At present, its main business is the "printing on the curved surface" and the "gel" business. The printing technology is used for car interiors, whereas the gel is a kind of silicone used for sport shoes. The firm employs 200 persons and reaches a sales figure of 20 billion Yen per year.

Both technologies have been developed in cooperation with other Japanese firms of approximately the same size as Suzuki Sogyo. Mr. Nakanishi, the president of the company, initiated contacts to start-up firms, which also have had interests in developing those business lines. During the phase of common research and development, there was no organizational boundary between Suzuki Sogyo and its partners. The network alliances existed only temporarily and were dissolved after the product was developed.

Figure 3. Suzuki Sogyo's Network Pattern



Today, Suzuki Sogyo continuously changes its network partners in order to seek new business opportunities. One instrument of partner search and partner selection is the *igyoshu koryu*, mentioned above. Additionally Mr. Nakanishi analyzes all kinds of social information around him in order to be provided with tips on new technologies and potential network partners.

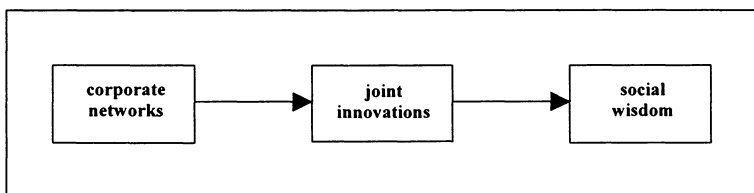
Within the company, Mr. Nakanishi actively transmits the knowledge which he and his employees grafted from his network partners. He promotes internal and external employee transfer to enhance the intra-organizational and inter-organizational learning effects. Mr. Nakanishi opposes formal cooperation, whether involving individuals or firms. He favors informal arrangements on the intra-organizational and inter-organizational level.

Implications and Conclusions

The argumentation of the paper is that both Schumpeter's entrepreneur as well as models of intrapreneurship have an inadequate perception of management. While correctly stressing the contribution of the personal qualities of entrepreneurs/leaders (creativity, managerial ability, etc.), both approaches virtually ignore the equally important dimension of contextual integration. Entrepreneurship and intrapreneurship have to be reconsidered in terms of emerging contextual opportunities.

The case study illustrated that Japanese entrepreneurs can be closely linked to their business environments. They act as though their organizations are virtual corporations (Davidow/Malone 1992). The entrepreneurs have therefore been called "interpreneurs". They create industrial networks and start to exchange knowledge. Hence, they generate joint innovations. By doing so, interpreneurs enhance social wisdom and promote a real contribution to society. The evolution of the interpreneur's mind can be seen as follows.

Figure 4. The Evolution of the Interpreneurial Mind



Creating Corporate Networks

Entrepreneurship, as Shumpeter has indicated, involves the formation of new combinations. By entering alliances with each other, interpreneurs create networks of inter-firm relationships. They enlarge their firms in order to accommodate the increased knowledge. Firms are no longer single organizations with distinctive boundaries, but are becoming integrated in permeable governance structures.

Generating Joint-innovations

After joining industrial networks, firms exchange their resources and recombine them. By doing so, new technologies and knowledge emerge. Firms joining networks overcome the dilemma of increasing development costs which cannot be provided by single firms any more. Together, firms organized in corporate networks achieve real advantages in terms of economies of scale and economies of speed.

Enhancing Social Wisdom

As seen in the case studies, Japanese entrepreneurs appeal for a new age of symbiosis. They argue that if firms want to conserve their trust-worthiness, they have to be actively contribute for economic welfare and have to lessen, by a certain degree, their own ambitions. They initiate learning activities based on mutuality. Corporate knowledge has to be passed back and forth in order to become mutually fruitful for the firms as well as for their environments. Organization-environment relations are two-way streets by definition. The firms' growth would likely be limited if growth was not linked to the environment. This fact is called *kyosei* in Japanese (Morita 1992).

In such a positive sum-game, both partners may advance their knowledge. The firms elicit behavior from their counterparts, which allows both to do well and they obtain similar advantages in regards to their business environment. The firms' knowledge evolves at the same speed and intensity.

Japanese entrepreneurs seems to have understood the signs of the time. They have begun to liberate themselves from Schumpeterian selective growth and from internal self-consciousness induced by charismatic leadership theorems. Western entrepreneurs, however, seem still to be reluctant to enter corporate networks (Klandt 1987). Western entrepreneurs are characterized by a relatively strong need for independence and for personal self-development. Although they have a high growth potential, their individual development is not necessarily linked to firms in a wider network context. Future studies should analyze the topic of interpreneurship on a broader empirical base and include comparative studies with similar features in Western firms.

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Section 3: Aspects of Financial Management in Europe and Asia

Chun-Hao Chang/Krishnan Dandapani/Arun J. Prakash

Current Assets Policies of European Corporations: A Critical Examination¹

Abstract

- This paper studies the current assets policies of selected European corporations and highlights the probable areas of strengths and weaknesses of European current assets practices and their economic implications for global competition.
- We compare European corporations' current assets practices with similar corporations in the United States and their European counterparts, and evaluate the comparative efficacy of the short-term working capital management policies.

Key Results

- In the emerging global economy it appears important for European managers to focus on comparative short term financial management policies of their counterparts in other countries to maximize efficiency of operation and improve competitiveness.

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Introduction

Do European corporations in one country/industry manage their short term financial resources more efficiently than their counterparts in the United States? Are there lessons to be learned for European corporations from their counterparts across the continent (or vice versa)? These questions, and related issues, are the focus of this paper. Historical experiences show that the average firm has 40% of its assets employed in current assets. In addition, discussions with corporate executive suggest that the typical corporate financial manager spends 80% of his time managing day-to-day short term financial resources; hence, management of corporate finances becomes paramount in maintaining flexibility and a competitive edge. Proper current assets, or working capital, practices can result in real and substantial financial gains; for example, the just-in-time inventory holding practices of Japanese corporations led to a major reassessment and readjustment of U. S. corporations' inventory holdings. Despite the importance of working capital management² in an increasingly global marketplace, it has not received adequate attention in the literature. A recent survey by Madura and McCarty (1989) documents the total dearth of research in international working capital management practices and points out that this will be an important area for future research.

In an era of free markets and vigorous competition, more and more corporations in Europe reach beyond their borders to increase the avenues for raw materials and markets for products, and to internationalize their corporate finances. Under this major geographical realignment, one area which will continue to attract increased focus in the future is the management of working capital resources, as it offers individual firms new avenues for financing and investing. The European integration also offers a rare and inspired opportunity for European firms to reach beyond their geographical borders to develop and adopt more efficient working capital policies and procedures. Hence, a study of working capital practices in European nations assumes added significance due to its potential to increase efficiency, competitiveness, and flexibility.

In this manuscript, we compare working capital management practices of European firms with their U. S. counterparts, to identify possible areas of improvements. The paper is organized as follows. In the next section, we analyze some of the underlying theoretical issues. This is followed by a brief discussion of our hypotheses, methodology, and the test statistics and procedures used. In the subsequent section, we analyze the results and the probable implications. This is followed by the conclusions and some issues for future research.

The Underlying Theoretical Issues

Two problems complicate an empirical comparison of working capital management across countries. First, there is a lack of reliable, readily available and testable data to pursue an empirical study. Second, the financial information for corporations in Europe has been generally very restricted and non-standardized. Most of the financial data is reported in the local language and is based on book values. In addition, the existence of multiple currencies and exchange risks, differing institutional arrangements, varied economic and political attitudes towards markets, complex accounting, tax treatments, regulatory hurdles, and legal systems compound these problems.

Our study directly addresses these problems. We use data from the COMPUS-TAT tapes for U. S. corporations and Disclosure Worldscape compact disc for European corporations. The second problem of the variation in valuation between cost and market numbers is somewhat mitigated in this work, since we are studying the effects of only short term assets and liabilities, which by definition, have a maturity of one year or less. Hence, it does not pose a serious limitation on the current study.

In reviewing previous research, we note a dichotomous development of theoretical models and empirical studies in the working capital literature.³ Smith (1973) has identified eight major theoretical approaches taken towards the management of working capital. He stresses the need for the development of a viable model with the dual financial goals of profitability and liquidity, and argues that only such models will assist practicing financial managers in their day-to-day decision making. Gentry et al. (1979) find that the working capital literature is rather limited and that the management of short-term resources is not understood too well by academicians. Thus, the consensus in academia seems to recognize the paucity of theory concerning the management of short-term financial resources due to the inherent difficulties in the development of a working capital decision model, while accepting the normative needs for a more critical examination. In an extensive review of empirical applications, McMahon (1991) concludes that the actual use of financial reports by owners/managers is minimal, while their potential use is increasing, and that corporations could benefit immensely by comparing their firms' performance with industry norms.

Hypotheses

While various definitions of working capital have gained prominence in both academia and practice, in this study we use the standard academic definition of working capital, which is the difference between current assets and current

liabilities (see Weston and Brigham 1993 and Dyckman et al. 1992). Working capital management involves the administration of current assets and current liabilities to achieve three primary objectives: increase profitability, prevent a liquidity crunch, and avoid potential bankruptcy. In line with the theory of the Fisherian separation of investment and financing decisions, our study focuses on the comparative working capital policies under the following areas:

- 1) working capital investment,
- 2) working capital financing,
- 3) interactions between investment and financing, and
- 4) impact of growth on working capital policies.

Under the area of working capital asset investment policy, we focus on both the appropriate level of investment in current assets, and the optimal mix of current assets for a certain desired level of sales activity. Traditionally, academicians have developed a functional classification of the corporations' current asset management policy as relaxed, moderate and restricted. Under the relaxed policy, the company holds a significantly higher ratio of current assets to sales than the industry average; while under the restricted policy, the ratio is significantly lower. The moderate policy is similar to the industry standards and averages.⁴ We use the ratio of current assets to sales to measure the asset investment policy of a corporation.

