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Why U.S. Managers Might Be More Short-run Oriented Than the Japanese

by Gerald H. Anderson

A decade ago, some business analysts began to accuse U.S. managers of concentrating too much on current profits and too little on enhancing their firms' long-run prospects. The implication of this alleged corporate myopia is that American companies would gradually become less competitive and less profitable relative to their foreign counterparts (particularly Japanese firms), which are thought to be more long-run oriented.

Excessive concern with the current quarter's bottom line may lead managers to take actions that hamper a company's long-run profitability, such as delaying maintenance, trimming customer service, raising prices, deferring new product development, and cutting employee training. All of these can eventually weaken a firm's ability to compete, but if the pressure for current profitability is high enough, such tactics may seem necessary.

In an efficient market, where outside investors are as aware of a firm's prospects as management, a manager could not raise a company's share price by instituting policies that increase current reported earnings at the expense of longer-run profitability. However, both intuition and substantial empirical evidence indicate that an information gap exists, with management being better informed about a company's prospects than outside investors.[1]

This article examines the alleged differences between U.S. and foreign business perspectives by asking whether American managers are indeed more shortsighted than their foreign counterparts and, if so, why. Because Japanese managers are often held up as paragons of long-run perspective, this essay focuses on differences between U.S. and Japanese business practices.

■ Are We More Shortsighted?

The view that American managers focus more on short-term goals than do the Japanese appears to have become conventional wisdom. In 1985, more than 1,000 corporate executives, trade unionists, and independent economists from 28 countries ranked Japan first and the United States twelfth among 22 industrialized nations when asked to what extent those countries' firms focus on long-run goals.[2] A more recent survey further strengthens that view. In 1990, when the same question was put to 1,800 executives from 34 countries, Japan maintained its number one ranking, but the United States fell to twenty-first among 23 industrialized nations.[3]

Surveys of U.S. and Japanese business executives reveal the same pattern. A 1984 study found growth to be more important to Japanese managers, while Americans were much more concerned with current share price.[4] And when the chief executive officers of the 500 largest Japanese and American corporations were asked to rank nine business objectives in order of importance to their own firms, similar results were obtained. The Japanese gave increased market share top priority, while that goal placed third on the Americans' list. Capital gains for stockholders was ranked second by the Americans but ninth by the Japanese, and new product ratio (the ratio of sales from relatively new products to sales from older products) placed seventh among U.S. executives but third among the Japanese.[5]

American managers have been accused of opting for strategies that enhance short-term profits at the expense of long-run competitiveness. One implication of this allegation is that U.S. firms will lose ground in the world marketplace to those that have patiently pursued long-term strategic objectives. This article compares U.S. and Japanese business practices and finds that American managers are indeed myopic relative to their foreign counterparts, that this divergence in perspectives stems from rational responses to different business environments, and that adopting the Japanese way of doing business is not necessarily the best strategy for the United States.

■ Evidence from R&D Allocations, Pricing, and Profits

If there is a difference in the goals that U.S. and Japanese managers set for their companies, it should be reflected in patterns of research and development (R&D) spending as well as in data on

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prices and current profits. Indeed, this appears to be the case.

While both groups have similar ratios of R&D expenditures to sales revenue, the Japanese emphasize basic research on new technologies and the development of new products — efforts not likely to pay off until well into the future. Americans, on the other hand, lean toward research aimed at improving and updating existing products — efforts likely to show a quicker return (see footnote 5, p. 44).

The divergence in perspectives is also evidenced by sharply different pricing responses to changes in costs. Over the 1980–1989 period, unit labor costs in the manufacturing sector (measured in dollars) rose 6.8 percent in the United States and 50.0 percent in Japan.[6] Because labor cost constitutes such a large share of total manufacturing expenses, American firms probably improved their cost position substantially relative to their Japanese competitors. That advantage appears to have presented U.S. firms with an opportunity to greatly increase their price competitiveness and thereby gain market share in international markets. But in an apparent bid to expand their current profits, American firms generally raised export prices by considerably more than 6.8 percent over this ten-year period. In contrast, the Japanese raised prices by much less than 50.0 percent on average, sacrificing current profits in an apparent attempt to maintain or to increase their market share.

