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A Socio-Economic Approach To The Japanese Corporate Governance Structure

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A SOCIO-ECONOMIC APPROACH TO THE JAPANESE CORPORATE GOVERNANCE STRUCTURE

MARLEEN A. O'CONNOR*

TABLE OF CONTENTS

I.	A SOCIO-ECONOMIC MODEL OF WORKER COMMITMENT.....	1533
A.	Motives for Human Behavior: Self-Interest Versus Altruism.....	1534
B.	The Model of the Firm: Contract Versus Organization.....	1536
1.	The Transaction-Cost Model of the Firm.....	1536
2.	Williamson's View of Trust.....	1537
C.	Trust and the Theory of the Firm.....	1539
1.	Criticism of the Transaction-Cost Model of the Firm.....	1540
2.	Talking About Trust: Cynics v. Innocents.....	1542
3.	Creating Institutions That Will Foster Trust.....	1543
II.	EMPLOYEES' VOICE: A PROCEDURAL JUSTICE PERSPECTIVE...	1546
A.	The Procedural Justice Effects of Employee Voice....	1546
1.	Process Control Versus Decision Control.....	1546
2.	False Consciousness and the Frustration Effect....	1548
B.	Procedural Justice, Worker Commitment, and Productivity.....	1550
1.	Corporate Culture and Worker Commitment.....	1550
2.	Procedural Justice and Productivity.....	1551
C.	Procedural Justice Research and the Socio-Economic Model of the Firm.....	1552
1.	The Self-Interest Model: The Outcome-Based View of the Person.....	1553
2.	A Relational Model of Procedural Justice: The Process-Based View of the Person.....	1554
3.	The Implications of the Two Models of the Person for Participatory Work Programs.....	1555
III.	THE EMPLOYEES' ROLE IN THE JAPANESE FIRM.....	1556
A.	The Trading Hazards Inherent in Japanese Shopfloor Practices.....	1557
1.	Mechanisms to Protect Firms from Worker Opportunism.....	1558

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2. Structures that Safeguard Workers' Human Capital Investments.....	1558
B. The Role of the Main Bank.....	1559
C. The Neutral Referee Model of Corporate Governance.....	1561
D. Socio-Economics and the Japanese Firm.....	1562
IV. CONCLUSION.....	1563

International competition is causing a fundamental transition in the workplace that highlights the need for corporate law scholars to rethink the standard assumption that the objective of the firm is shareholder wealth maximization.¹ Under the traditional method of work organization, firms reduce their dependence upon labor cooperation, supposing that workers will shirk when the opportunity arises.² This system also assumes that productive efficiency requires that managers formulate strategies concerning technology, work processes, and plant locations because workers are not competent to evaluate such matters. Seeking to gain a competitive edge in the global marketplace, many U.S. managers are changing their industrial relations policies by building effective work teams that encourage employee voice in shopfloor decisionmaking.³ These programs, however, provide only a limited form of worker participation, preserving unilateral managerial control over firm policies.

As international competition intensifies, corporate law scholars have adopted a comparative approach to search for alternative governance structures. For the most part, however, the focus of this analysis is too narrow. Assuming that the essential nature of the enterprise centers around the shareholder-management relationship,⁴ recent research has concentrated most

1. This article continues my work in this area. Marleen A. O'Connor, *Corporate Malaise—Stakeholder Statutes: Cause or Cure?*, 21 STETSON L. REV. 3 (1991); Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993) [hereinafter *Human Capital*]; Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189 (1991) [hereinafter *Displaced Workers*].

2. Under this system, management seeks to maintain control over production processes by segmenting tasks into repetitive motions, employing intensive monitoring, and establishing steep hierarchical chains of authority. These shopfloor practices began in the early twentieth century when industrial engineer Frederick W. Taylor devised the method of production referred to as "scientific management." FREDERICK TAYLOR, *THE PRINCIPLES OF SCIENTIFIC MANAGEMENT* (1911); see also HARRY BRAVERMAN, *LABOR AND MONOPOLY CAPITAL: THE DEGRADATION OF WORK IN THE TWENTIETH CENTURY* 126 (1974).

3. For further discussion of how firms are changing production processes to meet changing market demands, see, e.g., PETER B. DOERINGER ET AL., *TURBULENCE IN THE AMERICAN WORKPLACE* (1991); THOMAS A. KOCHAN ET AL., *THE TRANSFORMATION OF AMERICAN INDUSTRIAL RELATIONS* (1987); MICHAEL J. PIRE & CHARLES F. SABEL, *THE SECOND INDUSTRIAL DIVIDE: POSSIBILITIES FOR PROSPERITY* (1984); ROBERT REICH, *THE NEXT AMERICAN FRONTIER* (1983); William H. Simon, *The Politics of "Cooperation" at the Workplace*, RECONSTRUCTION, Winter 1990, at 18, 21.

4. See, e.g., Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional*

of its efforts on examining how financial intermediaries in Germany and Japan monitor management.⁵ I believe that a broader viewpoint is necessary because two aspects of the German and Japanese systems indicate that managers may be pursuing more complex objectives than shareholder wealth maximization.⁶ First, employees are given a voice in strategic decisionmaking—legally in Germany and implicitly in Japan. This feature symbolizes that German and Japanese enterprises encompass workers and shareholders as partners who have common interests in increasing the internal efficiency of the firm. Accordingly, corporate scholars are considering only part of the story when they discuss the role of institutional investors in these codetermined firms. A second and related feature is that German and Japanese firms use less hierarchical forms of work organization than the United States. German and Japanese shopfloor practices develop the workers' capacity to communicate information about production processes and adapt to flexible work assignments. The nature of the employees' firm-specific investments indicate that they share in the residual risk of the firm. These two features of the German and Japanese systems are interconnected; employee voice in corporate governance safeguards firm-specific investments from expropriation and facilitates employee commitment to the firm.

The point is that the German-Japanese experience indicates that corporate scholars need to make an in-depth examination of how the corporate governance systems of other countries complement their labor laws and industrial relations practices. Such inquiry will enable us to view corporate governance as a socio-cultural infrastructure which influences the employees' access to information, channels of communication, and intrinsic value of work. In turn, this more complex perspective will allow us to devise corporate governance structures that will promote changing shopfloor practices in the United States.

In Part I of this Article, I stress that the development of corporate law scholarship along these lines depends upon the way we portray human actors

Investor Behavior Under Limited Regulation (forthcoming); Ronald Gilson & Reinier Kraakman, *Investment Companies as Guardian Shareholders: The Place of the MSIC in the Corporate Governance Debate*, 45 STAN. L. REV. 986 (1993).

5. See *supra* note 4. But see Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871, 874 (1993) (“[O]ur system’s characteristics color the lens through which the first comparative studies viewed the rest of the world.”).

6. Masahiko Aoki, *Non-Hierarchical Aspects of the Internal Organization of the Enterprise: A Partial Survey in Comparative Perspective*, STANFORD DISCUSSION PAPER SERIES, CEPR Publication No. 331 (1992) [hereinafter *Non-Hierarchical*]. For further commentary on the Japanese firm, see MASAHIKO AOKI, *INCENTIVES AND BARGAINING IN THE JAPANESE ECONOMY* (1988); THE ECONOMIC ANALYSIS OF THE JAPANESE FIRM (Masahiko Aoki ed., 1984); Masahiko Aoki, *The Japanese Firm as a System of Attributes: A Survey and Research Agenda*, STANFORD DISCUSSION PAPER SERIES, CEPR Publication No. 288 (1993) [hereinafter *Attributes*]; Masahiko Aoki, *Toward an Economic Model of the Japanese Firm*, 28 J. ECON. LIT. 1 (1990) [hereinafter *Economic Model*].

and implicit employment agreements. In my view, corporate scholars need to recharacterize the firm as encompassing not just conflict and exchange, but also cooperation and consensus. Developing this new view requires us to shift away from the established conception of isolated economic actors entering into contracts and toward picturing persons in an enterprise joining in a network of social relationships to pursue common goals. Specifically, we need to decommodify our image of the employment relationship to embrace notions of morality and commitment. Part I reveals that the prevailing economic theory has little to contribute to this vision of corporate governance; this model focuses upon preventing opportunism because it presumes that work produces disutility. For these reasons, Part I turns to the field of socio-economics to obtain more realistic insights into human behavior and the firm. Rather than simply adopting the self-interest postulate, this research incorporates psychology and sociology to study altruistic motives. This background will allow us to analyze how corporate governance structures can advance work climates that encourage employees and managers to replace self-interest with a concern for others.

To further our understanding of participatory work programs, Part II examines the psychological aspects of employee voice by exploring research in the area of procedural justice. This literature demonstrates that people respond to the procedural aspects of decisionmaking at least as much as the outcome itself. In this Part, I will examine Professor Karen Newman's article in this symposium issue⁷ which extends her important work concerning how corporate cultures influence corporate decisionmaking.⁸ Newman concludes that providing employees with voice is the most effective method to raise perceptions that the corporate climate is ethical and enhance employee commitment and work group cohesiveness.

In Part III, I incorporate the lessons from the first two Parts to comment on how the results of procedural justice research can be translated into a richer paradigm of corporate law. In this Part, I present a model of the Japanese corporate governance system that explores how the financial and employment structures of the Japanese firm complement each other and mutually support participatory work programs.

I conclude by asserting that the essential weakness in American corporate law is that it fails to provide worker representation in corporate governance.

7. Karen Newman, *The Just Organization: Creating and Maintaining Justice in Work Environments*, 50 WASH. & LEE L. REV. 1489 (1993).

8. Karen L. Newman, *Procedural Justice and Ethical Decision Making*, 6 Soc. JUST. RES. 113 (1993) [hereinafter *Procedural Justice*]; Karen N. Gaertner, *The Effect of Ethical Climate on Managers' Decisions*, in MORALITY, RATIONALITY, AND EFFICIENCY: NEW PERSPECTIVES ON SOCIO-ECONOMICS 211 (Richard M. Coughlin ed., 1991) [hereinafter *Ethical Climate*]; Karen N. Gaertner & Stanley D. Nollen, *Career Experiences, Perceptions of Employment Practices, and Psychological Commitment to the Organization*, 42 HUM. REL. 975 (1989) [hereinafter *Career Experiences*]; Karen Gaertner, *Winning and Losing: Understanding Managers' Reactions to Strategic Change*, 42 HUM. REL. 527 (1989) [hereinafter *Winning and Losing*].

Providing employees in the United States with a voice in corporate governance will encourage workers to grow as moral agents and foster labor-management cooperation to meet the demands of a changing world economy.

I. A SOCIO-ECONOMIC MODEL OF WORKER COMMITMENT

My basic premise in this Part is that conventional economic models fail to capture the nature of contemporary productivity issues because labor-motivation problems extend beyond economic incentives and threats. Although short-term worker compliance can be obtained by external rewards and punishments, devising such monitoring schemes so that employees devote themselves to their fullest ability is costly and time consuming. More importantly, close supervision produces an adversarial atmosphere that leads to a low level of worker commitment.⁹ Participatory work programs depend upon attitudes that do not compute the net benefit from every unit of effort. Rather than relying upon economic incentives, management theories stress that labor efficiency for participatory work programs is based upon corporate values that signal fair treatment of employees.¹⁰ Studies, however, reveal that worker commitment to their firms is declining.¹¹ Accordingly, managers face the challenge of how to shape corporate cultures that will recapture employee loyalty in an unstable economic environment.