To determine the effect of individual assets, in our comparison, we also use the ratios of cash to sales, receivables to sales, and inventory to sales. In addition, we use the ratio of fixed assets to sales, since Laumas and Williams (1984) find that fixed assets and current assets can be complements in the manufacturing sector. This ratio can provide clues to the relative efficacy of asset management policies of corporations.

The working capital financing policy evaluates the efficacy of the chosen mix of financing of the current assets of the corporation. Researchers have traditionally classified a corporation's working capital financing policy as either aggressive, moderate or conservative.⁵ Under a conservative policy, a large portion of current assets is financed by long-term liabilities; while under an aggressive policy, a short-term liability is created in order to finance a short-term asset. Under a moderate policy, the corporation strives to achieve a balance of both short-term and long-term financing, with maturity-matching guiding the decision. Financing current assets by long-term debt may lead to wasted resources, and a non-revenue enhancing situation; conversely, if expectations do not materialize, financing current assets solely by short-term debt may lead to financial exigencies and inefficiencies. We measure the efficacy of these financing policies by using the current ratio and the quick ratio of corporations.

The interaction of investment policies and financing policies is best estimated by the cash conversion cycle.⁶ The cash conversion cycle, as developed by Richards and Laughlin (1980), shows the time interval between the actual cash expenditures for a firm's productive resources and the ultimate recovery of cash receipts from product sales. It establishes the period of time required to convert a dollar of cash disbursements back into a dollar of cash inflow from a firm's normal course of operations. The cash conversion cycle takes an integrated approach to the management of working capital.⁷ Other things being equal, an accelerated conversion of raw materials to cash flow results in a lower investment in current assets, while a delayed conversion results in a sub-optimal investment in working capital.

Another factor which determines the need for the working capital of a firm is the life cycle of a firm: whether it is in the infant, growth, maturity, or declining stage. The growth of a firm could have an impact on the working capital and, hence, is used as an additional variable. The rates of growth in assets and sales are thus used as proxies to reveal the relative need for the working capital of a firm.

We conduct comparative analyses on these four areas using the data from the United States and selected European countries for six major industry groups: automotive, chemical, electronic, metals, oil and gas, and retailing industries. We chose these industry groups because they are a representation of the broad categories of corporations. This is similar, in structure, to recent work by Roll (1992).

The following null hypotheses are tested:

- H₁:** The European firms' (industry's) working capital investment policy is the same as that of U. S. firms (industry).
- H₂:** The European firms' (industry's) working capital financing policy is the same as that of U. S. firms (industry).
- H₃:** The European firms' (industry's) interaction of working capital investment and financing policies is the same as that of U. S. firms (industry).
- H₄:** The impact of growth on working capital policies for European firms (industry) is the same as that for U. S. firms (industry).

Sample Selection and Methodology

Financial statement data from 1985 to 1990 for 14 European countries was extracted from the 1991 Disclosure Worldscope compact disc.⁸ Initially, 12 industry groups with 766 firms were identified. However, to ensure data consistency and availability, the sample selection was limited to the top five (based on asset size) firms in each industry group.⁹ In order to perform the statistical

analysis, we limited the minimum number of firms in each industry to four. This data selection process eliminated 629 firms from the initial sample, and only six industries in nine European countries were identified. The sample data is summarized in Table 1.

Table 1. Description of Sample Data: Number of Firms

Industry	U.S.A.	Belgium	France	West Germany	Italy	Netherlands	Spain	Sweden	Switzerland	United Kingdom	Total
Automotive	24	–	5	12	–	–	–	–	–	15	56
Chemical	70	–	5	5	–	–	–	5	–	5	90
Electronic	174	–	5	5	–	–	–	–	4	5	193
Metal	84	5	5	5	4	–	4	–	–	–	107
Oil and Gas	65	–	5	5	–	–	4	–	–	5	84
Retailing	86	–	5	5	–	4	–	5	–	5	110
Total	503	5	30	37	4	4	8	10	4	35	640

Financial statement data for firms in the corresponding U.S. industries were retrieved from the 1992 COMPUSTAT data tapes. In all, there were 503 firms selected for the six industries. A breakdown of the U. S. sample data is also listed in Table 1.

For the hypotheses listed in the section above we performed the statistical tests of significance using SAS. One potential problem with financial data is the question of the normality of the underlying parameters. Therefore, we conducted a test of normality on the underlying distributions of our sample data. Since the results suggest non-normality for most of the variables, we conducted non-parametric tests to determine the homogeneity of our samples: we compared a sample from a U. S. industry to a sample from the same European industry, to check if they had similar underlying distributions. As our samples were independently drawn from both the U. S. and the European countries, we first chose Kolmogorov-Smirnov two-sample test (K-S test, hereafter). The K-S test is a test of homogeneity of distribution. The null hypothesis is that two samples are drawn from the same population, or different populations with the same probability density function. The K-S test is sensitive to any difference between the two distributions, including median, dispersion, skewness, and other characte-

ristics. The one-tailed test determines whether the values of one sample are generally larger than the values of the other sample (see Siegel 1956, p. 130). The second non-parametric test we selected is the Kruskal-Wallis one-way analysis (K-W test, hereafter) by ranks. The K-W technique tests the null hypothesis that the k samples come from the same population, or from identical populations with respect to averages (see Siegel 1956, pp. 184–194).

Empirical Analysis and Results

Table 2. Test of Normality for European and U. S. Companies

Ratio	Kolmogorov		Result	
	U.S.	Europe	U.S.	Europe
(Current Assets)/Sales	0.62	0.21	Reject	Reject
(Fixed Assets)/Sales	0.57	0.40	Reject	Reject
Cash/Sales	0.34	0.55	Reject	Reject
Receivables/Sales	0.94	0.76	Normal	Reject
Inventory/Sales	0.93	0.19	Normal	Reject
Current Ratio	0.84	0.91	Normal	Normal
Quick Ratio	0.80	0.16	Normal	Reject
Cash Conversion Cycle	0.96	0.13	Normal	Reject
Sales Growth Rate	0.60	0.47	Reject	Reject
Asset Growth Rate	0.93	0.43	Normal	Reject

To address the potential problem of non-normality of the financial variables studied, we conduct a test of normality for their distributions. Table 2 reports the results of our study. In the tests, both the Kolmogorov D statistic and the kurtosis values are used in determining the normalities. With the exception of the current ratio, the hypotheses of normality is rejected for all European firms, and for a substantial portion of the variables in the United States. Hence, to obtain a clearer representation of the impact of the variables studied, we conduct the analysis using the non-parametric tests, specifically the K-S and K-W tests.

Table 3. Non-parametric Comparisons by Industry: Kolmogorov-Smirnov (K-S) and Kruskal-Wallis (K-W) Tests

Ratio	Test	Europe	Automotive	Chemical	Electronic	Metal	Oil	Retail
(Current Assets)/Sales	K-S		(-)	(-)		(-)		(+)
	K-W		(-)	(-)		(-)		(+)
(Fixed Assets)/Sales	K-S						(+)	
	K-W						(+)	
Cash/Sales	K-S	(+)	(-)	(-)	(+)	(-)	(+)	(+)
	K-W	(+)	(-)	(-)		(-)	(+)	(+)
Receivables/Sales	K-S			(-)		(-)		(+)
	K-W	(-)	(-)	(-)		(-)		
Inventory/Sales	K-S					(-)	(-)	(+)
	K-W					(-)	(-)	(+)
Current Ratio	K-S	(+)		(+)	(+)	(+)		(+)
	K-W	(+)		(+)	(+)	(+)		(+)
Quick Ratio	K-S	(+)			(+)			
	K-W	(+)		(+)	(+)			
Cash Conversion Cycle	K-S	(-)		(-)	(-)	(-)		(-)
	K-W	(-)	(-)	(-)	(-)	(-)		(-)
Sales Growth Rate	K-S	(-)	(-)	(-)	(-)	(-)		(-)
	K-W	(-)	(-)	(-)	(-)	(-)		(-)
Asset Growth Rate	K-S	(-)	(-)	(-)	(-)	(-)	(-)	(-)
	K-W	(-)	(-)	(-)	(-)	(-)	(-)	(-)

(+): U.S. industry average is significantly greater than the European average at the 95% level.

(-): U.S. industry average is significantly less than the European average at the 95% level.

First, we test to see whether the working capital policies of European firms, in general, are different from that of U. S. firms. Instead of reporting the test statistics, we use the (+) sign to indicate that the U. S. ratio in consideration is significantly higher (at the 95% confidence level) than its corresponding Euro-

pean ratio, and use the (–) sign to represent the opposite. The non-parametric test results for hypotheses H_1 to H_4 are shown in the third column of Table 3. They reveal that, in general, the European firms hold a similar ratio of current asset to sales with the U. S. firms, indicating that both practice similar working capital investment policies. A micro-analysis of the differences in current assets reveals that European firms, in general, hold a higher amount of receivables, and a lower amount of cash than the corresponding U. S. firms. This means that the European firms have the potential to lower their current asset holdings by the better monitoring of their receivables. This is because the higher investment in receivables point to longer collection periods. Efforts should be taken to either lower the collection period, or adopt other receivables management practices, such as factoring or securitization.

