OWNERSHIP STRUCTURE AND FIRM PROFITABILITY IN JAPAN

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We examined the relationship between the ownership structure and financial performance of 334 Japanese corporations for the 1986-91 period. The positive relationship we found between ownership concentration and financial performance is consistent with agency theory predictions. In addition, we observed a more pronounced profit redistribution effect characterized by the transferring of financial resources from more to less profitable firms. These findings indicate the need to account for both economic incentives and social context in corporate governance research.

In the economics, finance, and strategic management literatures, agency theory represents a dominant theoretical frame of reference for the study of the relationship between ownership and performance (Shleifer & Vishny, 1997). Agency theory highlights the idea that principals and agents often have divergent goals and divergent capacities to influence corporate behavior and outcomes (Mgrom & Roberts, 1992). An important contribution of agency theory is that it facilitates a structured approach to the analysis of economic motivations and the incentives of managers and shareholders (Eisenhardt, 1989). Agency theory has been criticized in the sociology literature, however, for its proponents' failure to pay sufficient attention to the contexts in which exchange and principal-agent relations are embedded (Hamilton & Biggart, 1988).

Ownership concentration is a variable of interest to scholars in a number of disciplines, and its influence on strategic behavior and corporate performance has been studied in a wide variety of national contexts (Gedajlovic & Shapiro, 1998) and from differing theoretical perspectives. In research emphasizing the influence of economic incentives on top executives and investors, ownership concentration has been used primarily as a barometer of agency costs (Shleifer & Vishny, 1997). In studies emphasizing social context, ownership concentration has been used as an indicator of the strength of the ties a firm has to its investors (Gerlach, 1992; Lincoln, Gerlach, & Ahmadjian, 1996). Previous empirical studies examining the ownership-performance link have had frames of reference restricted to one or the other of these perspectives. In this study, we bridge this divide by combining insights from both streams of research to analyze the impact of ownership concentration on firm performance in Japan.

We first used standard agency theory logic to develop the hypothesis that ownership concentration and firm performance are directly and positively related in Japan. Subsequently, we developed hypotheses that account for a unique feature of Japan's institutional context. Specifically, we evaluated the possibility that an important effect of ownership concentration in Japanese firms is to promote intercorporate goals of risk reduction and mutual assistance (Aoki, 1988; Dore, 1983; Nakatani, 1984). We built upon the work of Lincoln and colleagues (1996), who found that the performance of firms with close ties to one of the "Big Six"1 Japanese keiretsus is conditioned by past performance in a manner that benefits weaker performers at the expense of stronger companies. Our context-specific hypotheses address the likelihood that a similar pattern of structured interaction extends to a much broader set of Japanese firms through ownership ties.

Although the theoretical underpinnings of agency and redistribution effects emanate from different lit-

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1 The "Big Six" keiretsus are Mitsubishi, Mitsui, Sumitomo, Fuji, Sanwa, and Dai-Ichi Kangyo.
eratures and suggest different associations between ownership concentration and financial performance, there is no a priori reason why both effects cannot occur contemporaneously. On the contrary, since Japan’s unique form of industrial organization is characterized by both a pronounced separation of ownership and control (Claessens, Djankov, & Lang, 2000) and a complex network of intercorporate relationships (Gerlach, 1992), there is reason to expect that both agency and redistribution effects will be apparent. Accordingly, we derived and specified a model that accounts for the possible existence of both types of effects. We evaluated this model on a pooled cross-sectional sample of 334 publicly listed Japanese firms spanning their 1986–91 fiscal years.

BACKGROUND

National systems of corporate governance evolve in order to exploit the advantages of the corporate form of organization while mitigating concomitant agency costs in a manner consistent with a country’s history and legal, political, and social traditions. In this regard, nations differ significantly in terms of the variety and the effectiveness of the constraints placed upon their top executives (Gedajlovic & Shapiro, 1998). Japan’s system of governance represents an interesting case insofar as professional managers rather than entrepreneurs and their extended families (Hamilton & Biggart, 1988). Historically, the shareholdings of Japanese professional managers have been negligible (Charkham, 1994). At the same time, Japan’s system of corporate governance is intimately tied to the variety of intercorporate groupings and alliances that dominate its enterprise system. Joint and reciprocal monitoring among business partners engaged in a multiplexity of business relations is a distinctive feature of Japan’s system of corporate governance (Roe, 1994). Gerlach (1992) described how these intercorporate networks transcend formal groupings and pervade much of the Japanese economy. Although the most formal of these groupings are often referred to as keiretsus, Gerlach suggested that the term be used as “a metaphor for general patterns of inter-firm organization in Japan—as an ideal type” (1992: 5–6).

