The Evolution of Corporate Governance in Japan: The Continuing Relevance of Berle and Means

Takaya Seki & Thomas Clarke[*]

I. INTRODUCTION

The evolution of corporate governance in Japan towards international standards continues, though at a gradual pace that often concerns outsiders.[1] The substance of Japanese corporate governance is often

---

[*] Assistant Professor, Meiji University, Tokyo, Japan, and Professor, University of Technology, Sydney, Australia.

1. *See generally* SIMON LEARMOUNT, CORPORATE GOVERNANCE: WHAT CAN BE LEARNED FROM JAPAN? (2002); LUKE NOTTAGE, LEON WOLFF & KENT ANDERSON, CORPORATE GOVERNANCE IN THE 21ST CENTURY: JAPAN'S GRADUAL TRANSFORMATION (2008); Christina L.

questioned due to a lack of understanding of the unique elements of the Japanese institutional system. Japanese companies are under a sustained assault from overseas investors to introduce a greater number of independent directors on boards, improve accountability, and enhance transparency.[2] The majority of Japanese companies have taken what they regard as significant steps in this direction of accountability. In Japan, however, there is a different conception of the role of the board, the function of corporate governance, and the purpose of the corporation.[3] This Article will argue that significant changes in these enduring Japanese corporate values and practices can only be accomplished if a more convincing theory and model of the corporation is proposed. In important respects, the contemporary evolution of corporate governance in Japan reflects the fundamental dilemmas inherent in defining corporate purpose first recognized by Berle and Means.

II. THE CHANGING ROLES OF BOARDS AND DIRECTORS IN JAPAN

External perceptions of Japanese corporate governance often focus on a lack of board independence with few outside directors, insufficient disclosure, prevalent cross-shareholdings, and persistent instances of corporate fraud and scandals. On the contrary, the duties of directors were tested in Japan as the structure of share ownership changed and governance reforms were introduced: significant corporate disclosure is now occurring and independent directors are being appointed. The future of corporate governance in Japan lies in how the relationships between

---

Ahmadjian, *Changing Japanese Corporate Governance*, *in* JAPAN'S MANAGED GLOBALIZATION 215 (Ulrike Schaede & William Grimes eds., M.E. Sharpe 2003); Takaya Seki, *Legal Reform and Shareholder Activism by Institutional Investors in Japan*, 13 CORP. GOVERNANCE: AN INT'L REV. 377 (2005).

2. *Olympian Depths: Want to Invest in Underperforming Companies with No Outside Directors? Go to Japan*, ECONOMIST, Nov. 1, 2012, *available at* http://www.economist.com/news/leaders/21565626-want-invest-underperforming-companies-no-outside-directors-go-japan-olympian.

3. *See generally* TAKESHI INAGAMI & D. H. WHITTAKER, THE NEW COMMUNITY FIRM: EMPLOYMENT, GOVERNANCE AND MANAGEMENT REFORM (Cambridge Univ. Press 2005); SANFORD M. JACOBY, THE EMBEDDED CORPORATION: CORPORATE GOVERNANCE AND EMPLOYMENT RELATIONS IN JAPAN AND THE UNITED STATES (Princeton Univ. Press 2005); Masahiko Aoki, *The Japanese Firm As a System of Attributes: A Survey and Research Agenda*, *in* THE JAPANESE FIRM: SOURCES OF COMPETITIVE STRENGTH 11 (Masahiko Aoki & Ronald Dore eds., Oxford Univ. Press 1996); CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY (Masahiko Aoki, Gregory Jackson & Hideaki Miyajima eds., Oxford Univ. Press 2007); John Buchanan, *Japanese Corporate Governance and the Principle of "Internalism,"* 15 CORP. GOVERNANCE: INT'L REV. 27 (2007); Ronald Dore, *Deviant or Different? Corporate Governance in Japan and Germany*, 13 CORP. GOVERNANCE: INT'L REV. 437 (2005).

companies and shareholders develop, the role of directors and investors are conceived, and the ultimate purpose of the corporation defined.

In addition to full board members, Japanese companies also appoint *kansayakus* who are Audit and Supervisory Board Members performing a role similar to audit committees and are becoming more outspoken.[4] Table 1 shows a comparison of the composition of board membership in companies from the Tokyo Stock Exchange in the Nikkei 225 Index between 1998 and 2013.[5] While the number of directors is decreasing, the proportion of outside directors is increasing, as is the number of independent outside *kansayakus*. This is a reflection of the changing role of boards in Japan, which were traditionally regarded as a managerial bodies rather than supervisory organs.

