GLOBAL FORCE

Longevity of Japanese family firms and their challenge

Japan is known as the land of longeuous firms. According to Prof. Toshio Goto of Japan's University of Economics, 8,783 of the world's current companies were established more than 200 years ago, and 3,937 of them (44.6%) are Japanese companies. Most of them are family businesses owned or run by the founding families. Prof. Toshio Goto also says that 97% of Japanese firms today are family businesses, and 77% of the full-time employment in Japan is generated by family firms. The many factors that contribute to the longevity of Japanese firms include their commitment to continuity, ethical profit, long-term planning and a sustained relationship with stakeholders. These business approaches were organised in the late 17th century as “Sekimon Shingaku”, a movement based on the Buddhist, Shinto and Confucian schools of thought which has become widespread since the 18th century, by encouraging fair profit and commercial ethics amongst traders, ensuring the longevity of Japanese companies.

I would like to mention another factor that contributed to the longevity of Japanese companies: the "IE" principle of organisation. The literal translation of IE is “house”. But the “IE” system refers to its family, business and assets as a whole, and also the tradition inherited from ancestors.

In Ancient Japan the main principle of organisation was the bloodline. The Japanese imperial family followed this principle strictly. In the 15th century, however, a new principle emerged in eastern Japan, an area where it was necessary to protect the territory from other warriors and enhance the farming by cultivation and river control. Their successors needed to be very intelligent and physically strong. Although these warrior families respected the bloodline, they sometimes named a talented young man from their retainer's family or another warrior family with whom they had an alliance, as their successor. In these cases, the patriarch would adopt the young man from the other family, so that officially they were father and son. This practice created a pseudo bloodline and ensured the validity of the succession. The successor was appointed at an early age, and was educated and trained with young members of the retainer’s family, who would subsequently become his board of retainer in the future. As a result, in the “IE” system, sustainability was more important than in the bloodline system in which the patriarch - successor combination played an important part.

The “IE” system created a special culture of family-like context in its organization. Capabilities of self-support of living goods and self-defense made IE an independent organization. Decisions were taken by a mixture of bottom-up and top-down to conclude with unanimity. Retainers were treated as if they were relatives of the patriarch.

The Tokugawa Shogun family refined and organised this system, making it as a governing principle of samurai families through middle of 19th century. At the end of the 19th century, after Tokugawa’s governance became disrupted, the new government applied the “IE” system as a principle of the new constitution and civil law. As a result, all Japanese citizens were obliged to abide by the “IE” system.
The patriarch’s rights were protected by law. Family property was inherited by the first son (or adopted son), or the person the patriarch named as his successor. As a result of this law, many of the Japanese businesses established in the Tokugawa era were still going concerns at the end of World War II.

Many big businesses, such as Mitsui, Mitsubishi and Yasuda, called “Zaibatsu”, had developed during this period under the “IE” system. Zaibatsu families in the late 19th century created a very sophisticated governance system that included not only business governance, but also family governance. Its rules were structured as “Kakun” (governing philosophy, values statement), or “Kaken” (family constitution), and had strong ruling powers.

For example, these articles are included in their family constitutions.
- Companies and properties are not privately owned. They belong to the ancestors and we are looking after them.
- The patriarch is not allowed to divest of any family property without the consent of the other family members.
- The head family and branch families must observe each other.
- Major decisions must be taken at family meetings
- Non-family executives must attend the family meetings.

Some families had even more specific regulations such as the amount of reward to the family clerk.

Many small and medium sized companies had been aspired to this kind of sophisticated “IE” system, which created strong links between family members, non-family executives and workers. As the result, they could survive difficulties such as political turmoil, war, earthquakes and fire.

Japan’s defeat in World War II changed family firms considerably. As a result of the new constitution and civil law, the “IE” system was discontinued. The “IE” concept disappeared from civil law and the individual and the household took place as the component of the family. By the dissolution of “Zaibatsu”, the notion of family owned/managed firms became taboo in Japan. Even small and medium sized firms stopped considering the family and the firm to be an interwoven system. We all became “Separationist” of family and business. This is why we have a tendency to look down on family businesses. Most of the owners and managers of family firms are not proud of working for family firms.

The family firms established after WWII have big succession problems. They are now entering the 2nd or 3rd generation. The organisation principles of the old generation that remembers the “IE” system are different from those of the next generation which grew up in the “separatist” culture. What was normal for the old generation is not normal for the next generation, and the difference is particularly evident during succession.

Many family business owners/managers would like their children to take over the leadership and ownership, but fewer and fewer children are interested in following in their parent’s footsteps. The Small and Medium Enterprise Agency has been supporting family succession, but the falling numbers of successions involving family members have made them change their policy to support the succession of non-family managers and M&A. This means that Japan may have to surrender the title of the “land of longevous companies” to another country.
The challenge facing Japanese family businesses is how they can make their owners feel proud of owning and running a family business. With this pride, they must communicate actively with family members and non-family members, learn from family firms around the world and create an organisation method of their own able to make the family, the business and the individual flourish.

**Author:** Kazuoshi Takei, Family Business Consultant, President of WellSpring, Director of FBAA (Family Business Advisors’ Association Japan), author of “Why family businesses fail in three generations?” Cross Media Publishing