In terms of corporate governance, two varieties of these networks are particularly relevant: industrial, or vertical keiretsus, and financial, or horizontal keiretsus. Industrial keiretsus link vertically related firms along an industry value chain through the cross-ownership of equity (Dyer, 1996). Thus, the members are typically a large manufacturer and its major suppliers. An exchange of employees and directors often accompanies the cross-ownership of shares. Financial keiretsus link companies (usually in different industries) through a common main bank, which typically has an ownership stake in a network’s firms and provides loans and commercial services to them (Hoshi, Kashyap, & Scharfstein, 1990).

There exists a large body of research on the effects of network, or keiretsu, ties (e.g., Gerlach, 1992) and the role of main banks (e.g., Aoki, Patrick, & Sheard, 1994), but empirical evidence concerning the relationship between ownership and firm performance in that country is quite sparse and equivocal. Cable and Yasuki (1985) found that ownership concentration outside keiretsus was positively related to firm performance but that shareholdings within these groups were unrelated to performance. Prowse (1992) found no significant relationship between ownership concentration and financial performance among either keiretsu or nonkeiretsu firms. In the same year, Gerlach (1992) reported a positive relationship between ownership concentration and firm performance in a regression model that controlled for both keiretsu membership and debt ties to a main bank.

THEORY AND HYPOTHESES

Agency theory suggests that the corporate form of organization characterized by a professional management with little ownership operating a business on behalf of a large number of widely dispersed shareholders represents an archetypal principal-agent problem (Eisenhardt, 1989). This agency problem stems from the fact that managers often have both the discretion and incentive to pursue strategies and practices that benefit themselves at the expense of shareholders (Jensen & Meckling, 1976). The exercise of managerial discretion can be harmful to shareholders in two broad ways. Managers may engage in short-run cost augmenting activities to enhance their nonsalary income and/or they may indulge their need for power, prestige, and status by attempting to maximize corporate size and growth rather than corporate profits (Gedajlovic & Shapiro, 1998).

From an agency perspective, many Japanese managers may have both the incentive and the discretion necessary to pursue their own interests at the expense of shareholders. Top executives typically lack ownership incentives insofar as their
shareholdings are negligible and because the use of stock-based and other performance-based incentives has been very uncommon (Fukao, 1999). Under such conditions, agency theory suggests, managers lack the incentive to maintain tight cost control (Alchian & Demsetz, 1972) and will tend to adopt strategies and practices that benefit themselves at the expense of shareholders. At the same time, the absence of an active market for corporate control in Japan (Walsh & Seward, 1990) and the tendency for Japanese corporations to have insider-dominated boards (Charkham, 1994) create conditions that afford managers a broad scope of exercisable discretion. In the absence of either capital market constraints or vigilant outside directors, the monitoring of managers by shareholders who hold large blocks of shares (blockholders) takes on heightened significance (Shleifer & Vishny, 1997). As a consequence, we expected to find a positive relationship between the ownership concentration and financial performance of Japanese corporations.

Hypothesis 1a. There is a positive relationship between the sizes of the ownership stakes of shareholders and profitability among Japanese firms.

Hypothesis 1a does not distinguish among various types of blockholders. Recent theory and evidence suggest that shareholder identity may matter because shareholders can have heterogeneous incentives and capacities to monitor managers (Gedajlovic, 1993; Thomsen & Pederson, 2000). In this regard, shareholdings by Japanese financial institutions and nonfinancial corporations may impose important limits on managerial discretion. Since these firms are commonly not only a corporation’s shareholders, but are also its creditors, buyers, suppliers, and business partners, they are exceptionally well positioned to monitor the managers of firms within their network (Berglöf & Perotti, 1994). In such an information-rich context, managers are less likely to have the discretion necessary to pursue their own interests at the expense of their shareholders or stakeholders. Further, any such behavior is likely to be detected early because of the dense web of equity, debt, and commercial ties that characterize such relations.

Hypothesis 1b. There is a positive relationship between the sizes of the shareholdings of financial institutions and nonfinancial corporations and profitability among Japanese firms.