Table 1: Board Membership of Nikkei 225 Index[6]

	1998	2001	2004	2007	2010	2013
Directors	25.1	17.9	13.6	12.1	11.4	10.9
Of Whom Are Outside Directors	0.2	0.7	1.0	1.4	1.9	2.3
Kansayakus	4.2	4.2	4.1	4.3	4.3	4.2
Of Whom Are Outside *Kansayakus*	1.3	2.1	2.3	2.5	2.6	2.6
Ratio of Outside Board Members (%)	5.3	12.9	18.5	24.3	28.7	32.5

Table 2: Professional Background of Outside Directors[7]

	Directors/*Kansayakus*
From Other Companies	62.6 %
Attorney-at-Law	16.1%
CPA / Tax Accountant	13.6%
Academic and Others	7.7%
From Major Shareholders	19.2%
From Banks	11.1%
From Government Bureaus	1.9%

4. Details on Kansayaku can be found on the website of *About Corporate Auditor*, JAPAN AUDIT & SUPERVISORY BOARD MEMBERS ASS'N (Mar. 11, 2007), http://www.kansa.or.jp/en/About_Corporate_Auditor.pdf.

5. TOKYO STOCK EXCHANGE, INC., TSE-LISTED COMPANIES WHITE PAPER ON CORPORATE GOVERNANCE 2013 (2013) [hereinafter 2013 TSE-LISTED COMPANIES WHITE PAPER], *available at* http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje6000003ukm8.pdf.

6. *Id.*

7. *Id.*

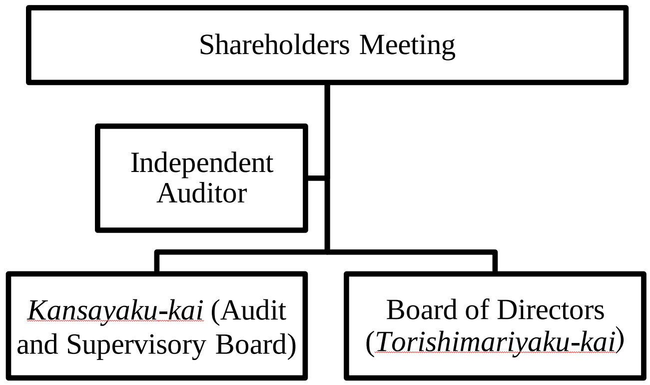
While Japanese company boards remain heavily dominated by inside executive directors, the number of outside directors is increasing in a process of professionalization. As Table 2 reveals, Japanese companies are assembling significant numbers of lawyers, accountants, and academics as board members, most of whom are drawn from the ranks of major shareholders, banks, and government bureaus. A critical mass of external directors is gathering, who are reinforced by *kansayakus.* In addition, the *kansayakus*, while remaining non-voting board members, are becoming increasingly active and visible.

To analyze the recent development of corporate governance in Japan, we would like to explore the series of amendments to Japanese commercial law by focusing on the revision of the roles of directors and *kansayakus*.[8] Japanese commercial law was first introduced at the end of the nineteenth century and was modeled after German stock corporation law. The underlying concepts of Japanese corporate law are similar to those in other major industrial economies, including the independence and separation implicit in corporate personality. Shareholders own the securitized assets of the company in shares and have a residual claim in the company. Directors are appointed by the shareholders to look after the company's assets and serve the best interest of the company. Duties of directors are interpreted similarly to Western corporate practice in a duty of care, duty to avoid conflicts of interest, and duty of loyalty. A series of corporate scandals, fraud cases, and the increasing litigation from shareholders recently tested these duties because of tensions over responsibilities for financial statements and internal control in the development of hostile bid and takeover defense measures.[9]

8. An English translation of Japanese company law is available at *Small and Medium-Sized Cooperative Act*, JAPANESE L. TRANSLATION, http://www.japaneselawtranslation.go.jp/law/detail/?printID=&ft=1&re=02&dn=1&ky=company+law&x=47&y=13&co=01&page=3&vm=04 (last visited Oct. 21, 2013).

9. Mark D. West, *Why Shareholders Sue: The Evidence from Japan* (Mich. Law & Econ. Research Paper No. 00-010, 2000), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=251012.

Figure 1: Corporate Governance in Japan



A century after the implementation of the essential elements that constitute Japanese company law, the law still maintains some German characteristics, such as the appointment of corporate auditors or supervisors in addition to directors. For larger companies listed on the stock exchange, shareholders elect an average of four *kansayakus* who form a board of *kansayakus*, officially translated as an Audit and Supervisory board (Figure 1). *Kansayakus* can serve up to four years, after which they can be re-elected. Their primary duties include supervising board members and auditing financial statements alongside the independent auditor. They attend board meetings and are encouraged to speak. Unlike their director colleagues, however, *kansayakus* have no voting rights for decisions at the board meetings. Because of the existence of *kansayakus*, directors can concentrate on daily management and execution of business matters.

Central elements of Japanese company law underwent major changes after 1945 when, under U.S. direction, attempts were made to enhance the role of the board of directors with the introduction of a duty of loyalty. In Japan, however, because of the inherited German dual-board concept, the function of the board of directors essentially remained the performance of executive duties. Directors were expected to be engaged full time in company affairs and participate in daily business conduct. Although they were liable by law to monitor each other, in reality, it is unlikely that they would ever express negative views on their "bosses" who were by law defined as "representative directors." The board itself contained the pyramidal hierarchical structure, which was regarded as an impediment to the monitoring function it was expected to perform. With the strong postwar recovery and growth of the Japanese economy, the voice of the board of directors became increasingly powerful, while the role of the corporate auditor–supervisory board remained weak.

