

are tax free. By retaining earnings, the value of a company's shares should rise. In effect, retained earnings delay shareholder income and provide it in a tax-free form.

Although it is generally agreed that Japanese firms have had access to long-term capital, there is much more debate on whether they have had access to relatively cheap capital.<sup>61</sup> A study by Kester and Luehrman casts considerable doubt on the conventional wisdom that Japan's high domestic savings rate and activist government policies have ensured a low corporate cost of capital.<sup>62</sup>

Kester and Luehrman point out a number of flaws in other cost of capital studies. These include: problems in matching data sources, as AA rated debt in the U.S. and AA rated debt in Japan are quite different; the general failure to control for different risk; and the failure to recognize different accounting practices in Japan and the U.S.. Kester and Luehrman cite studies that adjust their findings to account for each of the flaws. In every study, the cost of capital advantage that Japan was thought to enjoy disappears. Kester and Luehrman then correct for all the other studies' oversights and determine that: "We can find no compelling statistical evidence that, on average, the United States and Japan currently have different costs of capital."<sup>63</sup>

#### 4.2.3 Is the Horizontal *Keiretsu* Fading?

Several developments in the Japanese and international economies over the past decade or so have led to a weakening in the degree to which *keiretsu* firms are linked, particularly with commercial banks. The developments in Japan include regulatory changes as well as attitudinal changes within business management circles. The international developments centre on the integration of capital markets and the movement of Japanese firms to seek cheaper capital abroad.

One measure of the linkages between banks and other *keiretsu* members is the composition of bank lending. Throughout the 1970s, and even more so in the 1980s, the proportion of bank lending to manufacturing declined and lending to real estate,

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<sup>61</sup> Most studies compare Japan's cost of capital relative to that of the U.S..

<sup>62</sup> W.C. Kester and T.A. Luehrman, "The Myth of Japan's Low-Cost Capital", in *Harvard Business Review*, Vol. 70, No. 3, Boston, MA, May-June 1992, pp. 130-8.

<sup>63</sup> W.C. Kester and T.A. Luehrman, *op. cit.*, p. 134.