Following German and Japanese labor practices, American managers are relying upon team effort to instill a commonality of purpose and promote bonds of commitment among workers. To facilitate team work, firms replace the traditional emphasis upon the individual with greater dependence upon the group. Standard economic analysis predicts these actions will create incentives for each employee to shirk her responsibility because the individual worker's input has only a small impact on output.¹² This standard "free rider" response to collective action illustrates a basic misconception of the pursuit of common goals. To appreciate German and Japanese industrial relations practices, we must explore how to prevent moral hazard problems by considering notions of worker morale and team spirit.

To understand participatory work programs, we must shift from the prevailing economic concentration on short-term selfishness to the communitarian focus on long-term collective benefit. To do this, we can turn

9. BRAVERMAN, *supra* note 2, at 125.

10. Peter Doeringer, *The Socio-Economics of Labor Productivity, in MORALITY, RATIONALITY, AND EFFICIENCY*, *supra* note 8, at 103, 106.

11. See, e.g., RICHARD T. MOWDAY ET AL., *EMPLOYEE-ORGANIZATION LINKAGES: THE PSYCHOLOGY OF COMMITMENT, ABSENTEEISM, AND TURNOVER* 12-13 (1982).

12. Armen Alchian and Harold Demsetz first highlighted the measurement problems that arise when workers produce goods in a group. Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 *AM. ECON. REV.* 777 (1972); see also OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* 53-54 (1975).

to socio-economics,¹³ which encompasses noninstrumental motives such as the human need to share in collective activities. This richer picture corresponds with our intuition that employees will perform at a higher level if they view their daily work as part of a collaborative adventure, rather than "just a job." Accordingly, we can begin to comprehend how corporate cultures appeal to the non-rational, affective elements within workers.

I am not suggesting that employees do not take an instrumental attitude towards work; labor and management do not act against their self-interests in the long-run. The proportion of consensus and conflict in the workplace will depend upon the competitive position of the firm, the level of employment security, and other factors. My position is that it is crucial to study the interaction of diverse incentives in the firm, recognizing not only self-interested motives, but also the vitality of altruistic impulses.¹⁴

A. *Motives for Human Behavior: Self-Interest Versus Altruism*

Economics is built on a model of the self-interested actor rationally choosing a course of action after ascertaining the costs and benefits of various opportunities. Assuming that people's motives are egoistic, neoclassical economists reject the notion of altruism.¹⁵ Instead, they claim that enlightened self-interest governs expressions of ostensibly noneconomic behavior; people engage in charitable conduct to enhance their reputations or receive favors in the future.¹⁶ Socio-economics has a very different impression of altruism, suggesting that the motivations for our actions are more complex and subtle than neoclassical economics generally assumes. Moral factors constrain the impulse to act in a self-interested manner; when we compute the costs and benefits of our behavior, we incorporate not only our individual utility, but also preferences which reveal a concern for the affect of our actions upon others.

Behavior is so often determined by an interaction of altruistic and self-interested motives that it is difficult to isolate cases of pure altruism.¹⁷ Such an example can be found in experiments using one-shot prisoners' dilemma

13. See, e.g., AMITAI ETZIONI, *THE MORAL DIMENSION: TOWARD A NEW ECONOMICS* (1988); Jon Elster, *Selfishness and Altruism*, in *BEYOND SELF-INTEREST* 44 (Jane J. Mansbridge ed., 1990); Jane J. Mansbridge, *On the Relation of Altruism and Self-Interest*, in *BEYOND SELF-INTEREST*, *supra*, at 133; Amartya K. Sen, *Rational Fools: A Critique of the Behavioral Foundations of Economic Theory*, in *BEYOND SELF-INTEREST*, *supra*, at 25.

14. Mansbridge, *supra* note 13, at 133; see also Karl E. Klare, *The Labor-Management Cooperation Debate: A Workplace Democracy Perspective*, 23 *HARV. C.R.-C.L. L. REV.* 39 (1988).

15. The present-aim model assumes that a person is rational if she pursues whatever goals she currently holds. Under this model, moral values are referred to as a second source of utility. This is not a proper use of the term utility. Amitai Etzioni, *Socio-Economics: A Budding Challenge*, in *SOCIO-ECONOMICS: TOWARD A NEW SYNTHESIS* 3 (Amitai Etzioni & Paul R. Lawrence eds., 1991).

16. Oliver Williamson, *Calculativeness, Trust, and Economic Organization*, *J. ECON. PERSP.* (forthcoming).

17. Mansbridge, *supra* note 13, at 134.

games.¹⁸ In this game, each player chooses whether to cooperate or defect. The optimal solution involves both players choosing to cooperate. The dilemma arises because a defecting party has an opportunity to receive the largest return if the other party cooperates. Each player perceives that, regardless of whether the other player decides to cooperate or defect, the decision to defect will produce a higher return than the decision to cooperate. The rational economic actor model predicts each player will defect, producing an inferior outcome for both parties referred to as the "prisoners' dilemma solution."

To overcome the prisoners' dilemma, the standard economic model relies upon the motive of self-interest. This model changes the game by introducing norms of behavior that are backed by sanctions imposed by the community.¹⁹ According to this view, the community can exercise a tremendous amount of influence upon the players' behavior through admiration in the form of improved reputation and condemnation in the form of humiliation and shaming. Importantly, these conventions operate not by modifying a player's preferences between cooperation and defection, but by adjusting her expectations about how the other player will act. In other words, each player can feel safe in choosing to cooperate knowing that reputational concerns will prevent the other party from exploiting this vulnerable position.

In contrast to the traditional approach to solving the prisoners' dilemma, socio-economists reveal that it is possible to obtain the optimal outcome by relying upon two types of altruistic motives. The first type requires that the players feel an ethical obligation to pursue a cooperative course of action. Specifically, studies of one-shot prisoners' dilemma games reveal that some participants refuse to defect because they are motivated to "do the right thing."²⁰ To explain these results, socio-economists posit that altruistic motives alter the payoff matrix in a prisoners' dilemma game so that the cooperator's reward from acting morally outweighs the benefit from defection.²¹ The second type of solution to the prisoners' dilemma relies upon feelings of group solidarity. Studies demonstrate that permitting dialogue that raises perceptions of collective identity can increase the chance that both players will choose to cooperate to 85 percent.²² Importantly, this team spirit enhances cooperation independently of the dictates of conscience, future reciprocity, or reputational repercussions.²³

18. For an introduction to game theory and the prisoners' dilemma see, e.g., DAVID M. KREPS, *GAME THEORY AND ECONOMIC MODELLING* 29-39 (1990); ERIC RASMUSEN, *GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY* 27-30 (1989).

19. For further discussion of how conventions solve coordination games, see KREPS, *supra* note 18, at 65. See also ANDREW SCHOTTER, *THE ECONOMIC THEORY OF SOCIAL INSTITUTIONS* 11 (1981).

20. Robert H. Frank et al., *The Evolution of One-Shot Cooperation* (forthcoming *ETHOLOGY & SOCIOBIOLOGY*).

21. Mansbridge, *supra* note 13, at 136.

22. *Id.* at 134-35.

23. Robyn M. Dawes et al., *Cooperation for the Benefit of Us—Not Me, or My Conscience*, 97 in *BEYOND SELF-INTEREST*, *supra* note 13.

In sum, the solutions to the prisoners' dilemma developed by the rational choice model and socio-economics present dramatically different courses of action to prevent collective action problems. The rational actor model solves the prisoners' dilemma by developing institutions that make it in a person's rational self-interest to help others. In contrast, the socio-economic model relies upon the promotion of altruistic motivations; goodwill and mutual understanding can foster a collective preference that benefits everyone.

We can begin to see how to break the prisoners' dilemma involved in participatory work programs, that is, to ensure that managers and employees choose to cooperate rather than defect.²⁴ Labor efficiency depends upon encouraging worker identification with the goals and values of the firm so that internalized moral values ensure that workers act instinctively to benefit the organization. Neoclassical economics, however, is poorly equipped to approach such issues because it tends to assume that preferences are stable and therefore ignores the effects of culture. In contrast, socio-economics allows us to examine how corporate governance structures influence whether firms develop corporate cultures that foster worker commitment. Before we examine this socio-economic model, let us consider the vision of corporate governance offered by the transaction-cost theory of the firm.

B. *The Model of the Firm: Contract Versus Organization*

1. The Transaction-Cost Model of the Firm

The transaction-cost model of the firm sheds important light on the incentive aspects of various relationships within the firm. The general story told by transaction-cost economists begins with a perception of the firm as consisting of a nexus of long-term contractual relationships among shareholders, managers, employees, suppliers, and the local community.²⁵ These autonomous resource-holders interact with each other solely through deals of exchange set against a background of competition. According to Oliver Williamson, corporate governance is a means to secure transaction-specific investments against the opportunistic exploitation of temporary advantages by the other parties to the contract. Specifically, board representation depends upon the party's degree of asset specificity and uncertainty. For Williamson, shareholders' investments, but not those of employees, have high asset specificity that requires protection from unfair advantage through

24. For an application of the prisoners' dilemma to labor-management relations see HARVEY LIEBENSTEIN, *INSIDE THE FIRM: THE INEFFICIENCIES OF HIERARCHY* 32 (1987); HARVEY LIEBENSTEIN, *BEYOND ECONOMIC MAN: A NEW FOUNDATION FOR MICROECONOMICS* 29 (1976).

25. Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 257 (1979). This theory builds upon Ronald Coase's seminal theory of firms as cost-efficient alternatives to market transactions. Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937). For a critical evaluation of this theory's influence on corporate law, see William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: a Critical Appraisal*, 74 *CORNELL L. REV.* 407 (1989).

an opportunity to monitor and participate in the management of the firm.²⁶

Williamson's model makes significant contributions to our understanding why parties organize their relationships within firms rather than through markets. Economists, however, are just beginning to study the question of why performance differs among firms operating under diverse national-institutional structures.²⁷ Williamson recently addressed this issue, emphasizing that trading hazards involving uncertainty and opportunism vary depending not only upon the type of transaction involved, but also upon the conditions under which the transaction occurs.²⁸ Williamson submits that commercial relationships evolve as the product of social conditioning that takes place because of societal culture, politics, regulation, professionalization, networks, and corporate culture.²⁹ He maintains that institutional environments that provide safeguards against opportunistic conduct alleviate the demand for parties to devise transaction-specific protection. For example, Williamson recognizes that the law can reduce transaction costs so that parties can more easily invest in specialized assets.³⁰

To me, the degree of trust present in an organization can explain a great deal of the variance in organizational efficiency among firms. Williamson, however, has quite a different view. Recently, he has sought to clarify the concept of trust by distinguishing between three types of relationships.

2. Williamson's View of Trust

First, Williamson maintains that the terms "trust" and "risk" should not be used interchangeably for commercial transactions involving calculative relations.³¹ Similar to the traditional economic model discussed above, Williamson solves the prisoners' dilemma problem by developing institutions so that the decision to refrain from opportunistic conduct or engage in ostensibly altruistic conduct is based upon rational, algebraic reasoning. Williamson begins by explaining that parties feel safe in making transaction-specific investments if they operate in an environment that provides cost-

26. OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* 163-205 (1985) (discussing how parties attempt to foster trust by giving credible commitments) [hereinafter *CAPITALISM*]; Oliver Williamson, *Corporate Governance*, 93 *YALE L.J.* 1197, 1210 (1984); Williamson, *supra* note 25, at 257. For criticism of Williamson from a labor law perspective, see Katherine Van Wezel Stone, *Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities*, 55 *U. CHI. L. REV.* 73, 158 (1988).