After the Second World War, the Germans were under pressure to democratize their major corporations; they amended their own stock corporation law by the mid-twentieth century to empower the supervisory board together with the introduction of workers' representation. The Japanese, however, did not follow suit. The strong postwar performance by Japanese companies was often overshadowed by a series of corporate scandals and wrongdoings. Examples include illegal pollution and an avoidable major nuclear accident due to poor risk management;[10] bribery of politicians and bureaucrats; illegal payments to corporate racketeers (popularly known as *sokaiya*); and numerous cases of false descriptions on company reports.[11] The commercial law was revised every few years to deal with the wrongdoings by enhancing the powers and authority of the *kansayakus*. This reform reached its peak in 2005 when the law made it mandatory for the audit–supervisory board of larger companies to select at least half of its members from outside the company.

The tide changed towards the end of 1990, following the earlier bursting of the speculative bubble. When the Japanese economy gradually ran out of steam, people started to wonder if boards of directors consisting mainly of insiders were capable of responding effectively to a slowing economy and changing business environment. The focus of Japanese corporate governance shifted from the *kansayakus* to the directors. New pressures were also felt from outside Japan as overseas investors, including the California Public Employees' Retirement System (CalPERS), became increasingly active investors in Japanese corporations. Those overseas investors were quick to notice the main impairment to the Japanese board: the universal lack of external representation.

A working group on company law (Modernization of Company Law) was formed in 2002 by the consultative body of the Ministry of Justice, which proposed a series of reforms of Japanese company law. These reforms included major revisions to the commercial code, limited liability company law, and audits of public companies. The Moderniza-

---

10. *See generally* THE NATIONAL DIET OF JAPAN, FUKUSHIMA NUCLEAR ACCIDENT INDEPENDENT INVESTIGATION COMN'N, EXECUTIVE SUMMARY (2012).

11. Matt Nichol, *Japanese Corporate Governance and the Market for Corporate Information Disclosure: What Is the Role of Private Rights Enforcement?*, 27 AUSTL. J. CORP. L. 262, 263 (2013).

tion of Company Law was assembled into a corporation law that was passed by the Japanese Diet on June 29, 2005, and came into effect on May 1, 2006.[12] Takahashi and Shimizu identify the central purposes of the reforms as:

1. Securing the realization of corporate governance;
2. Establishing an intelligible law for an information age;
3. Improving disclosure and fundraising measures;
4. Adapting company law to the internationalization of corporate activity;
5. Consolidating and making coherent the company law.[13]

The reforms were followed by the Financial Instruments and Exchange Law that came into effect in September 2007, which replaced the Securities and Exchange Law, and provided a statutory framework of merger and acquisition activities with provisions for public offerings of securities, takeover bids, and insider trading.[14]

The first practical initiative came in 2002 when revision of the commercial law allowed Japanese companies to select alternative models of corporate governance: either maintain the traditional system with *kansayakus* or switch to a three-committee system (audit, nomination, and compensation committees) in which the majority of members of each committee must be outside directors. The alternative model—the three-committee system—went further and required companies to appoint a CEO with extensive authority to represent the company. Subsequently, this initiative and other corporate governance reforms were consolidated into a new Corporations Act. Despite initial enthusiasm for these proposals, the number of companies that switched to the alternative system remained very low (see Table 3). Several reasons are cited, including a lack of flexibility in the governance traditions and arrangements of Japanese corporations, and strong reservations among company presidents towards handing their power to CEOs.

12. Eiji Takahashi & Madoka Shimizu, *The Future of Japanese Corporate Governance: The 2005 Reform*, 19 J. JAPANESE L. 35, 36 (2005).

13. *See id*.

14. *See generally* HIROKI KODATE & RISA FUKUDA, MERGER AND ACQUISITION REVIEW 257 (Simon Robinson ed., 2d ed. 2008), *available at* http://www.amt-law.com/en/pdf/bulletins3_pdf/111129_1.pdf.

Table 3: Company Ownership and Board Structure Nikkei 225 Index[15]

	1998	2001	2004	2007	2010	2013
Ratio of Overseas Shareholding (%)	14.1	17.5	21.5	27.3	24.2	24.9[16]
Companies Adopting Committee Model	0.0	0.0	5.1	5.1	5.4	6.5
Companies With Takeover Defense Mechanisms	0.0	0.0	0.0	27.2	26.7	30.4

However slowly, the momentum to make Japanese company boards more independent continues with the company law review recommendations for the nomination of outside directors and the Tokyo Stock Exchange requiring the appointment of at least one independent director/*kansayaku*. There continues to be insistent pressure from institutional shareholders, with the Japanese Pension Fund Association encouraging the appointment of outside directors in the companies they invest in and Institutional Shareholder Services (ISS) recommending negative votes for companies without external directors.