The examination of the financing of current assets shows that U. S. corporations follow a much more conservative policy, by financing current assets mostly through using long term liabilities, than European corporations. In studying the interactions, we note that the cash conversion cycle for European firms take an average of 262.8 days, while the U. S. firms studied take an average of 115.9 days. Another interesting facet of this is that the European firms have a higher growth rate than U. S. firms. The Europeans lead the U. S. both in sales and asset growth rates. This could partly explain the higher cash conversion cycles for European corporations.

The rest of Table 3 reports the test results for working capital policies of seven different industries in Europe, *vis-à-vis* U. S. industries. In summary, three out of the six industries studied (automotive, chemical, and metal) use more relaxed working capital investment policies than their U. S. counterparts. This may due to the fact that these industries in Europe hold significantly more cash, receivables, and in the case of the metal industry, more inventory, than their U. S. counterparts. This suggests areas of improvement for these European industries. On the other hand, four European industries (chemical, electronics, metal, and retailing) are practicing more aggressive working capital financing policies than their U. S. counterparts by using more current liabilities to finance current assets. Most European industries have significantly longer cash conversion cycles than U. S. industries, due to larger receivable holdings, suggesting another area of improvement, and a need for more in depth examination. Inevitably, the European industries have higher growth rates in sales and assets, which may explain the higher holdings in receivables and longer conversion cycles.

Table 4. Non-parametric Comparisons by Country: European versus U.S. Countries Kolmogorov-Smirnov (K-S) and Kruskal-Wallis (K-W) Tests

Ratio	Test	Belgium	France	Germany	Italy	Nether-lands	Spain	Sweden	Switzer-land	U.K.
(Current Assets)/Sales	K-S		(-)		(-)	(+)				
	K-W		(-)		(-)	(+)				
(Fixed Assets)/Sales	K-S			(-)		(+)				
	K-W			(-)		(+)	(-)			
Cash/Sales	K-S		(+)	(-)					(-)	
	K-W		(+)	(-)					(-)	
Receivables/Sales	K-S		(-)		(-)	(+)				
	K-W		(-)		(-)	(+)				
Inventory/Sales	K-S	(-)			(-)					
	K-W	(-)			(-)					
Current Ratio	K-S		(+)		(+)	(+)		(+)		(+)
	K-W		(+)		(+)	(+)	(+)	(+)		(+)
Quick Ratio	K-S		(+)			(+)	(+)			(+)
	K-W		(+)			(+)	(+)	(+)		(+)
Cash Conver-sation Cycle	K-S	(-)			(-)	(+)				
	K-W	(-)	(-)		(-)	(+)				
Sales Growth Rate	K-S		(-)	(-)				(-)	(-)	(-)
	K-W		(-)	(-)				(-)	(-)	(-)
Assets Growth Rate	K-S		(-)	(-)				(-)	(-)	(-)
	K-W		(-)	(-)				(-)	(-)	(-)

The individual comparisons of companies in different European countries with the U. S. are presented in Table 3. France and Italy are more conservative in working capital investment policies and this is possibly due to the fact these countries have a tendency to hold more current assets in terms of receivables and inventories. On the contrary, the Netherlands practices a more aggressive investment policy than the U. S., and evidently holds less receivables than the U.S. As to the working capital investment policies, more than half of the European countries use a more aggressive practice than the United States. In addition, almost half of the European countries in the sample have longer cash conversion cycles than the U. S., which is possibly due to their larger holdings of receivables and inventories.

Overall, the non-parametric tests are not overwhelmingly conclusive. The tests do pinpoint certain areas for visible improvement. In certain industries/countries there appears to be better opportunities for enhancing efficiency in working capital investment and financing policies. For example, the inventory and receivable holdings are considerably higher in Europe, as compared to U. S. corporations. Hence, increased scrutiny of these assets, in the future, is warranted. The just-in-time inventory manufacturing concept, extremely popular and widely-practiced in Japan, may need closer scrutiny for possible adoption in Europe. Another aspect which needs closer inspection is the size of the receivable holdings. Investments in working capital assets results in sub-optimal returns. Hence, decreasing investments in idle assets will increase financial efficiency. In the U. S., the securitization and/or factoring of receivables is already well established. European firms could either implement more superior collection policies, or experiment with the speedier financing of receivables. Securitization of receivables is yet to develop to its full potential in Europe. Another striking feature is the high cash conversion cycle in European firms. Unless European corporations are maintaining comparable cash conversion cycles akin to U. S. firms (by instituting optimal payable deferral policies) special efforts are needed to speed up collections and increase efficiency by using the latest technology. One favorable aspect is that European firms have, in general, a higher growth rate of both sales and assets. Such sustained projected growth levels call for additional investment in working capital; however, unless competitive financing and investing policies are followed, the increased sales may not translate into higher cash flow, or profits. Thus, competitive working capital strategies will have a primary role to play in the future of European corporations.

The economic significance of the differences in working capital practices raises as many questions as it clarifies. How should, and how does, the performance of short-term financial management impact the market value of the firm? Within an industry or country, is one style/culture of management (i.e., aggressive or conservative) consistently superior to that of another? What should be the present value of gain (loss) by a lower (higher) level of an asset holding, with that of competing corporations, both industry and country-wide? These questions, while interesting enough, are beyond the scope of this study. However, the increased internationalization of corporations makes the study of such issues crucial for the survival of firms.

Conclusions

The world is becoming an integrated global marketplace. It is imperative that, as internationalization increases, more emphasis is paid to comparative management practices. In international financial management comparisons, both theory and research on the measures of comparison are still evolving. However, to be globally competitive, corporate financial managers have to focus on optimal allocation of resources and avoid sub-optimal/under-utilization of resources. Our results here reinforce some areas and techniques that could be profitably utilized by European financial managers. Given the immense benefits, such comparative studies could initiate the critical appraisal of firm performance and the drive towards efficiency. Future research along this line appears inevitable, and the development of techniques and procedures to enhance working capital investing/financing policies in Europe holds great promise.

Notes

- 1 An earlier version of the paper was presented at the Euro-Asia Management Studies Association meetings in Nürnberg, Germany, November 1993. The authors wish to thank the participants and the Editor of the Journal for constructive comments.
- 2 In this paper, the terms current assets management and working capital management are interchangeable.
- 3 In this paper, we focus our attention on the credit-bankruptcy risk aspect of working capital management. We do not, however, directly address the performance aspect of working capital which pertains to the relation between the market value of the firm and working capital management.
- 4 See Weston and Brigham (1993, pp. 364–370).
- 5 See Footnote 4.
- 6 There are three major factors in the cash conversion cycle. First, the inventory conversion period is defined as the number of days it takes a corporation to convert raw materials into finished goods sold. Second, the receivables conversion period is the number of days it takes to convert the firm's receivables into cash. Third, the payable deferral period is defined as the length of time between the procurement of raw materials and the payments to suppliers. See Richards and Laughlin (1980) for a detailed discussion.
- 7 The payable deferral information usually is firm specific and, thus, is not available from either *Worldscope* or *COMPUSTAT*. Therefore, we assume that the payable deferral period is constant across all firms. This assumption implies that the cash conversion cycle is simply the sum of the inventory and receivables conversion periods. We acknowledge that by ignoring the payable deferral period, there is a potential that the comparisons of cash conversion cycles between the European and U. S. industries are biased. Hence, the results should be interpreted with caution.
- 8 As in other empirical studies using accounting data across countries, our analysis may be subject to the potential limitations that the book values used in computing the selected values may not be comparable. This may result both from the accounting valuation methods, as well as the varied definitions of a specific balance sheet item. Nevertheless, in our study, the

resultant measurement errors may not be significant because we primarily examine the short term assets and liabilities, suggesting a convergence of book values and market values.

- 9 One concern is the potential selection bias resulted from including only the largest companies in the European sample. It may be argued that a company's working capital is correlated to its size. For example, even in the same industry, a larger company can acquire a revolving credit line and maintain a lower level of working capital than other smaller corporations. While the bias is acknowledged, since only similar corporations are being compared across countries, it does not pose a serious limitation to the present study. Another concern is that larger companies with foreign operations may contaminate the results. The ratios computed on consolidated balance sheets of these multi-national firms may not be suitable in comparing working capital practices across countries since working capital management may be a function of both local institutional and legal environment. While it would have been preferable to separate the foreign activities to study the contrast, the absence of such data does not mitigate the study. We believe that the working capital of a firm is more affected by the overwhelming dominance of corporate culture or philosophy of the top management of the corporation than any other factors, and thus the management practices of foreign affiliates will not be substantially different. However, this is the one area for possible future inquiry.

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Mohamad H. Mohamad

Capital Structure in Large Malaysian Companies¹

Abstract

- This paper attempts to examine the determinants of firms' capital structure in Malaysia covering the period between 1986 to 1990. A discussion on the capital structure behaviour in the Malaysian financial market implies that there are similarities between developed and less developed financial markets, involving the influences of firms' capital structure. Specifically, a firm's size and industry class play a significant role in determining a firm's capital structure.

Key Results

- There are significant inter-industry differences in capital structure among Malaysian companies. Highly-leveraged firms are more likely to earn higher profits than less-leveraged firms.

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Introduction

Firms experiencing poor performance respond either operationally, by making changes in top management (Gilson 1989) or in organizational strategy and structure (Chandler 1980 and Wruck 1990), or financially, through capital restructuring (Aharoni and Swary 1980). The capital structure of a company is an important influence on its profitability and stability. While a high proportion of debt may make a company highly profitable as it is growing, it also increases the probability of bankruptcy and ruin, especially if that growth slows down or temporarily becomes negative. Why firms choose capital restructuring over other responses, however, is largely unexplored. Analyzing this response may shed light on how to hasten a firm's reaction to distress, (specifically, given the alleged differences in capital structure among firms in Malaysia, especially compared to such relations in OECD countries). To what extent do these considerations regarding capital structure apply to Malaysian companies? What type of capital structure is used by large companies in Malaysia? What factors influence debt ratios among these companies? For example, is capital structure in Malaysia influenced by factors such as size and industry classification? If so, to what extent? This paper is an attempt to answer these questions.