Japanese companies also record much lower current profits than similarly sized American firms. Two recent studies comparing U.S. and Japanese multinational corporations found that net profit as a percentage of total assets is less than half as much in Japan, while net profit as a percentage of sales is about one-third that of American firms.[7]

Lower current profits can be consistent with a drive for growth and increased future earnings. A company may be willing to accept lower prices and profit margins to achieve greater market share, or it may find its profits down because current spending is high for new product development, employee training, customer service, and distribution-network expansion. Short-run earnings may also fall when a firm is incurring the start-up costs associated with plant and equipment expansion.

Lower current profits relative to sales and assets tell us nothing about the returns that Japanese stockholders are reaping compared to investors in American corporations. Japanese firms tend to be more highly leveraged than their American counterparts, which increases their profit as a percentage of equity relative to U.S. firms. More important, however, is the fact that the return to stockholders does not depend on current return to book equity, but on factors such as dividends per share, share-price appreciation, and tax rates on dividends and capital gains. Economic theory suggests that share price depends on the expected size and certainty of future earnings, while share appreciation is based on changes in those expectations after a share has been purchased. Stock market participants can be expected to respond to all of these considerations in a way that will equalize the expected after-tax, risk-adjusted rate of return on U.S. and Japanese stocks purchased at the same time. But such equality would provide no information about the relative growth rates of sales or profits of Japanese and American businesses.

■ Are These Differences in Behavior Irrational?

It would be hard to believe that Japanese managers are generally brighter and more capable than American managers. It would also be difficult to accept that U.S. managers, as a group, behave in an irrational way. How, then, can one explain Japan's greater emphasis on long-run profitability?

The answer can be found in both camps' rational responses to differences in shareholder relationships, attitudes toward employment tenure, and sources and costs of capital, as well as in other characteristics of the Japanese economy that encourage corporations to grow.

Shareholder Relationships. In both Japan and the United States, there is little overlap between management and ownership of large corporations. However, a key difference in this relationship exists *between* the two countries. In the United States, the primary relationship between a major shareholder (such as a pension fund or mutual fund) and a corporation is one of financial investment: Stockholders will readily sell their shares if an alternative investment appears more promising.

In Japan, by contrast, large stockholders tend to come from the ranks of a company's suppliers, customers, and bank lenders.[8] Thus, in addition to their financial investment, stockholders have other important relationships with the firm that are intimately tied to its long-run success. Because stockholding is a public affirmation of the important relationships that exist among Japanese firms, major shareholders typically do not invest with an eye to near-term earnings, but rather to solidify a long-term profitable association.

U.S. managers must monitor current profits closely, because a drop in either profits or near-term profit expectations generally causes share prices to fall. In Japan, however, large shareholders would not respond negatively to a temporary downturn in profits, so management is free to take a longer-run view.[9]

The apparent shortsightedness of American shareholders, rather than implying irrationality, may be a reasonable response to the greater gap in the United States between information available to management and information available to stockholders. Consider a decline in current profits that stems from actions that are likely to enhance a company's future earnings. In Japan, large stockholders are "insiders" who know this to be the case; thus, they will not be disturbed by the downturn. In contrast, American stockholders are "outsiders" who might interpret the drop-off as a bad omen for future earnings. Although management can publicly explain the reasons behind the decline, stockholders are likely to remain

skeptical because they have no opportunity to confirm the facts for themselves.