Hypotheses 1a and 1b are derived from an agency perspective that suggests that ownership concentration promotes the pursuit of profit maximization. However, it is often argued that the multiple equity, debt, and commercial ties characterizing the Japanese economy are linked to intercorporate goals of risk reduction and mutual assistance (Dore, 1983; Gerlach, 1992) that result in systematic patterns of profit redistribution among Japanese firms (Lincoln et al., 1996). In this respect, there is some evidence that firms pay “insurance premiums” to their main banks against the possibility of future financial distress in the form of overborrowing (Aoki, 1988) at high rates of interest (Weinstein & Yafeh, 1994).

Hoshi and colleagues (1990) and Morck and Nakamura (1999) have offered evidence supporting this view insofar as they have observed that Japanese banks treated firms with which they had close ties and those with which they did not have close ties differently during times of financial distress. Morck and Nakamura (1999) noted that banks act to prop up weak firms with which they have close ties. Lincoln and colleagues (1996) extended the insurance metaphor beyond the banking sector and suggested that by “taxing” prosperous members to ensure the survival and speed the recovery of troubled affiliates, keiretsu networks distribute benefits and burdens in a discriminating way. The process of redistribution is facilitated by the multiplicity of direct and indirect debt, equity, and commercial ties that characterize intercorporate relations in Japan. In such a context, banks can extend benefits to affiliated firms by increasing their shareholdings or by providing loans or professional services on favorable terms (Morck & Nakamura, 1999). Similarly, industrial firms can purchase or supply products and/or services on favorable terms in order to assist a troubled business partner (Lincoln et al., 1996).

The norm of redistribution may be widespread. In describing the pervasiveness of formal and informal links throughout Japanese industrial organization, Gerlach noted that intercorporate relationships within keiretsus have much in common with those found in ostensibly more independent firms (1992: 6). This assessment receives support in Hoshi, Kashyap, and Scharfstein’s (1991) finding that the benefits of bank-led bailouts extended to nonkeiretsu firms that nevertheless had strong ties to a bank. Thus, there is some evidence that the redistribution patterns observed by Lincoln et al. (1996) are a discernible characteristic of Japan’s broader business system rather than a keiretsu-only phenomena. In this regard, Clark’s widely cited comment that in Japan “shareholding is the mere expression of their relationship, not the relationship itself” (1979: 86) suggests that equity ties are symbolic indicators of more profound relational...
ties that extend beyond the shareholder-firm relations observed in arm's-length governance systems. In this study, we considered the effects of ownership structure on intercorporate profit redistribution. Specifically, we evaluated whether ownership ties in particular, the ties between Japanese financial institutions and nonfinancial corporations and the firms in which they hold shares—result in the same pattern of profit redistribution observed by Lincoln et al. (1996) with respect to keiretsu ties. Accordingly, we propose:

**Hypothesis 2a.** The relationship between the size of the ownership stake of corporate blockholders and firm profitability is conditioned by prior profitability. Firms with low prior profits benefit from high levels of ownership in the hands of blockholders, but firms with high prior profits have their profitability reduced.

**Hypothesis 2b.** The relationship between the size of the shareholdings of Japanese financial institutions and Japanese nonfinancial corporations and firm profitability is conditioned by prior profitability. Firms with low prior profits benefit from these equity ties, but firms with high prior profits have their profitability reduced.

### METHODS

**Specification**

Agency theory suggests that the empirical relationship between ownership concentration and performance can be estimated by an equation in the form

\[
\pi_{it} = \alpha + \beta_1 \text{ownership concentration}_{it} + \delta X_{it} + \lambda \pi_{it-1} + \phi \text{ownership share}_{it} \times \pi_{it-1} + \epsilon_{it} \quad (1)
\]

Equation 1 estimates the direct impact of ownership concentration on firm profitability (\(\pi\)), holding constant a vector of control variables \(X\). Agency theory suggests that the equation's beta coefficient is greater than zero (\(\beta_1 > 0\)). Our use of panel data is indicated by the subscripts, with \(i\) denoting a cross-sectional observation (a firm) and \(t\) denoting time. Our hypotheses are framed in terms of three measures of ownership structure described below: ownership concentration among blockholders without regard to identity, the total ownership shares of Japanese financial institutions, and the ownership shares of Japanese nonfinancial corporations. Accordingly, we estimated Equation 1 three times. Estimates indicating a beta greater than zero for each measure of ownership concentration would support Hypotheses 1a and 1b, which claim that there is a positive, direct relationship between ownership structure and firm performance in Japan.