Determinants of Corporate Capital Structure

Various theoretical models have explored the relation between a firm's capital structure – characterized by its debt-to-equity ratios. Beginning by the debate started by Modigliani and Miller (1958) who argued that in a world of perfect capital markets and no taxes, a firm's capital structure does not influence its cost of capital, and, consequently, there is no relevance of capital structure for maximizing the value of the firm. However, with the recognition of corporate uncertainty and tax shield afforded by debt financing, it has been shown that the optimal capital structure for a value-maximizing firm is attained at less than a 100 per cent debt level (Modigliani and Miller 1963).

Capital structure can be defined as "the mix (or proportion) of a firm's permanent long term financing represented by debt, preferred stock and common equity" (Van Horne and Wachowicz 1992). However, Schlosser (1989) simplified capital structure as the proportion of debt to the capital of the company by restricting capital structure as the choice between internal and external financial instruments. As capital structure is very much related to the choice between internal and external financial instruments, therefore, optimal capital structure should have been influenced by the expected cost of financial distress. However, costs of financial distress can be direct such as in the case of bankruptcy costs or indirectly, financial distress can be the result of the extraordinary administra-

tive costs, lost sales, loss of trade credit, possible loss of key managers and employees, and the reduced liquidity of its securities. As such, as firm moves closer to financial distress, it accelerates the process of failure as its costs may rise heavily and therefore financial distress is an important criterion for capital structure decisions (Haugen and Senbet 1988).

It has been contended that capital structure may also be associated by the agency costs incurred for bonding and monitoring the security and priority of creditors. This is largely the result of the contractual arrangement in which the security may provide provision for possible revision as there are differences in the motives of lenders, owners and managers.

In view of these costs the actual capital structure can be different from the theoretical optimum. Hence, Ellsworth (1985) found that U. S. firms were generally underleverage because U. S. managements were more in favour of firm-specific human capital and were more risk-averse than stock-holders.

As the amount of debt and cash flow instability increases the probability of financial distress, it has been argued that the optimal capital structure can be influenced by many industry-related variables. Among the industry-related variables are debt financing-related uncertainty which increases the discount rate that is applied to the future debt-related tax shield (Taggart 1980) and market imperfections which resulted from transaction costs (John 1987). In addition, industry-related variables that can influence capital structure decisions include the amount of collateralable and depreciable assets (Scott 1977), the structure of the product markets (Alberts and Hite 1983), differences in utility curves, and the price of risk faced by the holders of a firm's securities (Taggart 1980). Hence, it seems that in the presence of market imperfections, capital structure does matter and firms may achieve optimal financial structures at varying proportions of debt (Fischer et al. 1989). Since the impact of these market imperfections can be expected to vary by a firm's size and industry, empirical evidence of size and industry-related variations in capital structure among firms can be expected especially in the case of Malaysian companies where not many studies have been attempted.

Review of the Literature

Our statements are consistent with a number of earlier empirical studies of firms' capital structure. Scott and Martin (1976), Bowen et al. (1982) and Boquist and Moore (1984) find in their studies that industry classification influences capital. Using regression analysis, Ferri and Jones (1979) and Scott and Martin (1976) find positive relation, between capital structure and size while Flath and Knoeber (1980) find that the firm's tax rates and failure costs have strong influence on industry capital structure. In summary, both industry class and size of the

firms suggest that they are among the major determinants of capital structure. However, these studies suggest that this linkage between capital structure and a firm's size and industry class is only eminent in the OECD setting while no evidence has been confounded in the developing countries.

Data, Research Methodology and Results

The source of corporate data for this study was the national edition of Kuala Lumpur Stock Exchange Annual Reports. All companies listed in the Industrial Lists were included in the study when they had complete data for the five years, 1986 through 1990. Two-digit SIC codes were used for the industry classification for each company. Bivariate and multivariate correlation and analysis of variance procedures were used to assess the significance of industry and size as influences on capital structure.

Table 1 presents the average capital structure for the 108 Malaysian companies that are examined in this study. As this table indicates, there are significant differences in capital ratios for large Malaysian companies. The equity ratios range from a low of 2.5% and a high of 72.8% for the manufacturing sector. This table also groups companies according to respective period. Most of the Malaysian have moderate equity ratios, for the period, financing on average about 30.0% of their assets with equity.

From the data of Tables 2a – 2d, it can be seen that with the exception of professional goods industry, the Malaysian industries had a considerably moderate average equity ratios. The exception of professional groups may be explained by the usually alleged lack of direct investment in this sector as distinct from other industries.

Other industries, however, do suggest in range of difference in the average equity ratios and debt-to-total asset ratios. The average equity ratios varies from 36% to 72.80% for the manufacturing group. It is more interesting to note that the industry groups with the greatest ratios correspond to sample of OECD industries previously studied.

Unlike the equity ratios, the debt-to-total assets ratio generally register a much higher average for the Malaysian companies. The statistical results presented in Table 1 and Tables 2a – 2d) show that during the period the average debt-in-total assets ratio varies from 39.8% to 49.5% for the whole industries or categorically from 33.0% for manufacturing group for the year 1990 to 63.2% for professional goods sector for the year 1989. It is clear from these results that the most likely reason for the greater average of debt-to-total asset ratios in the stability of the capital markets in Malaysia is view of the optimism of the national economy during the period.

Table 1. Financial Analysis of Listed Industrial Companies on Main Board KLSE (RM '000)

Year	Total assets	Ordinary share capital	Total debt	Equity to total asset ratio	Debt to total assets ratio	Debt to equity ratio	Return on investment (%)
1986							
Maximum	4234935	463300	3529246	0.728723	0.868548	19.1985	27.60
Minimum	16739	2000	6365	0.036002	0.027117	0.070403	0.06
Mean	330430.0	66934.78	1946649	0.327485	0.449834	2.397767	4.96
Standard Deviation	774975.7	82397.17	6047519.5	0.159910	0.184161	3.224935	4.31
Industrial Total	21147525	4263826	12457571	0.202568	0.589079	2.908047	4.32
1987							
Maximum	4159786	500000	3457260	0.711060	0.909648	28.466	27.42
Minimum	23921	2000	7615	0.025253	0.276130	0.071487	-2.07
Mean	350090.2	72680.23	200605.0	0.315634	0.455662	2.651507	5.70
Standard Deviation	774541.2	95727.54	565708.6	0.156461	0.189832	4.119903	4.62
Industrial Total	22403775	4651535	12838723	0.207604	0.573009	2.760104	4.76
1988							
Maximum	4167000	517900	3391714	0.636369	0.876887	15.39387	24.42
Minimum	27448	4500	8499	0.056963	0.040344	0.111516	0.30
Mean	366310.8	80720.14	207614.6	0.310047	0.49493	2.187431	6.79
Standard Deviation	806568.1	100380.4	546152.3	0.146425	0.175028	2.324338	4.11
Industrial Total	24723893	5166089	13287335	2.208951	0.537428	2.572029	5.63
1989							
Maximum	4634807	518300	3991111	0.631384	0.955442	21.48587	18.37
Minimum	33379	7500	9514	0.044468	0.041518	0.118901	0.30
Mean	446282.6	86128.96	247278.5	0.292578	0.479920	2.586955	7.27
Standard Deviation	883735.6	100678.1	599893.2	0.144673	0.185571	3.043834	4.37
Industrial Total	28562092	5512254	15825825	0.192991	0.554084	2.871026	6.53
1990							
Maximum	5337773	779600	4595067	0.585148	0.829768	7.086362	19.09
Minimum	41744	7500	1685398	0.105510	-3.457980	-11.0066	0.57
Mean	550778.8	113843.1	260622.8	0.288325	0.398260	1.970465	7.80
Standard Deviation	1001995.0	153166.7	689768.1	0.129081	0.511985	2.232985	4.53
Industrial Total	35249847	7285963	16679860	0.206694	0.473189	2.289314	7.49

KLSE: Kuala Lumpur Stock Exchange
RM: Ringgit (Malaysian Ringgit)

Table 2a. Financial Analysis of Listed Industrial Companies on Main Board KLSE* by Sector 1986 (RM '000)

Year	Total assets	Ordinary share capital	Total debt	Equity to total asset ratio	Debt to total assets ratio	Debt to equity ratio	Return on investment (%)
Manufacturing (n = 39)							
Maximum	550576	224500	311898	0.728723	0.736819	19.1965	14.18
Minimum	29208	2000	6365	0.036002	0.195763	0.31825	0.13
Mean	169499.5	60425	68328.87	0.368276	0.400939	1.825722	4.85
Standard Deviation	154973.0	56272.79	72999.66	0.159101	0.149791	3.008585	3.32
Industrial Total	6610482	2356375	2664826	0.356490	0.130804	1.130804	5.81
Service (n = 25)							
Maximum	3590183	250000	3118247	0.668138	0.868548	12.47298	11.59
Minimum	39411	6000	7665	0.069634	0.027117	0.070403	0.94
Mean	354797	50745.33	256965.6	0.300373	0.542397	2.945277	4.40
Standard Deviation	869515.9	60393.39	765268.8	0.151057	0.208042	3.142171	2.52
Industrial Total	5321955	761180	3854485	0.143026	0.724261	5.063828	5.67
Holdings (n = 25)							
Maximum	4234935	341283	3529246	0.357883	0.833364	10.3411	27.60
Minimum	66748	15000	21751	0.080587	0.286128	0.799500	0.06
Mean	1022833	105710	773670.6	0.2220982	0.437633	3.368222	7.79
Standard Deviation	1613758	119873.1	1379905	0.102552	0.206539	3.597448	10.06
Industrial Total	5114315	528550	3868353	0.756377	7.318802	7.318802	0.96
Others (n = 19)							
Maximum	3415400	463300	1767100	0.311072	0.762947	10.66704	13.68
Minimum	16739	4500	9091	0.070078	0.286188	0.920004	0.35
Mean	820154.6	127504.2	413981.4	0.197155	0.565718	4.246733	4.59
Standard Deviation	1305646.0	174925.9	677627.1	0.067241	0.169331	3.485216	4.75
Industrial Total	4100773	637521	2069907	0.155463	0.504760	3.246805	4.38