Meanwhile, other important developments influenced changes in Japanese corporate governance. One development is the simplification of the procedures associated with filing derivative suits. For example, in 1993, an amendment reduced the fee required to file such a suit to 8,200 yen. The 2001 Enron bankruptcy and new sets of rules over directors' responsibilities regarding financial statements also made existing directors increasingly aware of the extent of their responsibilities. In order to improve the quality of financial statements in Japanese companies, there is a limit to what independent directors and *kansayakus* can do, and it has become necessary for everyone involved in financial reporting to coordinate their efforts to produce more accurate and reliable accounts.[17]

15. 2013 TSE-LISTED COMPANIES WHITE PAPER , *supra* note 5.

16. *Id.*

17. With reference to Olympus, a very thorough investigatory report was published. *See* OLYMPUS CORP. THIRD PARTY COMM., INVESTIGATION REPORT (2011), *available at* http://www.olympus-global.com/en/common/pdf/if111206corpe_2.pdf.

Table 4: Distribution of Share Ownership in Japan 1950–2010[18]

Year	Government	Banks	Insurance, Pensions & Trusts	Non-Financial Corps.	Overseas	Individuals	Total
1950	3.1	12.6	11.9	11.0	0.0	61.3	100
1960	0.2	30.6	3.7	17.8	1.3	46.3	100
1970	0.6	13.7	19.2	23.9	4.9	37.7	100
1980	0.4	17.5	22.2	26.2	5.8	27.9	100
1990	0.3	20.9	23.8	30.1	4.7	20.4	100
2000	0.2	19.2	20.6	21.8	18.8	19.4	100
2010	0.3	14.7	16.8	21.2	26.7	20.3	100

III. The Impact of the Changing Structure of Shareholdings in Japanese Corporations

As with other countries, the structure of shareholdings in Japan has changed substantially over time.[19] The percentage of shares owned by individuals has gradually diminished from 61.3% in 1950 to 20.3% in 2010, while the percentage of shares held by banks, insurance, and pension funds has varied from decade to decade, reflecting changes in financial market conditions though remaining a significant presence. Subject to a series of regulatory efforts to diminish the importance of cross-holding of shares, the proportion of non-financial corporations' cross-holdings of shares has been substantially reduced but remains significant.[20] The most critical transformation of share ownership in Japan, however, has been the increase of overseas ownership from 0% in 1950 to 26.7% in 2010. This is of immense significance for an industrial economy that was once typified by resolute insularity. Now, in contrast, the internationalization of the ownership shares in Japan exceeds that of the United States (12.7%) and many other European economies including Germany (22%) (Table 5).

18. 2013 TSE-LISTED COMPANIES WHITE PAPER, *supra* note 5.

19. *See* Table 4.

20. Hideaki Miyajima, *The Unwinding of Cross-Shareholding in Japan: Causes, Effects, and Implications*, *in* CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY, *supra* note 3, at 77, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=818346.

Table 5: Share Ownership of Major Economies Compared (2010)[21]

	Japan	U.S.	U.K.	Germany	France
Government or Local Government	6.2	-	2.9	2.3	8.7
Banks and Financial Institutions	9.0	-	18.0	3.8	19.0
Insurance and Trusts	14.9	47.8	21.9	19.8	1.1
Non-Financial Corporations	22.9	-	2.2	41.0	21.1
Overseas	26.7	12.7	40.0	22.0	38.7
Individuals	20.3	39.5	15.0	11.0	11.5

The changing shareholding structure over the last two decades had a significant impact on the governance of Japanese corporations. The impact of changing shareholding structures is twofold: first, pressure from untraditional and unfriendly shareholders threatening the control of the company; and secondly, demands from institutional shareholders, both domestic and overseas, calling for better corporate governance.[22] Together these forces amount to a challenge to the traditional corporate security of the *Keiretsu* shareholdings systems. Horizontal *Keiretsu* (such as Mitsubishi, Sumitomo-Mitsui, and Mizhuo), which revolve around a major bank and have cross-holding of shares between different industrial members of the group of companies, and vertical *Keiretsu* (in major industries such as automobiles, large engineering, and retail with parent companies owning shares in suppliers and distributors) were both designed to defend the *Keiretsu* members from external influence. Shareholdings were seen as the means of maintaining supportive relationships and not to be used primarily for profit-taking or dividend payments.

While traditional *Keiretsu* inter-corporate shareholdings were unwound in recent years, the domestic pension and insurance funds shareholders have remained largely passive. In contrast, investment companies with domestic and overseas clients became more active in corporate governance.[23] The new overseas owners of shares in Japanese corpora-

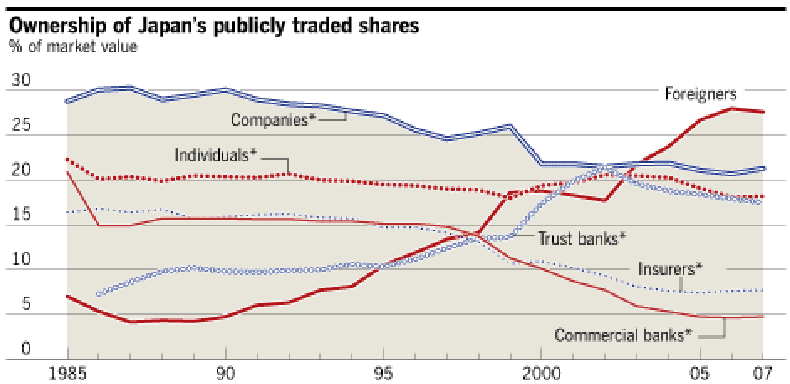
21. *See Share Ownership—Share Register Survey Report, 2010*, OFF. NAT'L STAT. (Feb. 28, 2012), http://www.ons.gov.uk/ons/rel/pnfc1/share-ownership---share-register-survey-report/2010/index.html (U.K.).

22. Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005).

23. *See generally* Michael A. Witt, *Japan: Coordinated Capitalism Between Institutional Change and Structural Inertia, in* THE OXFORD HANDBOOK OF ASIAN BUSINESS SYSTEMS ch. 6

tions, including U.S. and European pension funds and investment companies, other short-term investors such as hedge funds, and sovereign-wealth funds investment from newly industrialized countries, have begun to challenge company management directly. A critical inflection point was reached as overseas shareholders secured a larger proportion of shares than the non-financial corporate cross-holdings of shares between Japanese corporations themselves.[24] These overseas activists are being joined by Japanese pension, insurance, and investment companies, questioning the corporate governance standards of Japanese corporations.

Figure 2: The Transformation of Japanese Shareholding: Company Cross-holdings and Overseas Shareownership 1985–2007[25]



***Domestic**

Japan is the first Asian economy to experience the full rigors of shareholder activism on an extensive scale, as most Asian countries are dominated by companies that are majority family owned, state owned, or state directed.[26] In most Asian markets, including Indonesia, Thailand, the Philippines, and Korea, individuals and their families are the dominant shareholders, often with relatives and their advisers acting as direc-

(Michael A. Witt & Gordon Redding eds., 2014), *available at* http://faculty.insead.edu/michael-witt/documents/Witt_OUP_Japan_2013.pdf.

24. *See* Figure 2.

25. Michiyo Nakamoto & Kate Burgess, *Dividends to Reap: Shareholder Activists Begin to Make Their Mark on Japan*, FIN. TIMES (July 2, 2008), http://www.ft.com/intl/cms/s/0/be842ae4-4863-11dd-a851-000077b07658.html#axzz2rRbXmJsA (data adapted from TOKYO STOCK EXCHANGE, FACT BOOK (2007), *available at* http://www.tse.or.jp/english/market/data/factbook/b7gje60000003o32-att/fact_book_2007.pdf).

26. *See generally* Richard W. Carney & Michael A. Witt, *The Role of the State in Asian Business Systems*, *in* THE OXFORD HANDBOOK OF ASIAN BUSINESS SYSTEMS, *supra* note 23, at ch. 14.

tors on group company boards. In China, while family ownership and control is extensive, the dominant player remains the state, which often exercises determining influence over companies' governance and strategy, holding 83.1% of market capitalization in 2007. Finally, Asian countries have developed state investment vehicles that exercise an oversight function over state owned enterprises and other private sector investments, such as Temasek Holdings in Singapore, Khazanah Nasional in Malaysia, and the state-owned Assets Supervision and Administration Commission of the State Council in China.[27]

Though family or state control remains prevalent throughout most of Asia, in the Japanese corporate sector, overseas superannuation, insurance and investment funds, together with hedge funds and other short terms investors, are having a major impact. Institutional investors are becoming more critical on corporate governance issues, and dissident private investors research the voting of institutions to leverage their argument and increase their support. Overall, most Japanese corporations retain significant support for management policy in voting at AGMs; however, the more critical voting patterns of institutional investors represents something of a sea-change in Japanese corporate governance.[28]

Table 6: Voting Results at AGM: Votes Cast in Favor of Management Policy 2010

	Votes By All Shareholders %[29]	Votes By Institutional Shareholders %[30]
All Agendas	95.4	81.2
Election of Directors	95.4	76.4
Election of *Kansayakus*	94.7	77.2
Remuneration Packages	94.8	74.4
Approving Takeover Defense Measures	81.7	25.0
Shareholder Proposals	22.6	7.7

27. *See generally* OECD, REFORM PRIORITIES IN ASIA: TAKING CORPORATE GOVERNANCE TO A HIGHER LEVEL (2011), *available at* http://www.oecd.org/daf/ca/49801431.pdf.

28. *See* Table 6.

29. Toshikazu Nakanishi & Takaya Seki, *Current Analysis of Corporate Governance in Japan 2013*, Bessatsu Shoji-Homu (Commercial Law Centre), Tokyo No. 378, June 10, 2013 (Japan).

30. Naoyoshi Ema, Sumitomo Mitsui Trust Bank, *Voting by Institutional Shareholders 2012*, Junkan Shoji-Homu (Commercial Law Review), Tokyo Issue No. 1984, Dec. 5, 2012 (Japan).