A drop in share prices entails several disadvantages for a firm's managers, including increased capital costs, a heightened possibility that disaffected shareholders will participate in a proxy fight to wrest control of the company from its current managers, and a reduction in the potential price of a hostile takeover.[10]

Employment Tenure. Large Japanese firms have a more permanent relationship with their employees than is common in major American companies.[11] Because changing employers is not only less common but also more difficult for employees of large Japanese firms than for their American counterparts, workers and middle managers in Japan have greater incentives to push for policies that will both enhance a company's long-run health and create opportunities for promotion. Moreover, senior managers, having come up through the ranks in a company, tend to identify more with their employees than is common in America. In fact, it has been said that the mission of a Japanese firm is to survive so that it can fulfill its social obligation to provide employment for its workers, while American firms exist to generate profits for their shareholders. Because Japanese senior managers do not have to face pressures from stockholders for near-term profitability, they can pursue growth policies that are in the long-run interest of their employees.

Sources and Costs of Capital. Japanese companies seem to have benefited over the years from a lower cost of capital relative to U.S. firms, especially before the mid-1980s.[12] Lower capital costs facilitate a long-run business outlook by reducing the pressure on managers to choose investments with fast payoffs.

In recent decades, dividends and interest rates for bank loans have been much lower in Japan than in the United States, partly because of governmental controls on savings-deposit interest rates and on capital outflows. These restrictions have been progressively eased over the last several years, decreasing, and perhaps eliminating, this source of Japan's capital cost advantage.[13]

Nevertheless, the cost of capital is still probably lower in Japan than in the United States for two reasons.[14] First, as noted above, Japanese businesses often borrow from banks that are large stockholders in the company, reducing the risk that management will make decisions that are detrimental to lenders. As a result, agency costs of borrowing should be lower in Japan. Second, investors' expected bankruptcy costs are also lower, because Japanese firms' lenders and major stockholders are usually related companies that have a stake in a troubled firm's success; thus, they are likely to step in and support a company experiencing difficulties. Even the Japanese government will sometimes intervene on behalf of an ailing firm.

Other Factors. Most Japanese firms associate in large groups called *keiretsu*. Ties of loyalty among *keiretsu* members result in mutual support during hard times, even when such action is costly. For example, group members might pay higher prices to buy from a troubled member than they would have to pay to an outsider. This loyalty makes it easier for Japanese executives to take risks and to focus on long-run goals rather than on near-term profitability.[15]

In addition, the rapidly growing Japanese economy, which has expanded much faster than that of any other industrialized country since World War II, has forced the nation's companies to keep pace in order to maintain domestic market share, which is critical for competitiveness. Loss of market share often means that a firm loses economies of scale, the ability to finance R&D, and name recognition and prestige among its customers relative to its competitors. Thus, Japan's economy has created an environment in which a firm's survival depends on rapid expansion and where the negative consequences of shortsighted policies become apparent more quickly than in the United States.

■ Conclusion

This essay offers several explanations for why the Japanese might focus on longer-run goals than we do. The divergence in perspectives, if true, may represent a rational response to differences in such factors as employee tenure and patterns of corporate ownership. It is not my intention to imply, however, that the United States should wholly adopt the Japanese way of doing business, since some practices that foster a long-run management view also entail disadvantages.

Fear of a hostile takeover, for example, encourages U.S. managers to place greater emphasis on current profits and share prices. Policymakers could pass laws to prevent such takeovers, but this would eliminate what many believe to be an important source of market discipline on corporate management.

Consider also the so-called lifetime employment system. This practice greatly reduces the likelihood of layoffs or dismissals, but also makes it difficult for a worker who leaves a firm to find another employer. Although being effectively tied to a single employer throughout one's career may encourage devotion to that firm's survival and growth, it also substantially constricts personal freedom. Moreover, it constrains the efficiency and flexibility that an economy obtains from the geographic and job mobility of its workers.

Finally, consider the *keiretsu*. Close association and interlocking ownership of firms reduce the risks faced by group members and also avoid much of the information gap between firms and large stockholders that exists in America. But a *keiretsu* also concentrates tremendous economic power in the hands of a few executives — an outcome that most Americans would probably consider to run counter to the national interest.