KLSE: Kuala Lumpur Stock Exchange
RM: Ringgit (Malaysian Ringgit)

Table 2b. Financial Analysis of Listed Industrial Companies on Main Board KLSE* by Sector 1987 (RM '000)

Year	Total assets	Ordinary share capital	Total debt	Equity to total asset ratio	Debt to total assets ratio	Debt to equity ratio	Return on investment (%)
Manufacturing (n = 39)							
Maximum	697729	234500	634688	0.668635	0.909648	28.466	13.49
Minimum	32409	2000	7615	0.025253	0.177307	0.37722	0.67
Mean	193015.6	61869.35	87326.30	0.347648	0.423073	2.438050	5.80
Standard Deviation	175455.9	56696.09	114295.1	0.154548	0.172686	4.823942	3.42
Industrial Total	7577612	2412905	3405726	0.320540	0.452431	1.411462	5.75
Service (n = 25)							
Maximum	3506968	500000	2560156	0.711060	0.734771	8.830135	27.42
Minimum	37032	7400	7783	0.075515	0.027613	0.071487	-2.07
Mean	364143.8	71443.93	226086.9	0.315451	0.503290	2.362930	6.33
Standard Deviation	846501.2	118694.8	625226.5	0.154221	0.197419	2.133396	7.14
Industrial Total	5462157	1071659	3391304	0.196197	0.620872	3.164536	6.87
Holdings (n = 25)							
Maximum	4159786	341283	3457260	0.371209	0.831114	10.13018	8.31
Minimum	58414	15000	13331	0.082043	0.228215	0.674022	0.20
Mean	1012405	105710	764603.8	0.213429	0.454801	3.468013	3.36
Standard Deviation	1581287	119873.1	1348479	0.217975	0.217975	3.470477	2.80
Industrial Total	5062025	528550	3823019	0.755235	0.755235	7.233031	0.63
Others (n = 19)							
Maximum	3601800	463300	1889000	0.303447	0.807949	7.9735	10.97
Minimum	23921	4500	14540	0.083111	0.236247	0.778543	0.04
Mean	870796.2	127684.2	443734.8	0.168676	0.567836	4.365701	6.41
Standard Deviation	1373237.0	174802.4	723299.9	0.075212	0.189781	2.417480	3.78
Industrial Total	4353981	638421	2218674	0.146629	0.509573	3.475252	5.19

KLSE: Kuala Lumpur Stock Exchange
 RMI: Ringgit (Malaysian Ringgit)

Table 2c. Financial Analysis of Listed Industrial Companies on Main Board KLSE* by Sector 1988 (RM '000)

Year	Total assets	Ordinary share capital	Total debt	Equity to total asset ratio	Debt to total assets ratio	Debt to equity ratio	Return on investment (%)
Manufacturing (n = 39)							
Maximum	757479	234500	386752	0.636369	0.748280	5.95	15.70
Minimum	41062	6000	8499	0.093455	0.206773	0.393636	1.96
Mean	202654.9	68109.15	83905.53	0.343276	0.415156	1.677178	7.19
Standard Deviation	176909.8	62123.58	85236.39	0.148352	0.159828	1.324489	3.45
Industrial Total	7903543	2656257	3272316	0.336084	0.414031	1.231927	6.81
Service (n = 25)							
Maximum	3444174	500000	2182726	0.565125	0.682079	4.365452	24.42
Minimum	34672	13500	12037	0.145172	0.040344	0.111516	1.37
Mean	392169.2	80293.2	216898.0	0.315997	0.484365	1.859716	6.91
Standard Deviation	823360.3	115461.2	527806.0	0.119686	0.171295	1.091019	5.70
Industrial Total	5682538	1204398	3253471	0.204741	0.553072	2.701325	9.04
Holdings (n = 25)							
Maximum	4033270	341283	3391714	0.331418	0.840934	9.938127	6.64
Minimum	60211	15000	14442	0.084616	0.239856	0.814382	0.38
Mean	1001067	105710	761823.2	0.197136	0.476019	3.655964	3.62
Standard Deviation	1524465	119873.1	1317518	0.086995	0.217634	3.327739	2.26
Industrial Total	5005337	528550	3009116	0.105597	0.761010	7.206727	0.93
Others (n = 19)							
Maximum	4167000	517900	2112800	0.247676	0.876887	13.39387	10.97
Minimum	27448	4500	17194	0.056963	0.427301	1.991424	1.86
Mean	1186495	155376.8	590486.4	0.145927	0.506174	5.682009	6.46
Standard Deviation	1923257.0	192536.3	785102.2	0.061878	0.158919	4.909464	3.18
Industrial Total	5932475	776884	2952432	0.130954	0.497672	3.800351	4.63

KLSE: Kuala Lumpur Stock Exchange
RM: Ringgit (Malaysian Ringgit)

Table 2d. Financial Analysis of Listed Industrial Companies on Main Board KLSE* by Sector 1989 (RM '000)

Year	Total assets	Ordinary share capital	Total debt	Equity to total asset ratio	Debt to total assets ratio	Debt to equity ratio	Return on investment (%)
Manufacturing (n = 39)							
Maximum	884319	234500	589377	0.631384	0.752432	6.241690	18.37
Minimum	42491	13300	9514	0.119783	0.223906	0.376014	2.42
Mean	248280.7	73077.66	117681.8	0.330829	0.447624	1.895537	7.71
Standard Deviation	226375.4	61485.07	131081.5	0.140672	0.168868	1.548857	4.06
Industrial Total	9682950	2850029	4589592	0.294334	0.473906	1.610366	7.64
Service (n = 25)							
Maximum	3444272	500000	1851942	0.618723	0.820342	4.929980	16.80
Minimum	52810	13300	11387	0.041518	0.041518	0.118901	0.56
Mean	430121.9	86137.53	219498.9	0.281433	0.503055	2.370792	6.85
Standard Deviation	814802.2	114283.0	440573.7	0.138099	0.199572	1.459327	4.94
Industrial Total	6451829	1292063	3292484	0.200263	0.510317	2.548237	9.88
Holdings (n = 25)							
Maximum	4634807	341283	3991111	0.283448	0.861116	11.69443	10.42
Minimum	72276	15000	23264	0.073634	0.321877	1.326477	0.38
Mean	1133002	105710	889507.6	0.175426	0.510263	4.207348	4.56
Standard Deviation	1757869	119873.1	1552608	0.070932	0.189166	0.189166	3.59
Industrial Total	5665011	528550	4447538	0.093300	0.785089	0.785089	1.03
Others (n = 19)							
Maximum	4562800	518300	2325000	0.224692	0.955442	21.48587	15.69
Minimum	33379	7500	20998	0.044468	0.473030	2.799733	1.77
Mean	1352460	168322.4	699242.2	0.144806	0.632083	7.008112	7.91
Standard Deviation	1707572	195538.8	854038.7	0.062983	0.171104	7.262197	4.55
Industrial Total	6762302	841612	3496211	0.124456	0.517014	4.154183	6.35

KLSE: Kuala Lumpur Stock Exchange
RM: Ringgit (Malaysian Ringgit)

Table 3 presents the results of our correlation analysis to determine the influence of the firm's size on capital structure. As expected the results also suggest that the three measures of size i. e. sales, assets and equity, are fairly highly correlated, which indicate conformity with previous studies.

Table 4 presents the relation between a firm's leverage and its operational performance which is significantly positive. Total debt, however, is an aggregation of long and short term debt. Hence, the availability of debt financing may be associated to the source of debt financing. In the case of our study, it indicates that high debt ratios are only possible if borrowers and lenders can work and monitor their operation closely, often in the form of same members of the board.

Table 3. Firm Size and Equity Ratio Among Large Malaysian Companies

1986	Equity	Sales	Asset	Equity
Equity Ratio	1.000	- 0.288**	0.113	0.162
Sales		1.000	0.379**	- 0.265
Asset			1.000	0.233
Equity				1.00
1990	Equity	Sales	Asset	Equity
Equity Ratio	1.00	- 0.419**	0.167	0.182
Sales		1.00	0.493**	- 0.238
Asset			1.00	0.366
Equity				1.00

Table 4. Regression Results Equity Ratio (Dependent Variable)

	1986	1990
Constant	- 0.008 (- 0.005)	- 1.1403 (- 2.14)
Tax	- 0.032 (- 3.27)*	- 0.231 (- 3.94)*
Interest Expense	- 0.012 - 1.66)**	- 0.080 (-1.66)**
Equity	0.060 (3.29)*	0.213 (3.05)*
Adj: R	0.206	0.330
N	108	108

Numbers in parantheses are t-statistics.

* Significant at 0.05 level

** Significant at 0.10 level

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Similarly the relation between firm's profit and equity ratio is also positive and is reflected in terms of the importance of efficient capital markets.