IV. CURRENT ISSUES OF CORPORATE GOVERNANCE IN JAPAN

Lessons are being learned from the incidents of accounting fraud and other corporate wrongdoing in Japan, as in the Kanebo, Seibu, and Olympus cases. Kanebo, a Japanese conglomerate, was involved in long-running accounting fraud; the revelation of collaboration in falsifying accounting reporting between Kanebo executives and the auditor Chuo Aoyama (the Japanese arm of Pricewaterhouse Cooper) over a five-year period led to arrest of the executives of both the company and auditing firm, and the company was delisted.[31]

Seibu Railway was delisted from the Tokyo Stock Exchange in 2000 for falsifying financial statements. Seibu Holdings (with assets including hotels, railways, and the Saitama Seibu Lions baseball team) pursued governance reforms to become a publicly traded company, but encountered opposition from Cerberus Capital Management, a U.S. private equity firm that had taken a $1 billion stake in the company, becoming the largest shareholder with 32.4%. As Seibu prepared for relisting in 2012, Cerberus became concerned about the low offer price for shares, and believed the company needed more time to improve the business before listing by terminating unprofitable lines. At this point, Seibu moved to sever formal ties with its largest investor, insisting Cerberus's proposals lacked a long-term perspective and could undermine the corporate value of Kanebo, while Cerberus claimed it was not being informed about the proposed listing. Cerberus launched a hostile tender offer to increase its stake above 36% and appoint three new board members. In April 2013, Cerberus attempted to raise the stake again, aiming for 45% control and eight new board members, including Dan Quayle, former U.S. Vice-President and chairman of Cerberus. Falling short with a 35.5% stake, Cerberus, with over one-third of the stock, had the power to veto future board proposals.[32]

The classic corporate crimes identified in the past in Japan, such as widespread payments to racketeers and rank corruption, are diminishing. Now, all companies are encouraged to appoint at least one outside direc-

31. Shingo Numata & Fumiko Takeda, *Stock Market Reactions to Audit Failure in Japan: The Case of Kanebo and Chuo Aoyama*, 45 INT'L. J. ACCT. 175 (2010).

32. Ben McLannahan, *Cerberus Capital Management Raises Stake in Seibu Holdings*, FIN. TIMES (June 1, 2013, 4:47 PM), http://www.ft.com/intl/cms/s/0/9238450c-cad0-11e2-82bc-00144feab7de.html#axzz2f7X8pF8A. How this dispute revealed different orientations between U.S. private equity and Japanese corporate priorities is revealed in the *Wall Street Journal*'s *Inside the Seibu–Cerberus Fight*, WSJ LIVE (May 30, 2013, 10:30 PM), http://live.wsj.com/video/inside-the-seibu-cerberus-fight/76C46995-2764-42C0-8BCF-2D85AAE1B160.html#!76C46995-2764-42C0-8BCF-2D85AAE1B160.

tor; if they do not, companies are required to state reasons justifying why they do not have any outside directors. Japanese corporate boards are beginning to demonstrate a degree of independence in their monitoring of companies, and this has often been driven by the influence of more active shareholders. Along with the arrival of shareholder activism, a more active capital market is developing in Japan. Japan was once typified by a lack of a merger and takeover market, and the complete absence of hostile takeovers. However, in a different finance and investment climate, the possibility of hostile takeovers in Japan has now become real.

The most conspicuous case of an unfriendly shareholder trying to control a Japanese company occurred in 2005, when Livedoor, an aggressive and highly acquisitive Japanese Internet service provider company, tried to seize control of Fuji Television through Nippon Broadcasting. Nippon Broadcasting's initial attempt to fend off Livedoor by issuing the country's first "poison pill" with the intention of issuing new shares to reduce the stake of unfriendly shareholders was ruled inappropriate by the Tokyo District Court and the Appeals Court. The poison pill itself, however, was regarded as lawful, and subsequently a large number of companies adopted the measure.[33] This widespread determination to protect corporations from what was perceived as hostile influence or takeovers became the target of criticism from not only those with the intention to control corporations, but also from institutional shareholders, both domestic and overseas, who believed such a measure would undermine the value of companies.

Companies that adopted poison pills were generally required to upgrade corporate governance structures and the independence of their boards to demonstrate their neutrality. Subsequently, the number of outside independent directors was increased. Also, the government, led by METI, laid down a new set of rules corporate directors must respect when their company becomes a target of a hostile building up of shares and they consider protecting the existing management. Without sufficient cases representing precedence in Japan, cases from Delaware courts are often studied to obtain guidance from the epicenter of the exercise of U.S. corporate law.

---

33. Meanwhile Livedoor's meteoric career (encompassing twenty-seven acquisitions in ten years) crashed to earth in fraud charges of share-price manipulation, with the collapse of its share price and prosecution of its senior executives, including the colourful Takafumi Horie, ultimately leading to the takeover of the company by the Korean web portal NHN at a knock-down price. This fraud and collapse led to the passage of the Japanese Financial Instruments and Exchange Act on June 14, 2006 (often called the J-SOX in reference to the U.S. Sarbanes–Oxley Act), which enhanced disclosure obligations and internal controls in public companies.