27. Recently, Ronald Coase identified as critical the understanding of "why the cost of organizing particular activities differs among firms." Ronald Coase, *The Nature of the Firm's Influence*, 4 *J.L. ECON. & ORGANIZATION* 33, 47 (1988).

28. Williamson, *supra* note 16, at 26.

29. *Id.* at 26-30.

30. *Id.* at 28.

31. *Id.* at 26.

effective reputational sanctions. Trust is not involved, rather trading hazards are mitigated because reputational concerns will prevent the other party from expropriating these investments. With respect to prosocial activities, Williamson asserts that "if almost-automatic and unpriced assistance is the most efficient response, provided that the practice in question is supported by sanctions and is ultimately made contingent on reciprocity, then calculativeness obtains and appeal to trust adds nothing."³²

Second, Williamson recognizes that trust can arise in personal relationships characterized by positive, forgiving feelings rather than calculative monitoring. Williamson emphasizes, however, that the term "trust" should be reserved for personal relations such as those between family, friends, and lovers, not commercial transactions.³³ He quotes Robert Nozick:

"The intention in love is to form a *we* and to identify with it as an extended self, to identify one's fortunes in large part with its fortunes. A willingness to trade up, to destroy the *we* you largely identify with, would then be a willingness to destroy yourself in the form of your own extended self." If entertaining the possibility of trading up devalues the relation, a discrete structural shift that disallows trading up, which is a variety of calculativeness, is needed.³⁴

Thus, Williamson recognizes that people will not develop personal trust in a calculating atmosphere.

Finally, Williamson discusses institutional relationships, acknowledging that the calculative approach can be taken to extremes in certain types of commercial transactions.³⁵ Specifically, he argues that unless problems of alienation and workers' dignity are considered, the image of economic organization will be too narrow.³⁶ Williamson recognizes that traditional methods of work organization create calculating atmospheres that lead employees to perform their jobs in a minimal or "perfunctory" rather than a maximal or "consummate" fashion. He indicates that participatory programs create better climates for workplace cooperation because teamwork and less monitoring increase the workers' self-respect and facilitate the

32. *Id.* at 20.

33. *Id.* at 27.

34. *Id.* at 33-34 (quoting ROBERT NOZICK, *AN EXAMINED LIFE* 78 (1989)). Williamson, however, expresses some doubt about the value of trust for personal relationships:

Although some individuals may have the natural instincts to behave noncalculatively, others will need to figure it out—to look ahead and recognize that calculativeness will devalue the relation, which is a farsighted view of contract. It does not, moreover, suffice merely to figure it out, in that some of those who do may be unable to shed calculativeness—because calculativeness (or fear) is so deeply etched by their experience. . . . Such trust is also the stuff of which tragedy is made. It goes to the essence of the human condition.

Id. at 35-36.

35. *Id.* at 37.

36. WILLIAMSON, *CAPITALISM*, *supra* note 26, at 27 ("[C]apitalism is prone to undervalue dignity and that institutional safeguards can sometimes be forged that help to correct the condition.").

“transformation of ‘involvement’ relations, from a calculative to a more nearly quasimoral mode”³⁷ To Williamson, the corporate culture can serve a useful function by maintaining cohesiveness in firms, by fostering commitment, and by supporting personal integrity and honor.³⁸ Accordingly, Williamson seems to recognize implicitly that corporate cultures facilitate strong personal relationships that create the “we” feelings that give rise to trust. Yet, he fails to recognize the significance of these relationships: “If the decision to suppress calculativeness is itself purposive and calculative, then the true absence of calculativeness is rare if not nonexistent.”³⁹ To Williamson, nothing romantic or mushy surrounds Japanese employment practices because calculativeness underlies the “soft” notions of cooperative cultures in Japanese firms.⁴⁰

Although Williamson acknowledges that participatory work programs create cooperative climates in the workplace, he asserts that these programs probably will not succeed in the United States because they depend on the background culture to provide reputational sanctions to prevent opportunistic conduct.⁴¹ Williamson explains:

The “special problems” of soft contracting . . . are particularly great when soft contracting is introduced into an alien culture. The reason for this is that the entire burden of providing contractual safeguards falls entirely on the immediate parties to the transaction if background cultural supports are missing. Should one of the parties choose to defect, there is no further support for sustaining the transaction to which either can appeal.⁴²

For these reasons, Williamson concludes that participatory programs may be more viable in countries like Japan rather than the United States.

C. *Trust and the Theory of the Firm*

Williamson has made a substantial contribution to the theory of the firm, but his treatment of employees has revealed some of its intrinsic weaknesses. I agree with Williamson that trading hazards depend upon environmental factors such as societal and corporate cultures. For these reasons, I have written that even under Williamson’s transaction cost model of the firm, the law should mandate that workers have a role in corporate governance because participatory work programs require employees to make

37. WILLIAMSON, *supra* note 12, at 44.

38. Williamson, *supra* note 16, at 30 (quoting CHESTER BARNARD, *THE FUNCTIONS OF THE EXECUTIVE* 122 (1938)).

39. *Id.* at 30-31.

40. *Id.* at 30.

41. Oliver Williamson & W.G. Ouchi, *The Markets and Hierarchies Programme of Research: Origins, Implications, Prospects, in POWER, EFFICIENCY AND INSTITUTIONS* 13, 26-28 (Arthur Francis et al. eds., 1983).

42. *Id.* at 28.

significant investments of human capital⁴³ that involve a high degree of uncertainty due to the possibility of expropriation.⁴⁴ In contrast to Williamson's faith in the free market,⁴⁵ I argue that parties will not contract to provide employees with a voice in corporate governance because cultural norms, conventions, and institutions increase the transaction costs involved in introducing codetermination through the contracting process. Given the long-standing convention of shareholder supremacy and resistance to employee involvement in strategic decisionmaking, U.S. firms are reluctant to deviate from the traditional system of corporate governance because they fear reputational sanctions for violating established business practices.⁴⁶ Thus, legal reform mandating codetermination is needed to facilitate an atmosphere conducive to a high level of employee trust in volatile economic conditions.

In response, Williamson has written cautioning me that the term "trust" should not be used when discussing the employment relationship.⁴⁷ In this Article, I will persevere with my theory that interpersonal trust is important to our understanding why organizational abilities differ among firms, particularly with respect to productivity differences flowing from labor-management cooperation. Specifically, we need to discuss how trust arises among persons within corporations and how the law can foster societal conventions that will reinforce cooperative corporate norms.

1. Criticism of the Transaction-Cost Model of the Firm

Williamson's economic organization reduces the firm to a series of long-term contractual relationships between calculating individuals and dissolves corporate governance into a mechanism that safeguards firm-specific investments against opportunism. In my view, this theory overlooks definitive components of corporate governance, restricting the model's significance for corporation law.⁴⁸ Specifically, Williamson fails to recognize the origins

43. O'Connor, *Human Capital*, *supra* note 1, at 917.

44. *Id.* at 907-11.

45. WILLIAMSON, *supra* note 12, at 9-10; *see also* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423 (1993); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

46. *See, e.g.*, Thomas A. Kochan & Michael J. Piore, *Will the New Industrial Relations Last? Implications for the American Labor Movement*, ANNALS, May 1984, at 177.

47. Letter from Oliver Williamson to Marleen O'Connor, dated Sept. 2, 1992, commenting upon *Human Capital* article, *supra* note 2. Recently, economists have spent a great deal of effort in clarifying the notion of trust in business relationships. *See, e.g.*, Partha Dasgupta, *Trust as a Commodity*, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 49 (Diego Gambetta ed., 1988); David M. Kreps, *Corporate Culture and Economic Theory*, in PERSPECTIVES ON POSITIVE POLITICAL ECONOMY 90 (James E. Alt & Kenneth A. Shepsle eds., 1990); Lynne G. Zucker, *Production of Trust: Institutional Sources of Economic Structure, 1840-1920*, 6 RES. ON ORGANIZATIONAL BEHAV. 53 (1986).

48. For other critiques of the neoclassical economic approach to corporate law, *see* William W. Bratton, *The Economic Structure of the Post-Contractual Corporation*, 87 Nw.

of economic activity because the collective nature of corporate actors in an organized network cannot be commodified into marketable elements. In order to evaluate the comparative efficiency of various organizational forms, a broader perspective is required. Socio-economics permits us to picture the corporation as a moral world that influences the manner in which corporate actors appreciate the ethical decisions that pervade economic activity.

Taking a socio-economic approach, Mark Granovetter contributes to our understanding of economic life by analyzing the nature of trust in commercial networks.⁴⁹ He emphasizes the significance of "embeddedness," which refers to how social relationships give rise to goodwill and commitments that nurture trust. Granovetter asserts that parties in long-term commercial transactions may develop we-feelings, comparable to the close bonds among family members.⁵⁰ These business friendships form, not merely to further economic goals, but also to fill a person's need for companionship and kindness in the social interaction that pervades daily worklife. Such group affiliations have a personal history and connection that impact commercial life⁵¹ through intimate self-expression which supports the association and alters the path of the alliance.

Recognizing the capacity to develop the empathic tendencies from which moral sentiments derive, the socio-economic model presents a corporate world of compassion and connection that allows an ethic of care to mature and prosper. Similar to the prisoners' dilemma research, the socio-economic model of the firm envisions the formation of the desire to "do the right thing" that overcomes the utility derived from defecting. As applied to participatory work programs, industrial relations practices are geared toward transforming the utility functions of workers so that they engage in prosocial behavior for noninstrumental reasons, such as feelings of belonging or basic morals.

In sum, the socio-economic view of the role of trust in commercial transactions encompasses both altruistic and self-interested inclinations. It is true that in part, parties are motivated by self-interest because those who violate trust incur reputational losses. In one-shot deals, however, a major factor that supports trust is the internalization of values, a feeling that violating one's obligation is unethical. These moral sentiments confer material advantages in the long run. Robert Frank explains that because

L. REV. 180 (1992); Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215 (1992) (reviewing FRANK, A. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991) and ROBERT N. BELLAH ET AL., *THE GOOD SOCIETY* (1991)); Lawrence E. Mitchell, *The Cult of Efficiency*, 71 TEX. L. REV. 217 (1992) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991)).

49. Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness*, 91 AM. J. SOC. 481 (1985).

50. *Id.* at 490-91 ("In business relations the degree of confidence must be more variable [than the family context], but Prisoner's Dilemmas are nevertheless often obviated by the strength of personal relations." *Id.* at 491.).

51. *Id.* at 495-99.

cooperators use signals to deal with other cooperators and avoid defectors, the cooperators' altruistic motives allow them to make credible commitments at a lower cost.⁵²

A great deal of difference exists between talking about how trust is good for business because it enhances profitability and talking about how trust leads to a morally satisfying life which in turn facilitates business. In the next section, I will explore the significance of the language that we use to think and talk about trust.⁵³

2. Talking About Trust: Cynics v. Innocents

Williamson notes that the "Science of Organization" is growing as economists begin to undertake a comparative economic analysis of firms.⁵⁴ He stresses that this new science requires appropriate linguistics, urging that the word "trust" should be used much more precisely among social scientists.⁵⁵ "The world of commerce is reorganized in favor of the cynics, as against the innocents, when social scientists employ user-friendly language that is not descriptively accurate—since only the innocents are taken in."⁵⁶ I share Williamson's desire to stop using the term "trust" to talk about trading risks. Whereas Williamson prefers to avoid the use of the word "trust" in commercial transactions, I maintain that a need exists for more open use of ethical language in discussing economic life.