Conclusion

This paper examines the variations in capital structure and presents the influences of inter-market differences on capital structure among large Malaysian companies. A sample of 108 firms is used to conduct the test. The results show that there are significant inter industry differences in capital structure among large Malaysian companies. Average equity to asset ratios were often found to be similar for the period under study.

The results also indicate that highly-leveraged firms are more likely to earn higher profits than their less – leveraged counterparts. Such firms are also more likely to take individual actions such as restructuring assets when profit deteriorates.

Note

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Yasuo Hoshino

The Performance of Mergers of Japanese Agricultural Cooperatives¹

Abstract

- This study examines the merger effect of Japanese Agricultural cooperatives. In a comparison of 58 merging and 12 non-merging cooperatives, a negative merger effect is seen in four financial ratios.
- A general comparison of financial ratios between merging and non-merging agricultural cooperatives shows that non-merging cooperatives are superior to merging cooperatives on several ratios.

Key Results

- This study shows that there is a negative merger effect of Japanese Agricultural Cooperatives and financial performance of merging Cooperatives which is inferior to that of non-merging ones.

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Introduction

The Japanese cooperative sector is a diverse and generally strong part of the economy, which covers agriculture, distribution of food, insurance, medicine, housing and finance (Klinedinst 1994).

The strongest and most diverse cooperatives are still the more than 2,836 agricultural cooperatives (as of March 1993).

Agricultural cooperatives in Japan, or *nokyo*, play the central role for the vested interests of the traditional farming community, as a major Japan lobby group which benefited from subsidies and special favors by the government under the postwar policy of maintaining self-sufficiency, especially of rice (Fujitani 1992).

However, *nokyo* face strong international competition due to gradual liberalization of the market by the agreement of the Uruguay Round of the General Agreement on Tariffs and Trade.

In spite of government protection and subsidies, 210 *nokyo* went into red figures in 1993 and Japanese agriculture is in crisis.

The Headquarters for Merger Subsidy of Agricultural Cooperatives stresses the necessity of mergers as a means of establishing a management basis to deal with international competition, to maintain sound business practices and to obtain with diversification and promote professionalism.

There were 13,314 agricultural cooperatives at the end of March 1950 in Japan. The number decreased every year, to 12,050 at the end of March 1960.² After the passage of the Law on Merger Subsidy for Agricultural Cooperatives in 1961, the number decreased drastically to 2,836 in 1993 due to mergers.³

There are only case studies of mergers of agricultural cooperatives in Japan⁴ and no systematic empirical studies of the performance of mergers have been conducted so far.

Studies Related on Mergers of Agricultural Cooperatives

Recently, there have been several studies on economies of scale and simulation studies of mergers for agricultural cooperatives in Japan. Hasebe (1979) examined the economies of scale of agricultural cooperatives based on data from business reports of agricultural cooperatives in Hokkaido. He found economies of scale in the credit divisions and buying divisions in one region out of four, and in the mutual aid divisions, sales divisions and overall divisions in two regions.

Woo (1988) analyzed economies of scale in credit business and mutual aid business of 222 agricultural cooperatives and the sales and buying businesses

of 164 cooperatives in 1982 in Hokkaido. In the credit businesses, he found economies of scale by the using amount of savings at the end of month and gross profit for independent variables and total cost for dependent variables, in the mutual aid business. However, no economies of scale were found in the sales and buying divisions.

Iikuni (1989) estimated the cost function of Kochi Prefecture in 1986 for each division, by using sales as size variable, and operating direct costs and operating expenses as cost variables. Economies of scale were not observed in the credit and mutual aid divisions. However, it was seen in the sales and buying divisions due to the reduction of personnel expenses. Furthermore he simulated optimum merger combinations in agricultural cooperatives by using cost functions from his previous research. He analyzed three stages, from small to large levels, city-town-village, county (gun) and prefectural levels, and determined the optimum merger combination which results in the minimum cost among all possible combinations in city-town-village level.

He finds that one agricultural credit cooperative in each city-town-village level is optimum and the 97 cooperatives in Kochi Prefecture would be reduced to 39 by optimum merger combinations.

Kawamura (1990) calculated the trans-log and functional-log cost functions of four divisions by using operating gross profits and average salaries per male employee as independent variables, and total costs as dependent variable using the Comprehensive Statistics of Agricultural Cooperatives (1980–1987). As a result, he found that there exist specific economies of scale in the credit business.

Further, Kawamura and Murakami (1990) estimated the cost function of 73 agricultural cooperatives for four divisions with total profit, numbers of agricultural advisors and average salary per staff in Iwate Prefecture in 1988. They conclude as follows. When they simulate with an assumption that the wage rate is the same as that of merging agricultural cooperatives, mergers in all regions are favorable. With the assumption that the wage rate is the same as the highest of merging cooperatives, mergers in some regions are unfavorable.

To date, no previous quantitative studies on the performance of mergers in agricultural cooperatives in Japan have been conducted. However, there have been some case studies of mergers among agricultural cooperatives. The Central Union of Agricultural Cooperatives (1989) investigated 44 cooperatives mergers which occurred during the period, 1965 to 1986. Concerning merger performance, agricultural cooperatives responded that

(I) they could reduce the burden by: 1) the interest rate of loans (21 agricultural cooperatives), and 2) enlarging the amount of loans (16 agricultural cooperatives), and that

(II) they could strengthen the management base by: 1) building up the organization by increasing the number of members, and 2) strengthen their business functionality.

Muneshige (1989) obtained 645 (78.2%) responses by sending a questionnaire to 825 agricultural credit cooperatives which composed 20% of the cooperatives in existence in 1987. Concerning merger performance, the top five goals of average agricultural cooperatives which merged are as follows: 1) to become sound financially (53.3%) and 2) fixing facilities for members (50.7%); 3) to strengthen the advisory system of managing farms (46.0%); 4) to improve management performance (32.6%); and 5) to make progress on the mechanization of office equipment (32.2%).

There are some differences of the goals of merging and non-merging agricultural cooperatives. Merging cooperatives want a highly sound financial foundation. Non-merging cooperatives value a strong political voice in the association.

Takada (1991) examined the effects of mergers of two agricultural cooperatives by comparing their goals to the national average. He pointed out the higher rate of increase of savings, loans, the amount of long term mutual relief, the amount of purchasing, the amount of marketing and equity after merger for merging Miyakonojyo agricultural cooperatives in Miyazaki Prefecture than the national average for the period of 1975 and 1987. However, the ratio of operating cost to operating profit and operating profit per full-time officer and employee for merging agricultural cooperatives are still lower than national average.

He also analyzed Kobe City West agricultural cooperatives, and found a larger increase in the ratio of long term mutual relief and equity, but a lower ratio of savings, loans, the amount of purchasing, and the amount of marketing for the period from 1966 to 1987 in comparison to the national average.

Further, the ratio of operating expense to operating profit is lower and labor productivity is higher for merging agricultural cooperatives.

In the U. S., Lerman and Parliament (1991) revealed significant size and industry effects using financial ratios of 43 agricultural cooperatives over the period 1970–1987. However their study does not show the performance of merger.

Barton (1993) showed that small-sized agricultural cooperatives which are not realizing economies of scale are prime candidate of merger consideration, and that those cooperatives which are operating very efficiently or profitably, relatively, are less likely to significantly benefit from merger, based upon financial performance measure of two case study sets.

The Performance of Mergers

To measure the performance of mergers in agricultural cooperatives, it is necessary to compare merging to non-merging cooperatives. In most cases,

mergers in agricultural cooperatives are carried out between several cooperatives rather than just two.

In Gifu Prefecture⁵, there were a maximum of 352 cooperatives in 1950, but the number was reduced to 79 cooperatives by 1988, due to mergers, dissolution, and moving out. The appendix of Hoshino (1993) shows a list of 58 merging agricultural cooperatives which had 12 mergers. The 12 merged cooperatives were matched with the corresponding non-merging cooperatives in Gifu Prefecture considered most suitable.⁶

Fourteen financial ratios which compare the differences in financial characteristics between merging and non-merging cooperatives were selected from Ministry of Agriculture, Forestry and Fisheries (1990). This is shown in Table 1. When both Columns (I) and (II) have no significant differences or both have significant differences, there were no difference before and after mergers for each ratio. Three out of the 14 ratios have statistically significant differences in their means in Columns (I) not in (II) in Table 1. They are the ratio of cash and deposit to savings (3), the ratio of loans to savings (4), and the ratio of personnel expenses to operating expenses (9).

The ratio of cash and deposits to savings (3) is not statistically significantly different in its means before and after mergers as shown in Column (II) of Table 1. However, the corresponding merging agricultural cooperatives have a significant difference before and after mergers (56.24% vs. 40.11%), indicating less liquidity after mergers. This ratio is calculated by dividing savings defined as liabilities into cash and deposits defined as assets. The ratio of loans to savings improves after mergers (46.91% vs. 56.75%), indicating an improvement in financial condition. The ratio of personnel expense to operating expense increased after mergers (69.80% vs. 72.83%), indicating a negative effect of mergers. In summary, merger has rather negative effect.

Concerning the standard deviations of ratios before and after mergers, there are four ratios which Column (I) or Column (II) show as statistically significantly different. They are the net profit to total assets ratio (7), the ratio of operating expense to operating profit (8), the ratio of personnel expense to operating expense (9), and the ratio of operating profit to fixed assets (10). The ratios (7) and (10) have significant differences in Column (II); non-merging agricultural cooperatives which are 0.43% vs. 1.74% and 93.83% vs. 222.80% before and after mergers, respectively. Relatively speaking, this indicates a reducing effect on the standard deviations of these ratios by mergers. This is a stabilizing effect. However, ratio (8) is 49.28% vs. 326.14% before and after mergers for merging agricultural cooperatives, which shows a destabilizing effect. Moreover, ratio (9) is 11.04% vs. 6.73% for non-merging agricultural cooperatives indicating a destabilizing effect of mergers. To sum up, merger is neutral with respect to the stabilization of ratios.