More recently, further instances of corporate governance failures have been exposed in Japan. Financial misconduct on a grand scale revealed to have taken place at Olympus shone a bright light into a dark corner of Japanese corporate governance—a failure that was part of the "vortex of frantic efforts into which many companies were drawn when the bubble economy reached its peak."[34] By the mid-1990s, Olympus faced losses that reached 100 billion yen as a result of poor investments in financial assets during the bubble. Olympus transferred the financial assets on which the unrealized losses had occurred up to the end of March 2000 into multiple receiver funds at their book value.[35] Starting in 2007, a small group of Olympus executives sought to dispose of the losses by supplying a total of 135 billion yen to eliminate the receiver funds, using methods that included the following:

> i) The acquisition of three domestic subsidiaries, Altis, News Chef, and Humalabo, from the receiver funds at inflated prices (amounting to approximately 72 billion yen);
>
> ii) The payment of advisory fees when Gyrus Group PLC was acquired (amounting to approximately 63 billion yen);
>
> iii) The treatment of 'goodwill' in connection with Gyrus and the three domestic subsidiaries in the accounts as assets.[36]

In April 2011, the arrival of Michael Woodford, a long-standing British executive of Olympus, as CEO, president, and director of Olympus, caused a crisis in the company. Woodford raised serious concerns about the lack of transparency in significant past transactions of Olympus, information he derived not from within the company, but from the August 2011 edition of a journal, *FACTA*, in an article entitled, *Olympus Reckless M & A Mystery of Huge Losses*. In October, having not been able to secure an explanation from Olympus's executives, Woodford sent

34. With reference to the illicit transactions and fraudulent financial reporting at Olympus a very thorough investigatory report was published. *See* OLYMPUS CORP. THIRD PARTY COMM., *supra* note 17, at 178.

35. Olympus was anticipating a critical development in Japanese financial instruments: formerly valued at their book value at acquisition, market value accounting was to begin after April 2000 that would have exposed the losses.

36. *See* OLYMPUS CORP., REBUILDING TRUST: THE FIRST 100 DAYS, at 5 (2012), *available at* http://www.olympus-global.com/en/common/pdf/csr_confidence_2012.pdf. For a time in early 2012, it appeared as if there had formed "a united 'all Japan' front to prevent Woodford and foreign institutional investors from any involvement in Olympus management." *Close-up on Olympus: A Crossroad in Japanese Industrial History*, NIKKEI BUS. DIGITAL (Jan. 6, 2012), http://business.nikkeibp.co.jp/article/eng/20120106/225854/.

a dossier on the Gyrus acquisition to Pricewaterhouse Cooper, who responded that it was possible that illegal acts had taken place and directors had violated their duty of loyalty. Later in October, a special meeting of Olympus's board of directors was called, and Woodford was dismissed from his post and fled the country, which provoked media reports questioning the illicit transactions and aroused investor concerns.[37]

In November 2011, an independent inquiry by a group of distinguished lawyers confirmed in a thorough report that past losses had been concealed and acquisitions employed to eliminate these losses.[38] The committee made recommendations for improved governance and accountability of the company, and Olympus formed committees to reform the management of the company and to investigate director liability for the losses in December 2011.

On December 21, 2011, the Japanese Securities and Exchange Commission and police began a criminal investigation of Olympus. In January 2012, Olympus filed suits with the Tokyo District Court, seeking to establish the liability of directors and auditors of Olympus, and the Tokyo Stock Exchange imposed a penalty of 10 million yen on Olympus for a listing agreement violation. In March 2012, the Tokyo District Prosecutors Office filed charges that Olympus violated both the Securities and Exchange Act and the Financial Instruments and Exchange Act for fraudulent financial reporting. A special general meeting of Olympus shareholders convened in April 2012, at which a new team of Olympus managers was appointed and all members of the old team resigned.[39]

The Olympus Corporation Third Party Committee Report concluded that Olympus had resorted to financial engineering to disguise its losses while the majority of leading companies at the time returned to their core business and amended their balance sheets to reflect the actual financial status of the company. The senior executives and president of Olympus carried out the illicit transactions in secret, and there was no risk management system at Olympus that could detect this.

> Top management had put in place a one-man system over a long time, and an atmosphere was cultivated in which objections were not allowed to be spoken. Past Presidents had little awareness of

37. *See generally* MICHAEL WOODFORD, EXPOSURE: INSIDE THE OLYMPUS SCANDAL—HOW I WENT FROM CEO TO WHISTLEBLOWER 5 (Portfolio Penguin, London 2012).

38. OLYMPUS CORP., *supra* note 36; Simon C.Y. Wong, *Olympus Turmoil Shows Independent Oversight Is Critical at Japanese Firms*, HARV. BUS. REV. BLOG NETWORK (Oct. 21, 2011, 12:55 PM), http://blogs.hbr.org/cs/2011/10/olympus_turmoil_shows_independ.html.