My point is that rhetoric counts: our discourse and our reality are interdependent because language shapes our minds by habituating us to particular world views.⁵⁷ Language is a culturally sensitive system that conveys meaning in various ways by embodying implicit exhortations and

52. ROBERT FRANK, *PASSIONS WITHIN REASON: THE STRATEGIC ROLE OF THE EMOTIONS* 249 (1988).

53. Elsewhere I have emphasized that the law and literature movement can help to illuminate the nature of fiduciary obligation by teaching us to reflect upon the language we use to talk and think about these legal duties. Marleen A. O'Connor, *How Should We Talk About Fiduciary Duty? Directors' Conflict-of-Interest Transactions and the ALI's Principles of Corporate Governance*, 61 GEO. WASH. L. REV. 954 (1993). Other corporate scholars have begun to examine the issue of trust in corporate law. William W. Bratton, Jr., *Self-Interest and Good Will in Corporate Fiduciary Law* (unpublished manuscript, on file with author); Lawrence E. Mitchell, *Trust and the Promise of Corporate Community* (forthcoming); Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 1993 DUKE L.J. 425.

54. Williamson, *supra* note 16, at 36.

55. *Id.* at 37.

56. *Id.* at 30.

57. For an overview of the law and literature movement, see RICHARD A. POSNER, *CARDOZO: A STUDY IN REPUTATION* (1990); Richard A. Posner, *Law and Literature: A Misunderstood Relation* (1988). For a law-and-literature criticism of economics, see Robin West, *Authority, Autonomy, and Choice: The Role of Consent in the Moral and Political Visions of Franz Kafka and Richard Posner*, 99 HARV. L. REV. 384 (1985); JAMES B. WHITE, *JUSTICE AS TRANSLATION: AN ESSAY IN CULTURAL AND LEGAL CRITICISM* (1990). For a response to this criticism, see Richard A. Posner, *The Ethical Significance of Free Choice: A Reply to Professor West*, 99 HARV. L. REV. 1431 (1986).

social evaluations.⁵⁸ In this way, speech patterns at once reveal and reshape the attitudes and value choices of our community. Accordingly, the way we talk about trust significantly affects commercial relations because linguistic differences play an important role in constituting our social world. Specifically, the motives of altruism and self-interest encompass the fundamental conflict in psychology between the feelings of isolation and perceptions of connection.⁵⁹ The opposite sensations of self and relationship give rise to two distinct terminologies; we see that economics uses systematic notions of utility, rationality, and maximization, whereas socio-economics employs organic concepts of harmony, belonging, and empathy. In turn, these two languages give rise to different forms of thought and experience.⁶⁰ Williamson's emphasis on calculating language is dehumanizing, provoking withdrawal to foster independence, while the rhetoric of social connection is uplifting, fostering togetherness to promote goodwill.

Talking about trust solely in terms of calculativeness tends to legitimate behavior that conforms to it, bringing about a less satisfying way of life. Disturbing evidence suggests that the traditional economic model impedes cooperation by condoning selfish behavior;⁶¹ studies show that economists are more likely than others to engage in opportunistic conduct. In addition, when economics students play the prisoners' dilemma game, the level of self-interested behavior rises, indicating that self-interested people study economics or that economics students internalize self-interested values.⁶² With respect to the firm, Mark Granovetter cautions that the transaction-cost model views institutional arrangements as substitutes for trust, which "results actually in a Hobbesian situation, in which any rational individual would be motivated to develop clever ways to evade them; it is then hard to imagine that everyday economic life would not be poisoned by ever more ingenious attempts at deceit."⁶³ As applied to the work setting, Williamson's calculating discourse perpetuates the zero-sum thinking that has characterized our history of adversarial labor relations.⁶⁴

3. Creating Institutions That Will Foster Trust

Repeated play of the prisoners' dilemma game allows implicit agreements to refrain from opportunism to become self-enforcing; each player recognizes

58. WHITE, *supra* note 57, at 3-4.

59. CAROL GILLIGAN, IN A DIFFERENT VOICE (1988); Carol Gilligan, *Do the Social Sciences Have an Adequate Theory of Moral Development?*, in SOCIAL SCIENCE AS MORAL INQUIRY 32, 48 (Norma Haan et al. eds., 1983) [hereinafter *Moral Development*].

60. Gilligan, *Moral Development*, *supra* note 59, at 48.

61. John R. Carter & Michael D. Irons, *Are Economists Different, and If So, Why?*, J. ECON PERSP., Spring 1991, at 171; Robert H. Frank et al., *Does Studying Economics Inhibit Cooperation?* (unpublished manuscript, on file with author).

62. Mansbridge, *supra* note 13, at 135.

63. Granovetter, *supra* note 49, at 489.

64. William H. Simon, *Social-Republican Property*, 38 UCLA L. REV. 1335, 1388-89 (1991) ("Commodification undermines the sense of intrinsic satisfaction in economic activities by eroding the sense of connection between the activity of work and its social meaning and by eroding the experience of work as membership in a community.").

that the decision to defect in any round of play will trigger a similar response from the other player in the next round. Once the players make the initial move to cooperate, a "lock-in" effect arises that promotes a pattern of collaboration throughout the game.⁶⁵ Thus, iterated prisoners' dilemma games appear to lead to the development of informal norms that facilitate cooperation. What underlies the origin of these norms? Some game theorists rely upon morality or trust to explain why parties choose to cooperate and why the lock-in effect occurs.⁶⁶ Williamson, however, rejects the notion that the parties learn to trust one another.⁶⁷ Instead, he emphasizes that we need to learn more about the ongoing processes through which influences such as social conditioning and corporate culture affect economic exchange.⁶⁸

Here, we find ourselves in a "catch-22."⁶⁹ Informal norms confirm the fellowship and obligations of group members, allowing a group to develop solidarity. Camaraderie, however, appears to allow a group to create such norms in the first place.⁷⁰ Robert Ellickson explains that "[o]ne possibility is that the tightness of a groups' social structure and the welfare-enhancing features of its norms are linked symbiotically, and gradually feed synergistically on one another."⁷¹ As applied to participatory work programs, Peter Doeringer states that "the management of labor efficiency is directed at dynamic, rather than static, efficiency and it emphasizes the importance of social and organizational change as sources of labor productivity."⁷²

To further explore the processes by which corporate cultures facilitate cooperative workplace conventions, we can turn to Jane Mansbridge's discussion of how to promote self-interested versus altruistic motivations. Mansbridge emphasizes that empathetic and moral inclinations do not have unlimited value to most people and usually will not continue in the presence of self-interested action by others.⁷³ For example, researchers can increase the level of self-interested behavior in prisoner's dilemma games by raising the price of moral behavior or having the cooperators lose repeatedly.⁷⁴ Unless cooperation is reciprocated, it diminishes over time because people find it difficult to act with concern for others when norms condone narrowly self-interested behavior.⁷⁵ In contrast, once benevolent action is initiated,

65. ROBERT AXELROD, *THE EVOLUTION OF COOPERATION* (1984); KREPS, *supra* note 18, at 65-71.

66. Some rely on trust or moral grounds. David M. Kreps et al., *Rational Cooperation in the Finitely Repeated Prisoners' Dilemma*, 27 J. ECON. THEORY 245 (1982); Amartya Sen, *Goals, Commitment, and Identity*, 1 J.L. ECON. & ORGANIZATION 341, 342 (1985).

67. Williamson, *supra* note 16, at 24.

68. *Id.*

69. ROBERT C. ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 123 (1991).

70. *Id.* at 238 n.24.

71. *Id.*

72. Doeringer, *supra* note 10, at 108.

73. Mansbridge, *supra* note 13, at 136.

74. *Id.* at 138.

75. *Id.* at 136-37; AXELROD, *supra* note 65, at 34.

others may respond by cooperating with authentically altruistic motives. For these reasons, institutions need to supply some self-interested reward to altruistic action in order to prevent such behavior from being unreasonably expensive.⁷⁶ Such arrangements, however, do not nullify the substance of moral inclinations; we may not be able to quantify the empathetic element of behavior that also serves one's self-interest, yet this does not mean that the moral component does not exist.⁷⁷

In thinking about how to structure institutions to foster altruistic impulses, Alan Wolfe emphasizes that we should seek to clarify the circumstances that permit people to form their own moral rules.⁷⁸ Wolfe recognizes that moral obligations stem from process, that is, the extent to which the events of everyday life permit people to make their own decisions concerning the issues that confront them.⁷⁹ This focus on process allows individuals to be self-determining while also acknowledging the role of socializing forces such as group norms. By focusing upon the less intrusive procedural issue of how to secure an environment that will encourage cooperative norms, we can avoid the presumptuous practice of deciding what preferences individuals should have.

In fostering corporate cultures that will allow employees to act as moral agents, we need to consider the interplay between the legal system and less formal systems of social control. In my view, the law exerts a tremendous influence on the ongoing process of the development of cooperative norms in the workplace.⁸⁰ Codetermination in Japanese and German corporate governance mirrored the evolving relations between capital and labor in those countries; at the same time, the new legal relationship had a major influence on the forces within the firm. Of course, cooperative impulses are not directly traceable to labor laws, but the law can influence the socialization processes that play a major role in preference formation. The most significant aspect of employment law is symbolic and pedagogic because in many instances the threat of formal sanctions is remote.⁸¹ To me, the way we talk about trust in the employment setting is crucial because the most distinguishing characteristic of labor law is its operation as a system of moral education that promotes cooperation in the workplace. To further explore how to create cooperative corporate climates, the next Part will turn to literature in the area of procedural justice.

76. Mansbridge, *supra* note 13, at 137.

77. *Id.* at 138.

78. ALAN WOLFE, WHOSE KEEPER? SOCIAL SCIENCE AND MORAL OBLIGATION 244 (1989).

79. *Id.* at 245.

80. Lyman Johnson asserts: "[L]aw-and-economics enthusiasts who have inherited, along with the tools of neoclassical economic analysis, its stiff-necked obliviousness to the social influences on market activity fail to see the dialectic interaction of law and markets." Johnson, *supra* note 48, at 2223.

81. Mark Barenberg, *The Political Economy of the Wagner Act: Power, Symbol, and Workplace Cooperation*, 106 HARV. L. REV. 1381, 1478-81 (1993).

II. EMPLOYEES' VOICE: A PROCEDURAL JUSTICE PERSPECTIVE

Economists have not spent much time analyzing voice procedures.⁸² Taking a calculative approach, Williamson asserts that voice mechanisms are designed to give credible commitments and prevent opportunistic conduct.⁸³ But there is another side to the story which has not been considered by economists—voice may become an end in itself. In order to explore this aspect of voice, we can turn to procedural justice research.⁸⁴

Since procedural justice is a newly emerging field, scholars have not yet developed intricate theoretical models from conclusively proven empirical results.⁸⁵ At this time, however, researchers have assembled data about various issues that are related to the topic of how to develop corporate cultures that will foster employee commitment: Does providing employees with voice enhance their perceptions of procedural justice? Do negative outcomes affect employees' perceptions of voice procedures? Are procedural justice opinions enhanced when employees lack actual control over managerial decisions, yet are given an opportunity to discuss their opinions? Can management manipulate voice procedures to obtain procedural justice benefits? Does procedural justice lead to greater productivity, work group cohesiveness, and ethical decisionmaking? In this Part, I will review the procedural justice literature addressing each of these questions. This discussion will provide the background to examine the implications that procedural justice has for the socio-economic model of the firm.