Footnotes

1. See Kenneth A. Froot, Andre F. Perold, and Jeremy C. Stein, "Shareholder Trading Practices and Corporate Investment Horizons," National Bureau of Economic Research, Working Paper No. 3638, March 1991 (especially pp. 29–36, which report evidence of an information gap, obstacles to narrowing that gap, and further citations).

2. See EMF Foundation, *Report on International Competitiveness*, 1985.

3. See IMD International and World Economic Forum, *The World Competitiveness Report*, 1990.

4. See Toyohiro Kono, *Strategy and Structure of Japanese Enterprises*. New York: M.E. Sharpe, Inc., 1984, pp. 53–55.

5. See Tadao Kagono et al., "Mechanistic vs. Organic Management Systems: A Comparative Study of Adaptive Patterns of American and Japanese Firms," in Kazuo Sato and Yasuo Hoshino, eds., *The Anatomy of Japanese Business*. New York: M.E. Sharpe, Inc., 1984, pp. 32–37.

6. Appreciation of the yen relative to the dollar caused the Japanese increase. Japan's manufacturing unit-labor costs measured in yen actually fell more than 8 percent between 1980 and 1989.

7. See J. Haar, "A Comparative Analysis of the Profitability Performance of the Largest U.S., European and Japanese Multinational Enterprises," *Management International Review*, vol. 29, no. 3 (1989), pp. 5–18; and James C. Abegglen and George Stalk, Jr., *Kaisha, The Japanese Corporation: How Marketing, Money, and Manpower Strategy, Not Management Style, Make the Japanese World Pace-Setters*. New York: Basic Books, Inc., 1985.

8. See Kono, *Strategy and Structure*, p. 61.

9. See Kagono et al., "Mechanistic vs. Organic Management Systems," pp. 36–37.

10. Hostile takeovers are much more common in the United States than in Japan. According to a recent study, about 10 percent of Fortune 500 companies were taken over in the 1980s in transactions that began as hostile, while in Japan very little hostile activity was noted (see footnote 1, p. 25).

11. This relationship, often described as lifetime employment, has developed only since the end of World War II and is common in only the largest and most successful Japanese firms (affecting fewer than one-third of the country's workers). Moreover, because Japanese companies often require employees to retire at a younger age than is typical in the United States, "lifetime" is a relative term. While lifetime employment encourages managers to take a long-run view, it also reduces their freedom to make staffing-level reductions that might enhance profitability. See Kono, *Strategy and Structure*, pp. 318–20; Robert H. Hayes, "Why Japanese Factories Work," *Harvard Business Review*, vol. 59 (July/August 1981), pp. 63–64; Kagono et al., "Mechanistic vs. Organic Management Systems," p. 34; and Clyde V. Prestowitz, Jr., *Trading Places: How We Are Giving Our Future to Japan and How to Reclaim It*. New York: Basic Books, Inc., 1988, p. 304.

12. See George Hatsopoulos, *The Gap in the Cost of Capital: Causes, Effects, and Remedies*. Boston: Thermo Electron Corporation, 1985. For an opposing view, see Carliss Y. Baldwin, "The Capital Factor: Competing for Capital in a Global Environment," in Michael E. Porter, ed., *Competition in Global Industries*. Boston: Harvard Business School Press, 1986, pp. 185–223.

13. Some of the large outflows of long-term capital from Japan during the last decade may represent a portfolio adjustment by investors who had been prevented from acquiring as many foreign assets as they would have in the absence of controls. See Reuven Glick, "Japanese Capital Flows in the 1980s," Federal Reserve Bank of San Francisco, *Economic Review*, Spring 1991, pp. 18–31.

14. See William Osterberg, "The Japanese Edge in Investment: The Financial Side," Federal Reserve Bank of Cleveland, *Economic Commentary*, March 1, 1987.

15. See Prestowitz, *Trading Places*, pp. 293–306.

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