Equation 1 does not account for redistribution effects. Following Lincoln and colleagues (1996), we adopted a dynamic extension of the model that allowed us to test both the agency and redistribution hypotheses.

\[
\pi_{it} = \alpha + \beta_2 \text{ownership share}_{it} + \delta X_{it} + \lambda \pi_{it-1} + \phi \text{ownership share}_{it} \times \pi_{it-1} + \epsilon_{it} \quad (2)
\]

Equation 2 suggests that firm performance depends not only on ownership, but also on past profitability. Lincoln et al. suggested that the coefficient on the lagged profitability term would reflect the ability of Japanese firms to redistribute profits. The lower the coefficient, the greater is the redistribution effect.\(^2\) In such a specification, a possible agency effect is still captured by the direct effect of ownership on profitability, and Hypotheses 1a and 1b would be supported by a finding that \(\beta_2\) is greater than zero for each ownership measure. As Lincoln and coauthors suggested (1996: 73-74), the degree to which ownership structures influence the extent of redistribution can be estimated by \(\phi\), the coefficient on the interactive term between ownership concentration and past profitability. In our case, the hypotheses that redistribution is facilitated by ownership concentrated in the hands of blockholders (2a) or, more specifically, in the hands of either Japanese financial or nonfinancial corporations (2b) will receive support if \(\phi\) is less than zero for each ownership measure. That is, a negative phi coefficient would imply that an ownership variable is associated with the redistribution of profits from more to less profitable firms.

### Sample and Variables

The data consist of pooled time series and cross-sectional observations of 334 listed Japanese firms spanning 1986-91 (fiscal years). Firms included in the sample represent a broad cross-section of me-

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\(^2\) This may be seen by considering the partial derivative of current profitability with respect to past profitability in Equation 2. The higher the value, the more likely it is that high (or low) profits persist. Redistribution from high-profitability firms to low-profitability firms smoothes out performance over time and lowers the estimated coefficient on the lagged term. As indicated in Equation 2, we have assumed a one-period lag. This choice is consistent with the literature on the persistence of profitability (Mueller, 1990), though Lincoln et al. (1996) averaged the one- and two-year lagged profits.
The dependent variable in all equations is firm profitability. We measured profitability using return on assets (ROA), the ratio of net income to total assets. ROA is a commonly used measure of profitability and has been used by others in the Japanese context (e.g., Prowse, 1992; Lincoln et al., 1996). Prowse (1992) noted that since stock market returns are expected to adjust for any divergences between shareholders and managers, accounting-based measures such as ROA are preferable in studies relating ownership structure to financial performance.

The most important independent variables in terms of our hypotheses are three measures of ownership structure. The first measure, ownership by five largest blockholders, is a measure of ownership concentration that does not distinguish shareholders' identities. This measure is identical to the primary one used by Prowse (1992). This variable was used to evaluate Hypotheses 1a and 2a. As described above, a distinguishing feature of corporate ownership in Japan is the fact that other Japanese firms hold significant proportions of firms' outstanding shares. Consequently, we consider two additional ownership variables: ownership by financial institutions and ownership by nonfinancial companies. Each measure is equal to the percentage of a company's outstanding shares held by Japanese financial and nonfinancial companies, respectively. These variables were used to evaluate Hypotheses 1b and 2b.

The following variables constituted control (exogenous) variables, previously subsumed under the vector $X$ in Equations 1 and 2. We chose these variables to control for factors other than ownership structure that have been shown to affect profitability. Firm size, measured as the log of total assets, was included to account for the potential economies of scale and scope accruing to large firms. If present, these would produce a positive relationship between firm size and profitability. Firm growth, measured as year-over-year sales growth, was used as a control for demand conditions and product-cycle effects. Financial leverage, measured as the ratio of debt to capital employed, was included because a firm's capital structure may influence its investment decisions and the discretion afforded its managers (Harris & Raviv, 1991). A series of indicator variables was also included in all models, as controls for industry affiliation.

The focus of this study was on the effects of ownership structure rather than main bank or keiretsu ties. We controlled for main bank effects through the use of an indicator variable representing whether a firm's main bank was one of Japan's Big Six banks (Sumitomo, Mitsui Taiyo Kobe, Dai-Ichi Kangyo, Fuji, Sanwa, or Mitsubishi). Approximately 70 percent (234) of the firms included in our sample had a Big Six main bank. To control for keiretsu ties, we followed Lincoln et al. (1996) and used an indicator variable measuring whether a firm was a member of the shacho-kai (Presidents' Club) of a Big Six keiretsu. The sample contains 51 firms with shacho-kai membership (15 percent of the sample).