A. *The Procedural Justice Effects of Employee Voice*

1. Process Control Versus Decision Control

Voice procedures have a significant influence upon the way employees perceive their institutions; people view procedures that provide voice as

82. The most insightful economic analysis can be found in ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

83. Williamson, *supra* note 16, at 9-11.

84. For an overview of the procedural justice literature, see TOM TYLER & RALPH SCHULLER, A RELATIONAL MODEL OF AUTHORITY IN WORK ORGANIZATIONS: THE PSYCHOLOGY OF PROCEDURAL JUSTICE (1990); Robert Folger & Jerald Greenberg, *Procedural Justice: An Interpretative Analysis of Personnel Systems*, 3 RES. PERSONNEL & HUM. RESOURCE MGMT. 141 (1985); Blair H. Sheppard & Roy J. Lewicki, *Toward General Principles of Managerial Fairness*, 1 SOC. JUST. RES. 161 (1987); Tom R. Tyler, *Procedural Justice Research*, 1 SOC. JUST. RES. 41 (1987).

85. Some commentators assert that procedural justice research cannot be generalized to real organizational settings because the empirical results are merely products of the laboratory environments used to develop them. In many cases, however, field studies have not only confirmed laboratory results, but indicate that the magnitude of procedural justice effects may be stronger. E. ALLAN LIND & TOM R. TYLER, *THE SOCIAL PSYCHOLOGY OF PROCEDURAL JUSTICE* 206 (1988).

fairer than those that do not, particularly for negative outcomes.⁸⁶ The ability of procedures to influence employee opinions apart from the results of the procedure is highly significant because perceptions of procedural justice affect employee compliance with work rules. For example, Professor Newman's work has revealed that for workers who "lose" as a result of organizational change, perceptions of fair treatment is an important factor in gaining employee acceptance of the new arrangements.⁸⁷ Newman's study is representative of the procedural justice research that shows that worker commitment seems to have less to do with whether voice procedures provide advantageous results than with how employees are treated during the decisionmaking process. Of course, organizations have the strongest need to make unfavorable outcomes more tolerable for workers. Thus, voice procedures aid in maintaining employee loyalty in the circumstances that are the most beneficial to the organization.

Some studies show that procedural justice may have a stronger impact upon employees' attitudes toward their organizations than distributive justice. Research demonstrates that distributive justice and procedural justice judgments in employment settings are statistically independent, with procedural justice opinions having a larger effect upon job satisfaction, evaluations of supervisors, harmony in the workplace, and trust in management.⁸⁸

In many cases, voice procedures allow workers to participate in managerial discussions, yet provide little influence over the final decision. Procedural justice researchers explore this type of voice by distinguishing between "process control" and "decision control."⁸⁹ Process control refers to the chance to express an opinion to decisionmakers whereas decision control involves an actual governance role in the decisionmaking process. Several studies have focused upon whether people perceive that process control provides fairer treatment than procedures that do not allow any voice, even when the opportunity to state one's views accomplishes no purpose beyond the procedural relationship. Studies show that employee perceptions of procedural fairness rise in these circumstances, indicating that the opportunity to speak may have value in itself.⁹⁰ Researchers explain that these so-called "value-expressive effects" depend on the belief that the

86. See, e.g., Robert J. Bies, *Beyond "Voice": The Influence of Decision-Maker Justification and Sincerity on Procedural Fairness Judgments*, 17 REPRESENTATIVE RES. SOC. PSYCHOL. (1987); Robert J. Bies & Debra I. Shapiro, *Voice and Justification: Their Influence on Procedural Fairness Judgments*, 31 ACAD. MGMT. J. 676 (1988); Robert Folger, *Distributive and Procedural Justice: Combined Impact of "Voice" and Improvement on Experienced Inequity*, 35 J. PERSONALITY & SOC. PSYCHOL. 108 (1977).

87. Gaertner, *Winning and Losing*, *supra* note 8.

88. Sheldon Alexander & Marian Ruderman, *The Role of Procedural and Distributive Justice in Organizational Behavior*, 1 SOC. JUST. RES. 177, 192-94 (1987).

89. LIND & TYLER, *supra* note 85, at 186.

90. Tom R. Tyler, *Conditions Leading to Value-Expressive Effects in Judgments of Procedural Justice: A Test of Four Models*, 52 J. PERSONALITY & SOC. PSYCHOL. 333 (1987); see also Tom R. Tyler et al., *Influence of Voice on Satisfaction With Leaders: Exploring the Meaning of Process Control*, 48 J. PERSONALITY & SOC. PSYCHOL. 72, 79 (1985).

authority involved is not acting in a self-interested manner.⁹¹ Thus, if an adversarial atmosphere prevails in the workplace, process control effects may not occur.⁹² Although fairness judgments are enhanced by the opportunity to voice opinions even when there is no chance of altering the decision, it is clear that voice with actual control leads to even greater perceived fairness.

The existence of value-expressive effects raises the possibility that managers may be able to manipulate procedural justice results. Because the experience of procedural justice depends upon the perception that the decisionmaker is taking the workers' views into account, managers may attempt to deceive workers in order to obtain the benefits of procedural justice without offering real voice. Thus, we must consider the possibility of "false consciousness," that workers may be misled by procedures that appear fair, but are fundamentally unjust.⁹³

2. False Consciousness and the Frustration Effect

Although procedural justice researchers do not provide a method to prevent the false consciousness problem, they emphasize that some studies reveal that strategic uses of procedures may backfire. Specifically, process control may produce a "frustration effect," which occurs when apparently fair procedures produce perceptions of greater unfairness than procedures that appear to be less fair.⁹⁴ When people sense that the chance to express an opinion is a "sham," process control may provoke anger toward the decisionmakers, leading workers to engage in skillful disobedience.⁹⁵

In considering the frustration effect, however, it is important to restate that many studies demonstrate that process control raises perceptions of procedural justice for unfavorable outcomes.⁹⁶ These overall results have led some commentators to conclude that the frustration effect is uncommon, arising in limited situations where the evidence is clear that the procedures are tainted. Even when an extreme conflict of interest exists between an allocator and recipient, some studies show that people tend to accept that procedures operate as described.⁹⁷ In addition, when recipients are upset by inequitable distributions, the allocator often can alleviate the dissatisfaction by justifying the results in procedural justice terms.⁹⁸ Some researchers conclude that process control may create an illusion of actual control because

91. LIND & TYLER, *supra* note 85, at 176.

92. Tyler, *supra* note 90, at 339.

93. LIND & TYLER, *supra* note 85, at 172.

94. Ronald Cohen, *Procedural Justice and Participation*, 38 HUM. REL. 643, 647 (1985); Roger Folger, *Voice and Decision Control*, in 1 RES. ON NEGOTIATION ORGANIZATIONS (R. Lewicki et al. eds., 1986).

95. Cohen, *supra* note 94, at 651.

96. LIND & TYLER, *supra* note 85, at 183.

97. *Id.* at 184.

98. *Id.* Bies & Shapiro, *supra* note 86, at 683.

people tend, given the slightest support, to believe that they are in command.⁹⁹

On the other hand, the frustration effect shows that people behave like "intuitive detectives,"¹⁰⁰ scrutinizing the decision-makers' objective in allowing voice and looking for evidence that their viewpoints were regarded before rejected. Recipients may recognize that the opportunity to speak is a pretense designed to lull them into accepting the allocation, rather than a genuine effort to solicit opinions.¹⁰¹ Evidence of the frustration effect may explain certain studies that show negative employee reactions to participatory work programs. When worker dissatisfaction occurs, managers are apt to dismiss voice procedures as ineffective. Yet, workers may believe that managers are insincere in their efforts to consider the employees' opinions, using process control only as a means to raise productivity.¹⁰²

In my view, the procedural justice literature's focus on employee voice is too narrow. So far, the literature has examined only hierarchical, capitalist corporations that seek to maximize shareholder wealth. The type of "voice" studied is a very limited form of employee participation. Indeed, "process control" sounds like a form of Orwellian doublespeak because it really involves no control at all. Even where workers have decision control, the continued viability of the procedures is unilaterally determined by management. Thus, the procedural justice research tends to legitimate the existing power structure of the firm. The frustration effect, however, may indicate that participation has a self-reinforcing feature. That is, process control may cause employees to seek a redistribution of control that allows them more extensive participation to defend their interests. Future procedural justice research on employee voice needs to expand to include participation in matters relating to investment, product mix, work organization, and technology.

Research confirming the frustration effect is significant because participatory work programs rely upon workers voluntarily assuming tasks that are not specified by job descriptions. Although much work remains to be done, procedural justice researchers expect that procedural fairness has a strong positive influence on worker commitment to their organizations. In the next section, I will explore this issue by examining the procedural justice literature on the relationships between voice procedures, commitment, and productivity.

99. See *supra* note 53 and accompanying text.

100. Bies, *supra* note 85; see also Ronald Cohen, *Perceiving Justice: An Attributional Perspective*, in *EQUITY AND JUSTICE IN SOCIAL BEHAVIOR* 119 (Jerald Greenberg & Ronald L. Cohen eds., 1982).

101. LIND & TYLER, *supra* note 85, at 181; cf. Ronald Folger et al., *Effects of "Voice" and Peer Opinions on Responses to Inequity*, 37 *J. PERSONALITY & SOC. PSYCHOL.* 2253, 2259 (1979) (co-workers' opinion that outcome is unfair negates positive impact of voice).

102. Cohen, *supra* note 94, at 655.

B. Procedural Justice, Worker Commitment, and Productivity

1. Corporate Culture and Worker Commitment

In analyzing issues concerning employee loyalty, the procedural justice research distinguishes between instrumental commitment and psychological commitment. Whereas instrumental commitment seeks utilitarian gain from the employment relationship, psychological commitment refers to a willingness to give energy to an organization for its own sake.¹⁰³ Studies show that workers who develop an affective attachment to the values and goals of an organization show more pro-social behavior than those with an exchange-based connection to the organization.¹⁰⁴

Professor Newman has done a considerable amount of research on how corporate cultures affect psychological commitment. She explains that worker behavior is greatly influenced by corporate norms and values because the corporate climate conveys a sense of identity for its members and facilitates commitment to something larger than the self.¹⁰⁵ Newman explains that the corporate culture shapes decisionmaking by prohibiting consideration of factors that are inconsistent with the firm's culture and by emphasizing options that complement the firm's culture.¹⁰⁶ For example, she has found that managers engage in more ethical decisionmaking in organizations perceived to have a caring climate, whereas instrumental criteria are used when the climate supports it.¹⁰⁷

In another study, Newman found that although a caring climate has a positive influence on moral intent, perceptions of voice had the opposite effect. These results are surprising because one would think that perceptions of voice would signal and reinforce an ethical climate, which in turn would promote the use of moral criteria in decisionmaking.¹⁰⁸ Newman explains that employees may presume that voice guarantees the use of moral criteria, so that participation produces complacency which reduces the likelihood

103. Richard T. Mowday et al., *The Measurement of Organizational Commitment*, 14 J. VOCATIONAL BEHAV. 224, 225-26 (1979); Charles O'Reilly III & Jennifer Chatman, *Organizational Commitment and Psychological Attachment: The Effects of Compliance, Identification, and Internalization on Prosocial Behavior*, 71 J. APPLIED PSYCHOL. 492, 492 (1986).

104. Mary A. Konovsky et al., *Relative Effects of Procedural and Distributive Justice on Employee Attitudes*, 17 REPRESENTATIVE RES. SOC. PSYCHOL. (1987); O'Reilly & Chatman, *supra* note 103, at 497.