Table 1. Comparisons of Merging and Non-Merging Agricultural Cooperatives (A.C.) before and after Mergers

Financial ratios	Statistics	(I)		(II)		(III)	
		Merging A.C.		Non-merging A.C.		Before merger	
		Before merger	After merger	Before merger	After merger	Merging A.C.	Non-merging A.C.
(1) Current ratio	Means St. dev.	98.75 6.94 c	100.02 2.29	122.67 158.6 c	104.22 c 5.44	98.74 6.94 c	122.67 158.68
(2) Fixed assets to equity	Means St. dev.	80.34 58.84 a	75.10 77.63	103.54 161.43 c	132.87 154.56	80.34 a 58.84	103.86 61.85
(3) Ratio of cash and deposits to savings	Means St. dev.	56.24 c 17.53	40.11 16.34	52.60 18.78	51.10 18.74	56.24 17.53	52.66 18.78
(4) Ratio of loans to savings	Means St. dev.	46.91 a 19.49	56.75 20.75	48.66 20.41	55.10 19.00	46.64 19.71	48.66 20.41
(5) Net equity ratio	Means St. dev.	2.92 0.65 c	3.44 4.47	3.00 1.40 c	3.53 2.18	2.92 0.65 c	3.00 1.40
(6) Net profit to equity	Means St. dev.	21.62 14.01 c	23.40 20.99	29.78 43.96 c	45.52 154.14	21.62 14.01 c	29.78 43.96
(7) Net profit to total assets	Means St. dev.	0.58 0.24	0.55 0.27	0.71 0.43 c	1.01 1.74	0.58 0.24 c	0.71 0.43
(8) Ratio of operating expense to operating profit	Means St. dev.	125.98 49.28 c	194.73 326.14	141.18 104.70	125.95 107.79	125.98 49.28 c	141.18 104.70
(9) Ratio of personnel expense to operating expense	Means St. dev.	69.80 c 3.87	72.83 4.61	66.23 11.04 c	69.02 6.73	68.81 a 3.87 c	66.23 11.04
(10) Operating profit to fixed assets	Means St. dev.	113.56 47.89	107.39 39.06	162.75 93.83 c	194.42 222.80	113.56 c 47.89 c	162.75 93.83
(11) Operating profit per full-time officer and employee	Means St. dev.	958 c 396 c	2739 929	1071 c 432 c	2441 899	958.24 396.43	1071.14 431.73
(12) Operating expense per full-time officer and employee	Means St. dev.	702 c 220 c	2105 717	729 c 232 c	1752 653	701.72 220.09	728.75 232.18
(13) Savings per member	Means St. dev.	890 c 478 c	1860 817	1087 c 729 c	2226 1205	890 478 c	1087 729
(14) Loans per member	Means St. dev.	418 c 1334 c	1050 632	503 c 404 c	780 645	418 344	503 404
Classification Accuracy		95.83 %		91.67 %		81.25 %	

1) "a" indicates the statistically significant difference at the 5 % level, "c" at the 0.1 % level.

2) A unit of (11), (12), (13) and (14) is thousand yen.

3) St. dev. = Standard deviations.

Table 1. Comparisons of Merging and Non-Merging Agricultural Cooperatives (A.C.) before and after Mergers (continued)

Financial ratios	Statistics	(IV)		(V)		(VI)	
		After merger		Merging A.C.	Non- merging A.C.	Before merger	After merger
		Merging A.C.	Non- merging A.C.				
(1) Current ratio	Means	100.02	c 104.18	99.38	113.42	110.01	102.10
	St. dev.	2.29	c 5.96	5.18	112.08	112.36	c 4.95
(2) Fixed assets to equity	Means	75.15	a 132.87	77.74	c 118.37	92.10	104.01
	St. dev.	77.62	c 154.56	66.49	c 118.00	58.88	c 125.06
(3) Ratio of cash and deposits to savings	Means	40.08	c 51.10	48.16	51.85	54.42	c 45.59
	St. dev.	16.33	18.74	18.71	18.68	18.16	18.34
(4) Ratio of loans to savings	Means	56.75	55.10	51.69	51.88	47.65	c 55.92
	St. dev.	20.75	19.00	20.76	19.88	19.98	19.81
(5) Net equity ratio	Means	3.43	3.53	3.17	3.26	2.96	3.48
	St. dev.	4.47	c 2.18	3.19	c 1.84	1.08	c 3.50
(6) Net profit to equity	Means	23.60	45.51	22.61	37.65	25.70	34.56
	St. dev.	21.17	c 154.14	17.88	c 113.02	32.71	107.99
(7) Net profit to total assets	Means	0.55	0.27	0.56	a 0.86	0.64	0.78
	St. dev.	1.01	c 1.74	0.25	c 1.27	0.35	c 1.26
(8) Ratio of operating expense to operating profit	Means	194.94	125.95	160.46	133.56	133.58	160.45
	St. dev.	326.10	c 107.79	234.55	c 105.97	81.75	c 244.05
(9) Ratio of personnel expense to operating expense	Means	72.85	c 69.02	71.33	c 67.63	68.01	c 70.93
	St. dev.	4.61	a 6.73	4.51	c 9.20	8.42	c 6.05
(10) Operating profit to fixed assets	Means	107.70	a 194.42	110.63	c 178.59	138.16	151.06
	St. dev.	38.97	c 222.80	43.53	c 170.78	78.11	c 164.95
(11) Operating profit per full-time officer and employee	Means	2739	2443	1819	1757	1015	c 2591
	St. dev.	928	899	1142	984	416	c 921
(12) Operating expense per full-time officer and employee	Means	2105	a 1752	1404	1240	715	c 1929
	St. dev.	717	653	881	a 709	225	c 705
(13) Savings per member	Means	1860	2225	1375	1656	988	c 2043
	St. dev.	817	c 1205	825	c 1144	620	c 1040
(14) Loans per member	Means	1049	1180	734	841	460	c 1114
	St. dev.	632	645	598	634	375	c 639
Classification Accuracy		90.63 %		80.21 %		91.15 %	

Next we compare the ratios of merging and non-merging agricultural cooperatives before merger in Column (III), and after merger in Column (IV). Merely, there are three ratios: the current ratio (1), the ratio of cash and deposits to savings (3); and the ratio of operating expense per full-time officer and employee (12).

Ratio (1) has a statistically significant difference only after mergers with means of 100.02% vs. 104.18% for merging and non-merging agricultural cooperatives as shown in Column (IV). This indicates non-merging agricultural cooperatives have higher liquidity, a favorable characteristic. Similarly, the ratios of cash and deposits to savings (3) are 40.08% vs. 51.10%, a significant difference for merging and non-merging agricultural cooperatives. This also shows a favorable trend for non-merging agricultural cooperatives. The operating expenses per full-time officer and employee (12) are ¥2,105,000 vs. ¥1,752,000 for merging vs. non-merging agricultural cooperatives, meaning higher efficiency for non-merging agricultural cooperatives.

Therefore, the overall effect of mergers as shown by comparisons of Columns (I) and (II), and (III) and (IV) of Table 1, is negative. However, these comparisons show no effect for mergers on profitability related ratios.

Column (V) of Table 1 compares general financial ratios between merging and non-merging agricultural cooperatives. There are four ratios with statistically significant differences in their means. The fixed asset to equity ratios (2) are 77.74% vs. 118.37% for merging and non-merging agricultural cooperatives, which indicates that non-merging agricultural cooperatives have greater financial soundness.

The ratios of net profit to total assets (7) are 0.56% vs. 0.86% for merging and non-merging agricultural cooperatives, indicating higher profitability for non-merging agricultural cooperatives. The ratios of personnel expense to operating expense (9) are 71.33% vs. 67.63%. Non-merging agricultural cooperatives have a lower burden of personnel expense. The ratios of operating profit to fixed assets (10) are 110.63% vs. 178.59%, which indicate higher turnover for non-merging agricultural cooperatives. It is quite clear that the financial characteristics of non-merging agricultural cooperatives are superior to merging agricultural cooperatives.

There are not any significant trends in the size of ratio, standard deviations between merging and non-merging agricultural cooperatives.

Column (VI) of Table 1 compares the financial characteristics of agricultural cooperatives before and after mergers. Ratio (3), the ratio of cash and deposits to savings, and (4), the ratio of loans to savings have a trend opposite to the size. This is shown by the ratios: 54.42% vs. 45.59%, and 47.65% vs. 55.92% before and after merger. The ratios of personnel expense to operating expense (9) are 68.01% vs. 70.93% before and after mergers. All the four productivity related ratios: (11) operating profit per full time officer and employee, (12) operating

expense per full time officer and employee, (13) savings per member and (14) loans per member, are higher after mergers with a statistically significant difference in their means. This might be due to both internal and external growth.

The bottom row of Table I shows the classification accuracy of a discriminant analysis, which was applied to the same data used. Column (I) shows the classification accuracy of merging agricultural cooperatives, 95.83% before and after merger, which is about 4% higher than that of Column (II) which shows non-merging agricultural cooperatives, 91.67%.

The same trend is observed in Column (III) for merging and non-merging agricultural cooperatives before mergers with an accuracy 81.25% and in Column (IV) after mergers with an accuracy 90.63%. Mergers contributes to an increase in accuracy.