**ESTIMATION AND RESULTS**

Equation 1 can be estimated by conventional panel data methods (fixed- and random-effects). We first estimated the model using ordinary least squares (OLS). We then estimated the same model using a fixed-effects model and used a Lagrange multiplier test (Greene, 1993: 476) to choose between it and OLS. The fixed-effects model was preferred in all cases. The model was then estimated with a generalized least squares (GLS) random-effects model. We compared this to the fixed-effects model using the Hausman test (Baltagi, 1995: 68) and in all cases chose the random-effects model. As a consequence, we report the random-effects results in Table 2 below.

Dynamic panel data models such as the one required to test Hypotheses 2a and 2b, represented by Equation 2, can pose serious estimation challenges since the lagged dependent variable will be correlated with the cross-sectional component of the error term (Baltagi, 1995: 125–126). Standard panel data techniques can produce parameter estimates
TABLE 1
Means, Standard Deviations and Correlations

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>s.d.</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ownership by largest five blockholders</td>
<td>33.66%</td>
<td>14.07</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Ownership by nonfinancial companies</td>
<td>19.32%</td>
<td>17.07</td>
<td>.91***</td>
<td></td>
<td></td>
<td>- .64</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Ownership by financial institutions</td>
<td>19.19%</td>
<td>8.65</td>
<td>- .44</td>
<td>- .64</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Return on assets</td>
<td>3.84%</td>
<td>2.86</td>
<td>- .01</td>
<td>- .01</td>
<td>- .01</td>
<td>- .01</td>
<td>- .01</td>
<td>- .01</td>
</tr>
<tr>
<td>5. Logarithm of assets</td>
<td>7.47</td>
<td>40.96</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Debt to capital employed</td>
<td>8.26%</td>
<td>25.74</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Sales growth</td>
<td>40.96%</td>
<td>25.74</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Sample size is 334 firms observed over six years.
** p < .01
*** p < .001
Two-tailed tests.

that are biased and inconsistent, even if the error terms are not serially correlated (Baltagi, 1995: 126). Most proposed solutions rely on first-difference transformations of the data with some form of instrumental variable estimation (Baltagi, 1995: 126). Arellano and Bond (1991) suggested using the generalized method of moments (GMM) technique on differenced data and demonstrated how the GMM method could be used to provide unbiased and consistent parameter estimates (Baltagi, 1995: 127–128). Estimation using the Arellano and Bond method does come at a cost insofar as the method cannot provide coefficient estimates for variables that are time-invariant, such as the dummy variables for industry, main bank, and shacho-kai membership in this study. Since these variables are important in Japan, we estimated Equation 2 using GLS random-effects estimation. We also estimated models that excluded the time-invariant variables using the Arellano and Bond (GMM) technique. Fortunately, the results obtained from these two techniques are very similar, and we therefore report only the more familiar random-effects results. Considering the GMM results would change none of the conclusions reported below.5

Table 1 provides the pooled (1986–91) means and standard deviations of the continuous measures used in the multivariate analysis, as well as the correlation matrix for the same variables. As indicated in Table 1, a sample firm’s five largest blockholders own on average 33.66 percent of its outstanding shares; nonfinancial firms own 19.32 percent; and financial institutions own 19.19 percent. These means are consistent with those reported on similar measures by Charkham (1994) and Prowse (1994).

The three ownership measures examined in this study are clearly related. The ownership share of the five largest blockholders is very highly correlated with the total ownership share of Japanese nonfinancial corporations (r = .91). On the other hand, blockholder ownership concentration is negatively correlated with ownership by financial institutions (r = -.44). This indicates that ownership concentration levels vary directly and proportionally with ownership by nonfinancial corporations but are inversely proportional and less strongly related to ownership by financial institutions. Lastly, the proportion of outstanding shares held by financial institutions is negatively related to the proportion of shares held by nonfinancial corporations (r = -.64).

Regression results are presented in Table 2. Models 1–3 of Table 2 present the GLS (random-effects) estimates of the coefficients of the three measures of ownership. Models 4–10 are estimates of the coefficients of Equation 1. We also present one variant that includes both financial and nonfinancial ownership variables in the same specification (model 7). Models 8–10 are estimates of Equation 2 restricted to firms that are not shacho-kai members. We include these estimates because Lincoln and colleagues (1996) found that shacho-kai membership is associated with strong redistribution effects, and these may not be fully controlled for in our other estimations.