105. Gaertner, *Ethical Climate*, *supra* note 8; *see also* Thomas A. DeCotiis & Timothy P. Summers, *A Path Analysis of a Model of the Antecedents and Consequences of Organizational Commitment*, 40 HUM. REL. 445 (1987) (analyzing structure, process, and climate of organizational predictive of commitment); Robert Folger & Mary A. Konovsky, *Effects of Procedural Justice and Distributive Justice on Reactions to Pay Raise Decisions*, 32 ACAD. MGMT. J. 115, 126 (1989) (suggesting that procedural justice has more effect than distributive justice on trust in supervisor and organizational commitment).

106. Gaertner, *Ethical Climate*, *supra* note 8, at 212 (citing AMITAI ETZIONI, *THE MORAL DIMENSION: TOWARDS A NEW ECONOMICS* (1988)).

107. *Id.* at 215.

108. Newman, *Procedural Justice*, *supra* note 8.

that employees will make more ethical decisions.¹⁰⁹ Newman's study shows that a more promising way to increase ethical decisionmaking is for supervisors to treat employees with dignity and respect; such conduct will allow employees to feel safe in using the same criteria in making their own decisions.

Newman's contribution to this symposium issue reveals that the firm's moral climate affects employee commitment; she found that voice and supervisory relations have a positive influence upon employee identification with the goals and values of the company.¹¹⁰ Newman concludes that providing employees with a voice in decisionmaking processes is the most effective method to raise employee perceptions of ethical corporate climates. Her research is consistent with other studies emphasizing that the very act of participating creates psychological commitment to the decision.¹¹¹

In the past, Newman examined how firms seek to gain a competitive advantage by raising employee commitment through employment practices other than voice.¹¹² She found that employee perceptions of internal job mobility and job security are strong correlates of commitment.¹¹³ In addition, long-term employment contributes to psychological commitment.¹¹⁴ Indeed, these factors are more strongly related to psychological commitment than participation and supervisory relations.¹¹⁵ Newman concludes: "In addition to creating jobs and work settings that foster employee participation, good supervisory relations, and communication, firms may want to focus on a career orientation, creating an environment in which internal mobility and some employment security are available to employees."¹¹⁶

2. Procedural Justice and Productivity

Although the procedural justice research shows that voice leads to employee commitment to the organization, the relationship between voice and productivity is less clear.¹¹⁷ Because performance is determined by many factors, it is probably unreasonable to expect any single factor to have a direct effect on performance.¹¹⁸ Although a growing body of empirical evidence supports the view that collaborative workplace arrangements yield

109. *Id.* at 128-29.

110. Newman, *Just Organization*, *supra* note 8.

111. DeCottis & Summers, *supra* note 105.

112. Gaertner & Nollen, *supra* note 8, at 976.

113. *Id.* at 985.

114. *Id.* at 988.

115. *Id.* at 987.

116. *Id.* at 988.

117. P. Christopher Earley & E. Allan Lind, *Procedural Justice and Participation in Task Selection: The Role of Control in Mediating Justice Judgments*, 52 *J. PERSONALITY & SOC. PSYCHOL.* 1148, 1159 (1987) (suggesting that relationship between voice and performance is not clear). For an overview of the literature evaluating the effect of participation on performance, see Edwin A. Locke & David M. Schweiger, *Participation in Decision-Making: One More Look*, 1 *RES. ON ORGANIZATIONAL BEHAV.* 265 (1979).

118. LIND & TYLER, *supra* note 85, at 189.

significant increases in employee productivity,¹¹⁹ it is not possible to make definite conclusions from the research available.

Some studies, such as the one conducted by Professor Newman, show that employee voice motivates workers and contributes to enhanced performance.¹²⁰ On the other hand, other experiments reveal negative effects upon productivity.¹²¹ In one study, for example, the experimenters hypothesized that allowing employees to have a voice in their performance review procedures would promote perceptions of procedural fairness, leading to improved productivity. Although voice increased the perceptions of procedural fairness, it corresponded to lower performance.¹²² The researchers explained that employees may exert less effort under these circumstances because they may believe they can obtain favorable evaluations without regard to merit.

In sum, our knowledge of how procedural justice affects productivity remains largely speculative. Given the general findings that voice strongly influences employee attitudes towards their organizations, additional research is clearly needed. Group decisionmaking in participatory work programs is expected to lead to better utilization and integration of knowledge because these programs delegate control over production processes to employees on the shopfloor where useful on-the-spot information is available.¹²³ Yet, the importance of worker knowledge may be overemphasized. Rather, the main benefit of employee voice for the organization may stem from gaining worker commitment to the decisions reached. Even if additional research fails to show that voice leads to enhanced performance, the practical significance of procedural justice lies in its ability to improve the quality of work life.¹²⁴

C. *Procedural Justice Research and the Socio-Economic Model of the Firm*

As discussed above, studies demonstrate that perceptions of procedural justice increase when employees are given voice in decisionmaking. Justice theorists, however, debate about whether these results occur because of instrumental motives, such as the assumption that specific processes generate particular results, or noninstrumental purposes, such as fulfilling a desire to be heard, regardless of the power over the outcome.¹²⁵ Each of these

119. See, e.g., Barenberg, *supra* note 81, at 1480. Unions enhance the profitability of participating work programs. Adriene E. Eaton & Paula B. Voos, *Unions and Contemporary Innovations in Work Organization, Compensation, and Employee Participation*, in UNIONS AND ECONOMIC COMPETITIVENESS 189-94 (Lawrence Mishel & Paula B. Voos eds., 1992).

120. Newman, *supra* note 7, at 1507-08; see also LIND & TYLER, *supra* note 85, at 187.

121. LIND & TYLER, *supra* note 85, at 175.

122. Ruth Kanfer et al., *Fairness and Participation in Evaluation Procedures: Effects on Task Attitudes and Performance*, 1 Soc. JUST. RES. 235, 245 (1987).

123. Masahiko Aoki, *The Participatory Generation of Information Rents and the Theory of the Firm*, in THE FIRM AS A NEXUS OF TREATIES 26, 27 (Masahiko Aoki et al. eds., 1990).

124. LIND & TYLER, *supra* note 85, at 190.

125. *Id.* at 192.

perspectives employs a distinct model of the person. The first model corresponds to neoclassical economic theory by assuming that people judge their social experiences in terms of the outcomes they receive and that these outcome-based judgments control behavior. This second model offers a new way of looking at people's reactions to organizational decisions that views people as more interested in issues of process than results.¹²⁶ By examining these two models, we can explore the need to revise the self-interested image of the person which dominates the social sciences and corporate law.

1. The Self-Interest Model: The Outcome-Based View of the Person

The two primary theories of procedural justice research use the self-interested economic model to make predictions about procedural justice.¹²⁷ The first theory, espoused by John Thibaut and Laurens Walker, explores the amount of control that participants have in dispute resolution procedures. According to Thibaut and Walker, decision control allows the participants to prevent negative results, while process control allows them to convince the decisionmaker to grant favorable outcomes. Thibaut and Walker maintain that procedural justice may produce distributive justice, but it is not necessary to use specific procedures to achieve just outcomes.¹²⁸ In contrast to Thibaut and Walker's approach, the second instrumental theory developed by Gerald Leventhal discusses six interpersonal features of procedures that advance justice: consistency, bias suppression, accuracy, correctability, representativeness, and ethicality.¹²⁹ According to Leventhal, these procedural justice rules are meaningful because each increases the possibility that the end result will promote group goals. Unlike Thibaut and Walker, Leventhal argued that procedural fairness is a prerequisite to obtaining distributive fairness.¹³⁰

Both of these theories are built on an egoistic view of the person which assumes that people evaluate a procedure in terms of whether it will achieve results, not for the procedure's own attributes. This theory explains that group-oriented behavior such as cooperation and commitment occur because people perceive that the outcomes they obtain from belonging to the group are better than the outcomes they would obtain without the group.¹³¹

126. *Id.*

127. *Id.* at 221.

128. JOHN THIBAUT & LAURENS WALKER, *PROCEDURAL JUSTICE: A PSYCHOLOGICAL ANALYSIS* 3 (1975).

129. Gerald S. Leventhal, *What Should Be Done With Equity Theory?: New Approaches to the Study of Fairness in Social Relationships*, in *SOCIAL EXCHANGE: ADVANCES IN THEORY AND RESEARCH* 27, 39 (Kenneth J. Gergen et al. eds., 1980).

130. Gerald S. Leventhal, *Fairness in Social Relationships*, in *CONTEMPORARY TOPICS IN SOCIAL PSYCHOLOGY* 211, 230 (John Thibaut et al. eds., 1976).

131. Tom R. Tyler, *When Does Procedural Justice Matter in Organizational Settings?*, 1 *RES. ON NEGOTIATION ORGANIZATION* 7, 15 (1986) (Stating that procedural justice reduces uncertainty so self-interest served in long-run).

Procedures are critical components of group activity because a group reveals its values and objectives through its procedures. Accordingly, an unfair procedure is much more threatening than a one-time unfavorable outcome because procedures will continue to govern the relationship in the future. Applied to the employment setting, organizations must reconcile productivity concerns requiring high levels of group performance with the need to foster long-term commitment to the group.¹³² Procedural justice reduces uncertainty for workers, providing a basis for a continued belief in the value of organizational loyalty in the face of negative decisions.¹³³

2. A Relational Model of Procedural Justice: The Process-Based View of the Person

Procedural justice research shows that the enlightened self-interest model does not completely account for some procedural justice results.¹³⁴ For example, one study permitted subjects in laboratory work groups to express their views about work goals after the objectives of the group had been established.¹³⁵ The experimenter informed the participants that they could express their opinions about the goal, but that the goal would not be changed. Compared to a control group that was not allowed voice, the study shows that the opportunity for voice strengthens procedural fairness judgments, as well as enhancing approval of the goal and performance.¹³⁶ Such findings contradict the instrumental notion that process control is merely an inferior substitute for decision control.¹³⁷ It appears that the opportunity for voice raises perceptions of procedural fairness independent of the influence upon outcomes.

A group-value model of procedural justice is used to interpret these results, providing two explanations that parallel those developed by game theorists to explain cooperative outcomes in one-shot prisoners' dilemma games.¹³⁸ The first theory focuses upon group identification processes, emphasizing that people develop empathy which leads to concern for others beyond matters of individual cost and benefit.¹³⁹ The basic assumption is that group membership is psychologically rewarding because groups provide

132. *Id.* at 12.

133. LIND & TYLER, *supra* note 85, at 134.

134. *Id.* at 228.

135. *Id.* at 147.

136. *Id.*

137. *Id.* at 194. The subjects, however, appear to have believed they had some control, even though the experimenter told them that their opinion would not affect the goal and when the goal remained unchanged after they expressed their concerns. This study may indicate that process control creates an illusion of real control. If such an illusion exists, it is possible to account for the findings using the instrumental theory.

138. See *supra* note 20-23 and accompanying text.

139. LIND & TYLER, *supra* note 85, at 240; Tom R. Tyler & E. Allan Lind, *A Relational Model of Authority in Groups*, 115 in 25 *ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY* (Mark P. Zanna ed., 1992) [hereinafter *Relational Model*].

emotional support and a sense of belonging.¹⁴⁰ This view emphasizes that people are concerned with what procedures say about their status in the group.¹⁴¹ Voice procedures are perceived as fair because such procedures imply a full-status relationship to the organization, one that enhances personal growth, respect, and dignity.¹⁴² The second explanation offered is that people are influenced by social values about what is right and proper; people are attracted to a "just" society and this appeal is strong enough to influence people's thinking and actions. As applied to the work setting, the group-value model suggests that interest in procedural justice stems from concern about the interpersonal features of social relationships, rather than productivity and efficiency.¹⁴³ The model emphasizes that voice promotes democratic values and signals group membership.

