

The role of business corporation in Japan's early industrialization

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Japan's phenomenal economic growth since the end of World War II has often been described as nothing short of a miracle. But its roots go much deeper in time. Impressive as it was, its economic performance in the second half of the 20th century was building upon the foundations laid in the late 19th – early 20th century.

The story of how Japan became a developed country to begin with is, however, very much understudied. The country had been entirely closed to the outside world since the early 17th century until it was forced to open up in the mid-1850s under the military pressure from the US and other major powers. At that point Japan was still in the pre-industrial stage of development both economically and politically.

About half a century later, Japan became the first country with a modern industrial base and a parliamentary democracy to establish itself outside of Western Europe and its off-shoots in North America and Australia. A study of how this became possible and what general lessons can be drawn for today's developing nations that face a very similar situation has tremendous implications for the fight against poverty and stagnation.

Recent research (including my own) has demonstrated that early development of joint stock companies and business corporations in Japan was one of the most important factors in its industrialization, allowing firms to grow beyond the family boundaries (Braguinsky and Hounshell, 2014, Braguinsky, Ohyama, Okazaki, and Syverson, 2015; see also Nicholas, 2014). Through development of business corporation and the market for industrial securities Japan's nascent industries were able to largely overcome financial market imperfections, the presence of which prevent entrepreneurial entry and lead to large-scale capital and labor misallocation and low productivity (see Midrigan and Xu, 2014, and Moll, 2014 for examples of recent studies linking financial market imperfections and resource misallocation).

While the large role played by business corporation in propelling Meiji-era (1868-1911) Japan to successful industrialization thus seems to be beyond debate, little is known about how it became possible in such short historic time period, starting from a closed, pre-modern society. Past studies by Japanese historians (see, for example, Imuta, 1976) have used archival materials to look into charters of various early business corporations in Japan, and found them to lack uniformity in baseline provisions (such as the rules governing shareholders' voting rights, transferability of shares, etc.). This was interpreted as reflecting the "backward" nature of Japanese capitalism; however, recent studies of the development of business corporation in the US at around the same time present striking similarities (Lamoreaux, 2004; Dunlavy, 2004).

In the proposed research, I plan to dig deeply into institutional, organizational, and individual factors behind the advent of business corporation in Japan as the country started its modern nation-building process in the second half of the 19th century. The first part of the project will build on the detailed "nanoeconomic" database I have built on Japan's first major industry (cotton textiles). Right from the inception, almost all firms (including medium-size and small firms) in this industry were joint stock corporations, issuing detailed semi-annual shareholders' reports. I have photocopied all available such reports from the late 19th century and until 1920 during my previous

visits to Osaka University where they are preserved in a rare books section (about 1,500 such reports in total). The reports contain the lists of all shareholders (and the number of shares they owned) as well as directors and other board members lists. This enables me to construct long-term panel data with the unit of observation being individual-company-reporting period (half year). This panel can be matched to firm-level inputs, output (including product mix), prices, employment, wages and technology data, as well as firms' balance sheets, income statements and establishment-level input-output data. It thus enables the researcher to see exactly how important shareholders and directors were able to mobilize funds needed to implement technological progress and accomplish growth goals of their firms and the industry as a whole. The work on creating this database is currently under way with support for 2013/14 provided by the University of Chicago Booth School Initiative on Global Markets ("Ownership, Management, Productivity, Profitability, and the Making of a Globally Competitive Industry," supervised by my collaborator Chad Syverson) but that support is about to expire. These data have never been utilized before and they present a unique opportunity for an in-depth look into how exactly firms' performances were affected as a result of establishing or severing relationships across various prominent shareholder groups, hiring or losing managerial and engineering personnel and by network ties. Continued work by a highly skilled and dedicated RA is required.

The second part of the project will involve expanding the study beyond just the cotton textile industry. It appears that one of the most important factors which allowed development of the business corporation and the ensuing successful industrial growth during Japanese industrialization is the mechanism through which personal reputation and trust were used as collateral for bringing in resources needed to implement innovations, and especially the ability to be personally involved and familiar with the enterprise (cf. Demsetz and Villalonga, 2001). Available archival data, with which I plan to work during my half-year visit to Osaka University in March–August 2015 will allow me to identify most, if not all business corporations established early on in Japan (more specifically, prior to and immediately after the implementation of its first modern commercial code in 1893), examine their charters, founders and major shareholders, matching this with other available archival data to determine their net wealth, position in business, regional and political networks and the degree to which they actually supervised the ventures they invested in (and what kind of top managerial personnel was hired in case ownership and control were separated). The overarching aim is to develop as complete picture as possible of how Japan in that period was able, through trial and error, to establish a system of modern corporate governance which allowed it to successfully overcome the problems related to imperfect investor protection (especially minority investors' rights) considered to be a major problem in most less developed countries—see, e.g., a survey of the relevant literature in La Porta et al., 2008. The requested budget will be used to acquire and process data and for travel inside Japan to work with archival materials.

I anticipate a series of high-quality papers to come out of this project that will shed light on important issues related to creating conditions for large-scale entrepreneurial ventures and improved capital allocation in modern-day developing countries, which institutional conditions closely resemble those that Japan had at the dawn of its industrialization.

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