Table 1 suggests that there is some collinearity among the independent variables. Sensitivity tests revealed that the essential results are not sensitive to the exclusion of independent variables. However, we did find that the inclusion of the growth term in the GLS estimates of Equation 2 sometimes caused the lagged dependent variable to become

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5 Details regarding GMM estimation of the Arellano and Bond model can be found in Baltagi (1995: Chapter 8). The GMM results, based on 226 firms, are available from the authors on request.
<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
<th>Model 8</th>
<th>Model 9</th>
<th>Model 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership by five largest blockholders</td>
<td>0.09*** (6.36)</td>
<td>0.10*** (5.25)</td>
<td>0.11*** (5.01)</td>
<td>0.07*** (6.53)</td>
<td>0.04** (2.36)</td>
<td>0.07*** (4.17)</td>
<td>0.10*** (7.05)</td>
<td>0.17*** (6.74)</td>
<td>0.15*** (5.35)</td>
<td>0.18*** (6.40)</td>
</tr>
<tr>
<td>Ownership by nonfinancial companies</td>
<td>0.03*** (3.65)</td>
<td></td>
<td></td>
<td>0.03*** (2.61)</td>
<td>0.03 (0.07)</td>
<td>0.03*** (2.55)</td>
<td>0.03*** (2.58)</td>
<td>0.03*** (2.59)</td>
<td>0.03*** (2.56)</td>
<td>0.03*** (2.58)</td>
</tr>
<tr>
<td>Ownership by financial institutions</td>
<td></td>
<td></td>
<td></td>
<td>0.03*** (2.61)</td>
<td>0.03*** (2.55)</td>
<td>0.03*** (2.58)</td>
<td>0.03*** (2.59)</td>
<td>0.03*** (2.56)</td>
<td>0.03*** (2.58)</td>
<td>0.03*** (2.58)</td>
</tr>
<tr>
<td>Logarithm of assets</td>
<td>-5.53* (2.14)</td>
<td>-6.62* (2.35)</td>
<td>-6.53* (2.39)</td>
<td>-7.04** (2.48)</td>
<td>-8.50** (2.98)</td>
<td>-7.20** (2.55)</td>
<td>-7.45** (2.61)</td>
<td>-7.41* (2.29)</td>
<td>-8.69** (2.67)</td>
<td>-7.39* (2.26)</td>
</tr>
<tr>
<td>Sales growth</td>
<td>0.26*** (21.77)</td>
<td>0.29*** (20.75)</td>
<td>0.26*** (21.19)</td>
<td>0.29*** (14.80)</td>
<td>0.29*** (14.80)</td>
<td>0.29*** (14.80)</td>
<td>0.29*** (14.80)</td>
<td>0.29*** (14.80)</td>
<td>0.29*** (14.80)</td>
<td>0.29*** (14.80)</td>
</tr>
<tr>
<td>Debt to capital employed</td>
<td>0.30*** (14.80)</td>
<td>0.29*** (14.47)</td>
<td>0.29*** (14.80)</td>
<td>0.43*** (21.00)</td>
<td>0.42*** (20.08)</td>
<td>0.43*** (21.01)</td>
<td>0.42*** (20.41)</td>
<td>0.50*** (21.11)</td>
<td>0.48*** (20.27)</td>
<td>0.49*** (21.19)</td>
</tr>
<tr>
<td>Big Six main bank</td>
<td>-0.75 (0.20)</td>
<td>0.32 (0.11)</td>
<td>-0.77 (0.27)</td>
<td>1.23 (0.39)</td>
<td>2.82 (0.89)</td>
<td>1.26 (0.40)</td>
<td>1.62 (0.51)</td>
<td>1.62 (0.51)</td>
<td>1.62 (0.51)</td>
<td>1.62 (0.51)</td>
</tr>
<tr>
<td>Shachio-kai member</td>
<td>0.74 (0.20)</td>
<td>1.15 (0.31)</td>
<td>0.41 (0.11)</td>
<td>4.15 (1.04)</td>
<td>3.94 (0.98)</td>
<td>3.96 (0.98)</td>
<td>3.48 (0.87)</td>
<td>3.48 (0.87)</td>
<td>3.48 (0.87)</td>
<td>3.48 (0.87)</td>
</tr>
<tr>
<td>Return on assets</td>
<td>-0.08*** (5.32)</td>
<td>0.11*** (7.35)</td>
<td>0.14*** (6.10)</td>
<td>0.15*** (6.35)</td>
<td>0.09*** (5.31)</td>
<td>0.11*** (6.20)</td>
<td>0.16*** (6.00)</td>
<td>0.16*** (6.00)</td>
<td>0.16*** (6.00)</td>
<td>0.16*** (6.00)</td>
</tr>
<tr>
<td>Ownership by five largest blockholders × ROA</td>
<td>-0.002 (-0.21)</td>
<td></td>
<td></td>
<td>-0.004 (-0.34)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Ownership by nonfinancial companies × ROA</td>
<td>-0.04** (-2.64)</td>
<td></td>
<td></td>
<td>-0.03† (-1.92)</td>
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<tr>
<td>Ownership by financial institutions × ROA</td>
<td>-0.06** (-2.95)</td>
<td></td>
<td></td>
<td>-0.05* (-2.20)</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>$R^2$</td>
<td>0.42</td>
<td>0.41</td>
<td>0.43</td>
<td>0.31</td>
<td>0.30</td>
<td>0.31</td>
<td>0.32</td>
<td>0.35</td>
<td>0.34</td>
<td>0.35</td>
</tr>
<tr>
<td>$n$</td>
<td>334</td>
<td>334</td>
<td>334</td>
<td>334</td>
<td>334</td>
<td>334</td>
<td>283</td>
<td>283</td>
<td>283</td>
<td>283</td>
</tr>
</tbody>
</table>