3. The Implications of the Two Models of the Person for Participatory Work Programs

The procedural justice literature reveals that people care deeply about justice issues, yet it does not indicate that we should abandon the self-interested model of the person. The critical issue is the extent to which altruistic and self-interested motives influence procedural justice perceptions, worker commitment, and productivity. Further research should continue to explore how self-interested motives are modified into preferences, beliefs, and behaviors that reflect a clear and long-term concern for others.

Although it may be difficult to disentangle instrumental and noninstrumental elements of voice procedures, it is clear that efficiency is a concept that needs serious rethinking by economists and legal scholars. The need for a broader perspective is significant because analysis based upon a narrow group of behavioral assumptions may fail to grasp the nature of evolving employee-employer relations. Although the need for increased productivity has prompted managers to reject traditional labor philosophies, it is important to keep in mind that these policies were morally flawed from the beginning. Workers have always deserved to be treated with equal respect and dignity. If employees sense that the managers are allowing voice merely to enhance productivity, participatory work programs will be ineffective.¹⁴⁴ Accordingly, managers must recognize that worker participation is valuable in its own right because it achieves human values by enhancing worker dignity. In the next Part, I will further explore the topic of worker voice by developing a socio-economic model of the employee's role in the Japanese corporate governance structure.

140. Tom R. Tyler, *The Psychology of Procedural Justice: A Test of the Group-Value Model*, 57 J. PERS. & SOC. PSYCHOL. 830, 831 (1989).

141. LIND & TYLER, *supra* note 85, at 189.

142. Folger & Konovsky, *supra* note 105, at 126 (discussing noninstrumental values such as respect and dignity of workers).

143. Tyler, *supra* note 84, at 75.

144. Doeringer, *supra* note 10, at 114.

III. THE EMPLOYEES' ROLE IN THE JAPANESE FIRM

The conventional notion found in the management literature is that basic cultural attributes are responsible for Japan's distinctive labor relations. According to this view, the overall pattern of solid bonds between individuals and groups in the Japanese culture fosters the strong attachment that workers have to their firms. One reason for the prevalence of this cultural thesis is that neoclassical economists view the Japanese workers' eagerness to participate in team activities as being quite odd. History, however, indicates that more than cultural factors were involved in the formation of the present system of Japanese industrial relations. After the Second World War, several influences, including government regulation, operated to promote a corporate governance system that would elicit commitment from the work force.

Masahiko Aoki uses economic principles to explain how the Japanese corporate governance structure facilitates participatory work programs by harmonizing relationships among the shareholders, managers, and employees.¹⁴⁵ Aoki stresses that it is not possible to properly understand Japanese industrial relations and the financial arrangements of the firm if these systems are viewed separately. Rather, these structures can be grasped only when analyzed as part of an overall governance scheme. Under Aoki's model, labor efficiency is enhanced by the monitoring function of the main bank that serves to uphold implicit employment agreements, and the mediating role of managers who balance the interests of investors and employees.¹⁴⁶

In this Part, I will briefly describe these components of Japanese corporations. This broader picture of corporate governance highlights significant incentive features of the Japanese firm that are not captured by traditional models that concentrate solely on management-shareholder relations. This economic model of the Japanese firm, however, contains several drawbacks in explaining how to resolve the collective action problems

145. See *supra* note 7; see also Masahiko Aoki, *The Contingent Governance of Team Production*, Center for Economic Policy Research Publication (1993); Masahiko Aoki, *Monitoring Characteristics of the Main Bank System: An Analytical and Historical View*, Center for Economic Policy Research Publication No. 352 (1993) [hereinafter *Main Bank*]; Oliver Williamson, *Strategizing, Economizing, and Economic Organization*, 12 STRATEGIC MGMT. J. 75 (1991); Paul Sheard, *The Main Bank System and Corporate Monitoring and Control in Japan*, 11 J. ECON. BEHAV. & ORGANIZATION 399 (1989) [hereinafter *Monitoring*]; Paul Sheard, *The Economics of Interlocking Shareholdings in Japan*, Center For Economic Policy Research Publication No. 259 (1991) [hereinafter *Interlocking*]. Use of this system of main bank monitoring is decreasing due to deregulation and internalization of securities markets. Sheard, *Monitoring, supra*, at 405.

146. The Japanese system of subcontracting also serves to support industrial relations practices. Through subcontracting, the Japanese firm can externalize a substantial amount of operational activities which serves to allow the firm to reduce the amount of permanent employees and hire a homogenous body of workers. Aoki, *Attributes, supra* note 6, at 24. For a detailed examination of the subcontracting system as it relates to the Japanese corporate governance system, see Gilson & Roe, *supra* note 5.

associated with team production. Exploring these weaknesses reveals ways in which future research in socio-economics will enable us to develop a richer and more complex picture of the employees' role in the Japanese firm.

A. The Trading Hazards Inherent in Japanese Shopfloor Practices

The Japanese firm employs versatile shopfloor practices that are well-suited to global competition which requires frequent adjustment to market changes and technological developments. In general, the Japanese firm attempts to raise productivity by utilizing shopfloor workers' first-hand experience and by entrusting workers with more responsibility than would be typical in the United States.¹⁴⁷ In addition, job assignments are more flexible, allowing Japanese workers to rotate among positions to develop their problem-solving capabilities. This team work system is highly dependent upon having individual employees work together, teach each other new tasks, and share information.

Although these practices allow the Japanese firm to respond to fluctuating market conditions, this system contains higher risks of opportunism by workers and managers than the methods commonly used in the United States. Specifically, the firm's dependence upon the workers' flexibility and knowledge raise several questions: How does the Japanese structure protect the firm from the employees' ability to withdraw their cooperation once they have developed an informational advantage concerning production? How does the Japanese system create incentives for employees to reveal information about job practices that could be used by management to reduce employment? Japanese workers also face greater dangers because Japanese shopfloor practices require workers to invest in more firm-specific skills. Their exposure poses the issue of how the Japanese structure safeguards workers from the expropriation of their human capital investments.

Providing an overview of the Japanese employment system, Aoki uses the gift exchange model¹⁴⁸ which describes the firm as providing workers with a secure environment in return for higher effort. The reciprocal nature of gift exchange suggests that if one party fails to meet the other's expectations, the other party will respond in kind. Using this "tit-for-tat" strategy, the parties learn to cooperate because norms develop to guide behavior. Aoki emphasizes that when workers and managers collaborate under this scheme, they are acting out of their own enlightened self-interest, rather than out of loyalty to each other. In the next section, I will explore how specific features of the Japanese corporate governance system enhance the possibility of self-interested cooperation by mitigating particular trading risks for workers and the firm.

147. Masahiko Aoki, *The Participatory Generation of Information Rents and the Theory of the Firm*, in *THE FIRM AS A NEXUS OF TREATIES* 26, 27 (Masahiko Aoki et al. eds., 1990).

148. George A. Akerlof, *Labor Contracts as Partial Gift Exchange*, 97 Q.J. ECON. 543 (1982).

1. Mechanisms to Protect Firms from Worker Opportunism

Economists have a difficult time explaining what prevents Japanese team members from shirking. Some simply sweep the problem away by assuming that all team members have the same goals. Aoki asserts that employees as a group engage in self-supervision to ensure that each member follows a collective norm of work effort.¹⁴⁹ The workers' socialization process is promoted by individual incentives associated with lifetime employment, compensation, and promotion schemes, and group incentives facilitated by enterprise unions.

Long-term employment relationships are more common in Japan than in the United States. Workers in large Japanese firms have an implicit guarantee of lifetime tenure.¹⁵⁰ The Japanese resort to layoffs only in extreme circumstances, implementing shorter work hours, work sharing, and transfers before issuing dismissals. Employment security creates an incentive for greater work effort in three ways. First, these employment guarantees reduce the workers' fear that their effort and information sharing will lead to managers' reducing the workforce. Second, lifetime employment serves to reinforce reputational sanctions within work groups because opportunistic conduct will not soon be forgotten. Finally, the promotion system leads to substantial differences in lifetime earnings among Japanese workers.¹⁵¹

The firm provides pay incentives through bonus payments which depend upon an employee's rank. Age and tenure are important determinants of promotion for Japanese production workers while job characteristics play a greater role for American workers. Japanese workers are not given substantial promotions until they have provided ten to fifteen years of service. In making promotion decisions, supervisors evaluate the worker's reputation for cooperation among the worker's peer group. Frequent job rotation within work groups facilitates mutual monitoring and sanctioning among team members that aid in preventing shirking.

Just as promotional rank hierarchies provide incentives for individual workers, Japanese unions may provide collective incentives for workers as a group. Unlike the industry unions in the United States, the Japanese enterprise unions negotiate on the firm level. The enterprise union's fate is more closely tied to a specific firm, supporting the implicit gift exchange between workers and managers. Specifically, repeated interaction between the enterprise union, composed of permanent employees, and the management team, recruited from within the ranks of shopfloor employees, promote standards of behavior conducive to participatory work programs.

2. Structures that Safeguard Workers' Human Capital Investments

The high labor efficiency in Japanese firms generates economic gains that can be shared with workers at the discretion of the managers. Such

149. Aoki, *Attributes*, *supra* note 6, at 32.

150. *Id.* at 13-14. Aoki stresses that discharge is used as an enforcement mechanism, but the firm arranges a new job for the worker. *Id.*

151. *Id.*

discretion creates the potential for internal conflict over the allocation of income, employment, and economic security. To protect Japanese employees from managerial opportunism, the Japanese system relies upon judicial recourse, disclosure of strategic information, and main bank monitoring.

In some instances, the Japanese courts enforce implicit lifetime employment policies. Under Japanese labor law, firms must give thirty days notice before dismissing workers. In many cases, however, the courts also require firms to show just cause and that no feasible alternative to the layoff exists.¹⁵² In addition, the courts allow workers to express their opinions during reorganization proceedings, and rule against plans that fail to sufficiently safeguard employee interests.¹⁵³

Although Japanese law provides some worker protection, to a large extent, reputational sanctions operate to prevent firms from breaching implicit employment arrangements. To enhance the effectiveness of these reputational safeguards, the Japanese firm provides workers with information that allows workers independently to assess the firm's economic condition. In addition, strategic corporate policies are made after management has conferred with workers through quality control circles and consensus-based decisionmaking procedures. These information and consultation mechanisms provide workers with the opportunity to monitor the managers' performance of implicit employment obligations; if managers renege upon the gift exchange, employees can hold them accountable in future interactions by reducing effort norms.

To observers of American corporate governance indoctrinated in zero-sum thinking, a surprising feature of the Japanese system is that the firm's shareholder and creditor relationships operate to promote job security for workers. In the next section, I will examine how the Japanese main bank system and labor practices complement each other to promote the efficient operation of the Japanese organization.

B. *The Role of the Main Bank*

Large Japanese corporations have traditionally relied upon debt financing provided by several banks and have maintained close ties to the corporation's principal creditor and largest shareholder, known as the firm's main bank.¹⁵⁴ This banking system is part of a larger industrial structure known as the *keiretsu*, which encompasses a group of firms that maintain stable patterns of reciprocal stockholdings and trading associations.¹⁵⁵ The

152. WILLIAM B. GOULD, *JAPAN'S RESHAPING OF AMERICAN LABOR LAW* 106 (1984).

153. Aoki, *Attributes*, *supra* note 6, at 28 n.4.

154. Sheard, *Monitoring*, *supra* note 145, at 400-02. In contrast to the U.S. system, Japanese financial institutions can hold debt and equity in the same firm. By relying upon several banks, this system allows the main bank to reduce its losses in the event of default and the firm to decrease its dependence upon a single source of financing.