Analysis by Relative Financial Ratios

The relative financial ratios of agricultural cooperatives are compiled from the difference in absolute financial ratios between merging and non-merging agricultural cooperatives as follows.

$$d_{ijk} = M_{ijk} - N_{ijk}$$

where,

d_{ijk} : relative financial ratio k ($k = 1, 2, \dots, 14$), of the i th ($i = 1, 2, \dots, 58$) agricultural cooperatives at the j th ($j = 1969, \dots, 1983$) year

M_{ijk} : financial ratio k of the i th merging agricultural cooperatives at the j th year.

N_{ijk} : Corresponding financial ratio k of the i th non-merging agricultural cooperatives at the j th year.

Table 2 compares agricultural cooperatives before and after merger for the whole year, one year, two years and three years. There are three ratios with statistically significant differences in their means. They are the ratio of cash and deposits to savings (3) with means of 3.64% vs. -11.02%, a negative effect after mergers, operating profit per full-time officer and employee (11), (- ¥112,900 vs. ¥296,090) with a positive effect, and operating expense per full-time officer and employee (12) (- ¥27,030 vs. ¥353,060), with a negative effect. The two ratios with opposite effects offset each other.

Table 2. Yearly Comparison of Merging Agricultural Cooperatives by Relative Financial Ratios

Financial ratios	four years		one year		two years		three years	
	Before merger	After merger	Before merger	After merger	Before merger	After merger	Before merger	After merger
(1) Current ratio	- 23.93 158.91 c	- 4.16 5.89	0.25 4.79	- 2.54 4.34	- 45.69 224.75 c	- 3.85 6.78	- 31.66 183.47 c	- 4.07 6.21
(2) Fixed assets to equity	- 23.52 75.81 c	- 57.73 24.90	- 30.24 93.70	- 1.29 62.88	- 27.57 84.60	-19.82 70.05	- 26.89 81.88 c	- 58.01 157.76
(3) Ratio of cash and deposits to savings	3.64 c 19.21	- 11.02 25.21	0.35 19.14	- 12.62 33.42	0.52 18.23 a	- 11.17 28.46	4.44 a 20.95	- 10.43 26.25
(4) Ratio of loans to savings	- 2.02 18.62 a	1.64 25.11	1.22 15.79	1.15 27.47	1.93 17.32	1.46 23.98	- 2.29 19.56	1.21 24.66
(5) Net equity ratio	- 0.08 1.37 c	- 0.10 4.96	- 0.33 1.57	- 0.80 1.28	- 0.19 1.46	- 0.45 1.61	- 0.16 1.42 c	- 0.81 2.63
(6) Net profit to equity	- 8.15 47.84 c	21.92 156.25	- 2.22 18.00 c	- 90.51 308.13	- 2.41 19.90 c	- 48.84 218.27	- 3.69 21.39 c	- 28.04 180.44
(7) Net profit to total assets	- 0.13 0.54 c	- 0.46 1.79	- 0.07 0.51 c	- 0.74 2.54	- 0.07 0.51 c	- 0.78 2.47	- 0.12 0.55 c	- 0.54 2.05
(8) Ratio of operating expense to operating profit	- 15.20 105.95 c	68.98 349.73	- 3.70 104.95	- 23.90 192.85	- 11.19 97.72	12.54 148.33	- 11.08 93.15 c	81.88 402.59
(9) Ratio of personnel expense to operating expense	3.57 11.30	3.82 8.72	6.26 19.11 a	7.11 9.21	4.07 14.55 c	6.05 7.70	3.69 12.30	4.93 7.46
(10) Operating profit to fixed assets	- 49.19 91.23 c	- 86.72 223.56	- 35.01 98.99	- 26.04 76.31	- 36.95 100.96	- 42.74 91.16	- 45.19 96.42 c	- 81.69 216.02
(11) Operating profit per fulltime officer and employee	- 112.90 c 404.09 c	296.09 863.65	-122.62 531.34	- 167.87 731.48	- 105.86 474.59 a	25.65 781.48	-123.51 436.13 c	190.89 858.18
(12) Operating expense per fulltime officer and employee	- 27.03 c 190.44 c	353.06 659.25	7.90 203.78	- 25.42 378.04	- 22.45 211.88 c	149.55 537.11	- 27.30 c 201.37	258.35 581.74
(13) Savings per member	- 197.06 637.97 c	- 365.26 1158.46	- 255.20 841.64	- 325.90 1013.27	- 235.14 746.45	- 326.95 1033.92	-201.72 678.02 c	- 343.45 1083.85
(14) Loans per member	- 85.64 463.91 c	- 129.82 864.60	- 77.35 606.60	- 144.20 835.21	- 65.71 528.0 c	- 129.14 823.89	- 94.14 501.33 c	- 137.05 844.51
Classification Accuracy	84.38 %		79.17 %		75.00 %		76.39 %	

1) "a" indicates the statistically significant difference at the 5 % level, "c" at the 0.1 % level.

2) A unit of (11), (12), (13) and (14) is thousand yen.

3) To each cell, upper figures are means and lower figures are standard deviations.

Yearly comparisons of agricultural cooperatives from one year to three years, are provided in Table 2. There are no financial ratios with significant differences in their means in the comparison of one year before and after mergers. But there are three ratios with significant differences in their standard deviations. The net profit to equity ratio (6) and the net profit to total assets ratio (7) have higher values while the ratio of personnel expense to operating expense (9) has a lower value after mergers. No clear trend is found. In comparison with data two years before and after mergers, no financial ratios with significant differences in their means are found.

Five more ratios such as (1) the current ratio, (3) the ratio of cash and deposits to savings, (11) operating profit per full-time officer and employee, (12) operating expense per full-time officer and employee and (14) loans per member are found as ratios with significant differences in their standard deviations. Except for (1) the current ratio, four other ratios have higher values after mergers.

Comparing three years before and after mergers, two ratios, (3) the ratio of cash and deposits to savings and (12) operating expense per full-time officer and employee are found as ratios with statistically significant differences in their means. This shows the same trend when compared to the fourth year.

The bottom row of Table 2 shows the classification accuracy of agricultural cooperatives using discriminant analysis from one to four years before and after mergers. The classification accuracy of one year before and after merger is 79.17% and 75.00% for two years, 76.39% for three years, and 84.38% for four years, the highest of all, before and after mergers. This result supports the previous tests of *t* and *F* values.

Conclusion

By comparing financial ratios for 58 merging and 12 non-merging agricultural cooperatives in Gifu Prefecture using *t* and *F* tests, and discriminant analysis, a negative merger effect is seen in four ratios: (1) the current ratio, (3) the ratio of cash and deposits to savings, (9) the ratio of personnel expense to operating expense, and (12) operating expense per full-time officer and employee. A positive effect is associated with (4) the ratio of loans to savings.

By using relative financial ratios, the difference in financial ratios of merging and non-merging agricultural cooperatives, (11) the operating profit per full-time officer and employee shows positive effect, and (3) ratio of cash and deposits to savings and (12) operating expense per full-time officer and employee have a negative effect.

However, neither method contributes to finding merger effects on profitability-related ratios.

In summary, we find negative merger effects for agricultural cooperatives in Gifu Prefecture in Japan.

A general comparison of financial ratios between merging and non-merging agricultural cooperatives show that non-merging agricultural cooperatives are superior to merging agricultural cooperatives.

The October 1991 National Convention of Agricultural Cooperatives adopted a plan of the creation of bigger amalgamated cooperation in order to streamline management further⁷.

However our findings do not support the plan. Moreover, Hoshino (1982, 1988, 1991, 1992) has demonstrated that merger brings negative performance for similar financial institutions such as credit associations and credit cooperatives, as well as for stock listed corporations in Japan.

Therefore as a business strategy for survival, merger is not effective. They might be able to pursue other alternatives such as tie-ups or joint ventures among cooperatives or changing the business form into stock issued corporation.

Notes

- 1 The author would like to thank Professors Marc Bremer of Nanzan University and Stephen Turnbull of University of Tsukuba for editing this paper. However, the author alone is responsible for any remaining errors. This work is supported by the Research Fund of Central Union of Agricultural Cooperatives of Japan.
- 2 See Ministry of Agriculture, Forestry and Fisheries (1990).
- 3 Kitagawa (1989) describes various policies and operations for promoting mergers of agricultural credit cooperatives for the period of October 1953 to the seventh extension of the Act for Mergers to Advance Agricultural Cooperatives by the Ministry of Agriculture, Forestry and Fisheries, and the Central Union of Agricultural Cooperatives of Japan.
- 4 The Central Union of Agricultural Cooperatives and the Agricultural Development and Training Center (1989) examine the cases of Mie and Hyogo Prefecture.
- 5 We investigated three prefectures in the Tokai area, Aichi, Gifu and Mie Prefectures. In Mie Prefecture, samples including merging and non-merging agricultural cooperatives could not be selected to cover a period long enough for analysis. In Aichi Prefecture, only three agricultural cooperatives merged in 1981, 1982, 1983 and can be used as samples. However the situation is quite different from Gifu Prefecture, where mergers occurred in 1972, 1973, 1974 and 1977. Thus, we only analyzed mergers in Gifu Prefecture to avoid errors due to completely different years with ten years' time difference.
- 6 The agricultural cooperatives with 5,000 homes and over are most efficient in terms of total cost ratio and operating expense ratio. However, the smallest agricultural cooperatives with less than 500 homes rank second out of 6 on operating expense ratio and third on total cost ratio. We can not expect a simple relationship between size and efficiency.
- 7 Takada (1989) pointed out that bigger agricultural cooperatives have lower cost related ratios and they are more efficient than smaller agricultural cooperatives. However, even if this is true, we can not conclude that mergers contribute to improvement in management efficiency. Corporate growth is composed of internal growth and external growth, i. e. merger. Internal growth by enlargement of the size of the organization is connected to raising management efficiency.

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