* Columns 1–7 contain estimates using the full sample for five years; one year (1986) was lost because of the lagged dependent variable. Each equation contains unreported dummy variables for industry and an unreported constant. Columns 8–10 contain results for firms that are not shachio-kai members. These equations contain unreported industry dummy variables and an unreported constant. Figures in parentheses under the coefficient estimates are t-statistics.

† $p < .10$

* $p < .05$

** $p < .01$

*** $p < .001$

Two-tailed tests.
percent benefit from redistribution. However, for Japan. However, they are not of equal strength. An
2 indicate that firms with ROA levels below 2-2.5
profitability is evaluated at the mean value of
derivation levels that do not account for the identity of
owners (the shares of the largest blockholders), the
interaction term is not statistically significant in any specification or sample. Thus, Hypothesis 2a is
rejected. Insofar as redistribution effects are found
to be associated with ownership by strategic inves-
tors (financial institutions and nonfinancial com-
panies), but not with an undifferentiated measure of ownership concentration, these findings indicate
that shareholder identity matters.

When we account for the identity of owners by
using the ownership shares of financial and nonfi-
nancial companies, the results suggest that both
agency and redistributive effects are operative in Japan. However, they are not of equal strength. An
evaluation of the relevant equations (models 5, 6, 7, 9, 10) indicates that, with other factors held con-
stant, the combined effect of ownership by finan-
cial and nonfinancial companies is negative when
profitability is evaluated at the mean value of
lagged ROA (3.6). That is, the net effect of these
large ownership stakes is positive only for the least
profitable Japanese firms. In these cases, the agency
effect and the redistribution effect combine to ben-
efit poorly performing firms. The estimates in Table
2 indicate that firms with ROA levels below 2–2.5
percent benefit from redistribution. However, for
firms with higher profit rates, the net effects of
these large shareholdings are negative.6

The results are also clear as to whether financial
or nonfinancial companies create stronger redistrib-
duction effects. Whether each term enters the equa-
tion separately or jointly, and regardless of sample,
GLS estimates suggest that financial firms provide
stronger redistribution effects. This is seen from the
magnitude of the relevant coefficients on the inter-
active ownership-lagged profitability terms. The
coefficient for the ownership share of financial in-
istitutions (-0.06 [−0.063]) is roughly twice that for
nonfinancial firms (-0.04 [−0.035]) for the full
sample (models 5–6) and even greater when the
sample is restricted to companies that are not sha-
cho-kai members (-0.07 versus -0.03, in models
9–10).

In concluding this section, we note that the
coefficients of the reported control variables are
reasonably stable across specifications. Firm
growth is positively related to profitability, and
the relationship with firm size is always negative.
Both of these results are consistent with those
obtained by Lincoln, Gerlach, and Ahmadjian (1996). The estimates also suggest that firms with
higher levels of debt are more profitable, reflect-
ing perhaps the risk associated with debt. Fi-
nally, we find no evidence that having a Big Six
main bank or shacho-kai membership is directly
related to profitability. These results are not al-
tered when one or the other of these two variables
is excluded from the equation.