155. Two-thirds of the shares of listed Japanese firms are held by domestic firms, including banks and other financial institutions. *Id.* at 402.

interlocking relationships of the *keiretsu* serve to shield managers of Japanese firms from takeovers.¹⁵⁶ This insulation allows management to take a long-term view, yet raises the capital market's monitoring expenses to prevent managerial shirking. The Japanese capital market also faces special supervision costs because the workers' human capital investments increase the firm-specificity of production information.¹⁵⁷ The *keiretsu* reduces duplicative supervision efforts by delegating the monitoring function to the main bank.

The hallmark of the main bank system is close information-sharing between the bank and the firm.¹⁵⁸ If the firm is doing well, the main bank does not exert explicit control over corporate policy. The main bank's monitoring, however, allows it to discover difficulties as soon as the firm begins to decline. At this point, the main bank decides whether the firm should be rescued or liquidated. In rescue operations, the main bank will supervise a recovery plan which includes rescheduling loan payments, providing emergency funds, liquidating some assets, and replacing top management. Nonmanagerial employees also face losses in the form of bonds deferral, wage cuts, and more stringent working conditions. If the firm is liquidated, the main bank will normally find new jobs for the displaced workers.¹⁵⁹ Here again, the workers face losses because the new jobs are typically at less prestigious firms.

In conducting a rescue operation, the main bank is confident that the other shareholders will not interfere in the main bank's efforts by implementing alternative strategies or by selling their shares.¹⁶⁰ Thus, interlocking shareholdings facilitate the role of the main bank. At the same time, cross-ownership and the bank system complement industrial relations practices of the Japanese firm.¹⁶¹

The Japanese managers' ability to detect the degree of cooperation among team members is restricted because close supervision is costly; the main bank system serves as an external monitor of team production. In the event of poor performance, the main bank provides discipline by imposing losses upon managers and employees. To prevent these losses, managers are encouraged to voluntarily disclose information and allow main bank intervention. In turn, bank monitoring provides workers with the motivation needed to prevent free riding in team production.¹⁶² The main bank system not only serves to reduce moral hazard problems, but it also creates an environment in which workers feel safe in maintaining high levels of team performance. Specifically, when the firm is doing well, the main bank system relieves managers from outside pressure so that they have leeway to

156. Sheard, *Interlocking*, *supra* note 145, at 3.

157. Aoki, *Attributes*, *supra* note 6, at 28.

158. Sheard, *Monitoring*, *supra* note 145, at 405.

159. Aoki, *Attributes*, *supra* note 6, at 14.

160. Sheard, *Interlocking*, *supra* note 145, at 22.

161. Aoki, *Main Bank*, *supra* note 145, at 6.

162. *Id.* at 21.

respect commitments to employees.¹⁶³ In times of crisis, the main bank provides substantial assistance to displaced workers.

The industrial relations structure of the Japanese firm also serves to facilitate the smooth functioning of the main bank system. In many cases, it may be less costly for the main bank to liquidate a firm than attempt to save it.¹⁶⁴ Since other investors have assigned the monitoring role to the main bank, they may not be able to recognize when the main bank dodges its obligation by liquidating a firm that should be rescued. Thus, how can the main bank credibly commit to save a firm when the rescue costs exceed the value of its loan? Aoki suggests that the workers ensure that a main bank will perform its responsibilities. Since employees can observe output, their strong voice operates to deter opportunistic conduct by the main bank versus other creditors.¹⁶⁵

C. *The Neutral Referee Model of Corporate Governance*

Aoki rejects the traditional model of corporate governance that posits that the shareholders have unilateral control over managers who seek to maximize shareholder wealth. Instead, Aoki models the firm as a bargaining process between the employees and the shareholders. For the iterated prisoners' dilemma game to yield cooperation, both parties must have some assurance that the other party will be a repeat player. Otherwise, an end-game problem arises, causing cooperation quickly to unravel.¹⁶⁶ In the Japanese firm, the employees are also "locked in" because their human capital investments are firm-specific; shareholders are "locked in" because of the stable pattern of reciprocal ownership. Thus, Aoki's model presents a relatively permanent group of shareholders and employees engaged in a repeated bargaining game.

Aoki asserts that Japanese managers serve as neutral referees to balance the conflicting objectives of shareholders and managers.¹⁶⁷ The dualistic control structure of the Japanese firm provides incentives for the managers to perform this role. Employees can exert substantial influence over management as a group by threatening to withdraw cooperation. In many cases, the enterprise union can force top management to resign. When the firm performs poorly, the role of the employees becomes subordinated to that of the main bank, which sends in its own management team.¹⁶⁸

163. Sheard, *Interlocking*, *supra* note 145, at 25.

164. Aoki, *Main Bank*, *supra* note 145, at 22; Sheard, *Monitoring*, *supra* note 145, at 412.

165. Aoki, *Main Bank*, *supra* note 145, at 39. Some economists surmise that repeated participation in these banking consortiums ensures that the main bank fulfills its rescue mission because its reputation as a responsible monitor is at stake. Aoki, however, is not convinced of the reliability of these reputational sanctions.

166. Reinhard Selten, *The Chain-Store Paradox*, 9 *THEORY & DECISION* 127 (1978).

167. Gerald T. Garvey & Peter L. Swan, *The Interaction Between Financial and Employment Contracts: A Formal Model of Japanese Corporate Governance*, 6 *J. JAPANESE & INT'L ECON.* 247 (1992).

168. Aoki, *Main Bank*, *supra* note 145, at 19.

The implication of this multi-stakeholder corporate governance structure is that the Japanese firm cannot be viewed as pursuing a single goal. Rather, the bargaining process that reconciles the conflicting interests of shareholders and managers leads the firm to pursue a more complex objective than shareholder wealth maximization.¹⁶⁹ As a result of the employees' role, the Japanese firm will pursue a higher rate of investment and will provide job security to a smaller work force.

D. Socio-Economics and the Japanese Firm

This overview of the interrelated aspects of the Japanese firm demonstrates that a number of non-contractual safeguards promote the building and maintenance of long-term relationships within the Japanese firm. But Aoki's model conforms to basic conventions of microeconomic theory which construe parties' acts in instrumental, cost-accounting terms. Marginal costs and benefit calculations, however, create an unsuitable metaphor for analyzing the motivational processes that create a workforce that is self-supervised and self-disciplined.¹⁷⁰ Like Williamson, Aoki fails to take into account the importance of personal trust relationships.¹⁷¹ Socio-economics allows us to see that voice procedures may generate trust-building sentiment by fostering bonds of friendship. Such interaction may aid workers to discover their common concerns and transform self-interested preferences to benefit the firm.

Importantly, Aoki suggests that to evaluate the role of reciprocity that operates within the Japanese firm, we need to look at the role of government regulations in bringing about the Japanese corporate governance system. For the most part, economists focus on how the law provides deterrents to opportunistic conduct by sanctioning the breach of agreements. They tend to ignore the socializing force of the law. In my view, it is necessary to appreciate that labor law reform is a highly symbolic event that clarifies cultural values by presenting an idealized picture of industrial relations.¹⁷² Unfortunately, we do not know how labor relations rhetoric influences consciousness and behavior.¹⁷³ Economics, as well as psychology and sociology, have much to contribute to our understanding of this important issue. Procedural justice research may also be particularly helpful; by assessing comparative data on workplace attitudes, we can better understand the differences that exist between the corporate cultures of American and

169. MASAHIKO AOKI, *THE CO-OPERATIVE GAME THEORY OF THE FIRM* 126-27 (1984).

170. Doeringer, *supra* note 10, at 107.

171. For a calculative approach to trust relationships within the Japanese and German firms, see W. Carl Kester, *Governance, Contracting and Investment Time Horizons*, Working Paper, Harvard Business School 19 (1991).

172. Alan Hyde, *A Theory of Labor Legislation*, 38 *BUFF. L. REV.* 383 (1990).

173. *Id.* at 391.

Japanese firms.¹⁷⁴ This research will allow us to comprehend how the Japanese law fosters governance structures that breed cooperative norms for efficient production.

IV. CONCLUSION

Comparative analysis of the Japanese corporate governance system reveals several important attributes. First, stable stockholdings insulate Japanese managers from the market in terms of corporate control. Second, the Japanese system enhances the economic power of workers through information sharing and consultation mechanisms. Some commentators assert that forces of international competition may cause the American and Japanese models of corporate governance to converge.¹⁷⁵ We are beginning to see signs pointing in this direction. Stakeholder statutes¹⁷⁶ and other legal barriers insulate managers from hostile takeovers. In addition, institutional shareholders are starting to engage in "relational investing" that may promote more stable stock ownership patterns. Finally, depending on future interpretations of the National Labor Relations Act,¹⁷⁷ participatory work programs could evolve into employee representative bodies that perform roles similar to enterprise unions. Thus, several factors indicate that repeat bargaining between the shareholders and employees in U.S. firms may become more feasible in the future.

In my view, a comparative approach to corporate law does not allow us to find new models to imitate, but it does permit us to gain fresh perspectives about the essential nature of the firm. The most important insight that we can gain concerning the Japanese model is that it contains complementary structures for the financial and employment aspects of the firm that mutually support production. To develop organizational arrangements that will facilitate participatory work programs in the United States, we must recognize that workers are not likely to exert maximum effort if they are unprotected from the adverse consequences of doing so.

174. E. Allan Lind & P. Christopher Earley, *Procedural Justice and Culture*, 27 INT'L J. PSYCHOL. 227 (1992).

175. KAZUO KOIKE, UNDERSTANDING INDUSTRIAL RELATIONS IN MODERN JAPAN (1921) (presenting statistical data to support convergence thesis); Koji Taira, *The End of Convergence Theories: Japanization of U.S. Human Resource Management and Industrial Relations*, 5 RES. INT'L BUS. & INT'L REL. 241, 241 (1992).

176. For a variety of interpretations of these statutes, see Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971 (1992); David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 379 (1992); O'Connor, *Displaced Workers*, *supra* note 2; Terry O'Neill, *Employees' Duty of Loyalty and the Corporate Constituency Debate*, 25 CONN. L. REV. 681 (1993); Symposium, *Corporate Malaise—Stakeholder Statutes: Cause or Cure?*, 21 STETSON L. REV. 1 (1991).

177. The legality of using employee involvement committees in a non-union setting was reviewed recently by the National Labor Relations Board in *Electromation, Inc.*, 309 NLRB No. 163 (1992).

The potential of participatory work programs may remain untapped in the United States unless we merge the study of corporate and labor law. As corporate scholars, we need to examine how American labor laws promote adversarial relations that prevent shareholders and employees from reaching cooperative solutions. Specifically, in contrast to most other industrialized countries, American labor law fails to restrict managerial control by providing workers with the ability to effectively bargain through unions and participate in strategic corporate decisionmaking. In addition, the United States is one of the last industrialized countries that continues to allow employment at will, permitting American firms to externalize the costs of economic adjustment through layoffs and plant closings. Examining these issues will allow us to encompass the changing nature of the employment relationship within the legal model of the corporation. For the most part, however, corporate scholars have been reluctant to examine the politically sensitive issues surrounding employment. In my view, this is why a crisis exists in corporate law.¹⁷⁸

178. David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE. L. REV. 1373 (1993).