6 Statements in this paragraph are based on calcula-
tions found by taking the partial derivative of profitabil-
ity (the dependent variable) with respect to ownership
centration. Consider models 5 and 6. The effect of a 1
percent change in the ownership share of nonfinancial
 corporations is given by 0.07 − 0.04 × lagged ROA (mod-
el 5) and .17 − 0.06 × lagged ROA (model 6). Thus, there
is a positive direct (agency) effect of 0.07 (.17), but a
negative indirect (redistribution) effect, the magnitude of
which depends on past profitability. With evaluation at
the mean for lagged ROA (3.6), it is readily seen that the
net effect is negative. The point at which net negative
effects set in is found by solving for the level of past
profitability that sets .07 − 0.04 × lagged ROA equal to
zero for model 5 and 0.17 − 0.06 × lagged ROA equal to
zero for model 6. This occurs where lagged ROA = 2.11
(model 5) and 2.54 (model 6). Firms with lagged profits
below these amounts will experience a positive owner-
ship effect. Calculations for other models produce simi-
lar results.
DISCUSSION AND CONCLUSIONS

In positing a positive relationship between ownership concentration and firm performance, agency theorists focus on the economic incentives associated with separated ownership and control, without regard to social context. On the other hand, sociological treatments of Japanese industrial organization highlight the distinctive character of traditional Japanese business relationships distinguished by intercorporate goals of risk reduction and mutual assistance (Dore, 1983; Gerlach, 1992). Insofar as clear agency and redistribution effects were observed, our results indicate that the relationship between ownership concentration and firm performance in Japan reflects both economic incentives and social context.

Since the redistribution effects are stronger than the agency effects, the net impact of ownership concentration is negative for most Japanese firms. Although firms with relatively high profits suffer impaired profitability, firms with low and, particularly, those with negative profits appear to benefit from concentrated ownership in two ways. Our finding of a positive direct relationship between ownership concentration and performance suggests that large Japanese investors can operate as effective monitors of top executives in other firms. At the same time, our finding of significant redistribution effects indicates that poorly performing firms with concentrated ownership structures also benefit from the transfer of financial resources from more profitable firms. Insofar as an investor's inclination to redistribute profits to a weaker firm is likely to be positively related to its ability to monitor how those proceeds are utilized, agency and redistribution effects may act in tandem and reinforce each other.

Our results clearly indicate that shareholder identity matters. When we measured ownership concentration without reference to the identity of the investor, we found agency effects but no redistribution effects. Redistribution effects were found only when we examined the ownership shares of financial and nonfinancial firms. Such a result is consistent with the notion that distinct classes of shareholders differ in their investment objectives and capacities to influence corporate behavior (Thomsen & Pedersen, 2000). Research that examines whether similar redistribution effects are apparent in other networked and/or relational governance systems would constitute a logical follow-up to this research.

The findings reported here support and extend previous research showing that Japanese financial institutions organize bailouts for troubled industrial firms with whom they have close keiretsu or debt ties (Morck & Nakamura, 1999; Hoshi et al., 1990). The result that similar (though weaker) redistribution effects are associated with the shareholdings of nonfinancial corporations provides evidence that industrial firms also assist firms with which they have equity ties. Further, our results indicating that firms with ROA levels as high as 2–2.5 percent benefit from profit redistribution suggests that redistribution is ongoing and is not restricted to situations of severe financial distress. In summary, the study offers strong evidence that corporate ownership concentration is associated with the same type of profit redistribution observed by Lincoln and colleagues (1996) among firms sharing keiretsu ties. As such, our study indicates that traditional norms of mutual assistance (Dore, 1983) and risk reduction (Nakatani, 1984) extend beyond formal networks to Japan's broader enterprise system.

Since the results reported here pertain to a period (1986–91) that predates significant structural reform to Japan's financial system as well as its banking crisis, care must be taken in generalizing our findings to the current situation. On the one hand, it is widely believed that Japan's enterprise and governance systems have become much less relational and that traditional business practices have eroded significantly in recent years (Fukao, 1999). On the other hand, traditional Japanese business practices have proven remarkably resilient in the past (Dore, 1983; Gerlach, 1992). Further, the redistribution effects observed here relate to a time when Japanese businesses were already under severe pressure from the endaka (high yen) shock as well as the bubble economy of 1987–90 and its subsequent collapse. Ultimately, the question of whether such traditional business practices have persisted through Japan's recent economic travails remains an open empirical question for subsequent research. In this regard, the findings reported here may constitute a useful benchmark for future research aimed at gauging the scope and degree of change in Japanese traditional business practices as that country continues to reform its financial and enterprise systems.

REFERENCES


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