39. OLYMPUS CORP., *supra* note 36.

> transparency or governance. . . . A system for replacement of presidents had not been established among the officers, so it had become possible to occupy the position arbitrarily. There was little openness, and a corporate environment where opinions could not be freely stated had been formed, so that among the officers, the attitude of personalizing the corporation had spread, and the sense of the duty of loyalty to the shareholders was weak. In actuality, the mindset of the officers had become stunted to the extent that the management and transfer of an enormous amount of funds and the incurring of enormous losses were not perceived to be issues.[40]

In this instance, all of the relevant bodies under the Companies Act had failed in their duties including the board of directors, auditors, the board of auditors, and the auditing firm. The Third Party Report recommended the replacement of all of the directors, executives, and auditors involved; the appointment of an independent external body to renew the governance of Olympus; and the changing of the unquestioning mindset of management.[41] Whether this impetus may encourage a slight move from the traditional management model of the board's role in Japan towards a more monitoring role for boards remains to be seen.[42]

V. RECENT GOVERNMENT INITIATIVES TO REVISE COMPANY LAW

Aware of continuing concerns of both domestic and overseas investors regarding the fairness and transparency of Japanese financial markets, and the adequacy and independence of corporate governance, the Japanese government embarked on a new and ongoing campaign to transform institutions and practices. A corresponding report focused on three dimensions: (1) issues concerning capital raising policies; (2) structural aspects of corporate governance; and (3) issues on exercising voting rights.[43] With reference to capital raising policies, a range of measures were proposed to protect minority shareholders, including full disclosure of third parties in financing and the review by statutory auditors of any favorable terms. In addition, independent and stock exchange

40. OLYMPUS CORP. THIRD PARTY COMM., *supra* note 17, at 180.

41. *Id*. at 183.

42. *See generally* Bruce E. Aronson, *The Olympus Scandal and Corporate Governance Reform: Can Japan Find A Middle Ground Between the Board Monitoring Model and Management Model?*, 30 UCLA PAC. BASIN L.J. 93 (2012).

43. *See generally* MINISTRY OF ECONOMY, TRADE AND INDUSTRY (METI), REPORT BY THE FINANCIAL SYSTEM COUNCIL'S STUDY GROUP ON THE INTERNATIONALIZATION OF JAPANESE FINANCIAL AND CAPITAL MARKETS (2009) (Japan), *available at* http://www.fsa.go.jp/en/news/2009/20090618-1/01.pdf.

examination of any issuance significantly diluting ownership of existing shareholders, changing the control of companies, or squeezing out shareholders was necessary. Further, clarification was required of the governance of corporate groups and of the relationships with subsidiaries, subsidiary listings, and cross shareholdings.[44]

In regards to the structural aspects of corporate governance, the report acknowledged that less than 3% of the Tokyo Stock Exchange listed companies had adopted the model of the company with committees and looked instead to increase the number of independent outside directors to one-third or one-half of the total (which matched the requirement by law that a majority of the auditors on the board of statutory auditors be external auditors). The report suggested strengthening the supervision of management by electing one of the independent outside directors to coordinate the efforts of the board of statutory auditors and officers in charge of audit and internal control.[45] The report also looked to institutional investors to exercise their voting rights as part of their fiduciary duties and to disclose their voting guidelines and the results. The report called upon companies to disclose the ballot results at shareholder meetings and to promote the use of electronic platforms to assist shareholders. Finally, the report required the stock exchanges to establish a framework to ensure the discipline of listed companies, to maintain high standards of corporate governance with an enhanced disclosure regime, and to continue discussions on improving company law.[46]

As part of the response to these recommendations, the Tokyo Stock Exchange issued new Securities Listing Regulations and new Guidelines Concerning Listed Company Compliance.[47] In 2010, depending on whether a firm had the *kanasayaku* statutory auditor system or the committee system, it became mandatory to have a minimum of one independent auditor or director to protect shareholder interests.[48] Independent directors were no longer allowed to have conflicts of interest, which

44. *See id.* at 2.

45. *Id.* at 9–11.

46. *Id.* at 14–18.

47. TOKYO STOCK EXCH., INC., SECURITIES LISTINGS REGULATIONS (2011); TOKYO STOCK EXCH., INC., GUIDELINES CONCERNING LISTED COMPANY COMPLIANCE (2011). These regulations were updated in 2013: TOKYO STOCK EXCH. INC, SECURITIES LISTING REGULATIONS (2013) [hereinafter 2013 SECURITIES LISTING REGULATIONS], *available at* http://www.tse.or.jp/english/about/rules/b7gje600000044tu-att/securities_listing_regulations_2013-03-28-03-31.pdf; *see also* TOKYO STOCK EXCH., INC., GUIDELINES CONCERNING LISTED COMPANY COMPLIANCE (2012), *available at* http://www.tse.or.jp/english/about/rules/b7gje600000044tu-att/Guidelines_Concerning_Listed_Company_Compliance_2012-05-10.pdf.

48. 2013 SECURITIES LISTING REGULATIONS, *supra* note 47, at 436–32.

excluded people from being independent who have a relationship with management or the firm, but no further definition of independence was offered. In addition, despite the common practice of interlocking boards, no company breached the director independence requirement, suggesting the requirement is not exacting.[49]

Adopting the approach to independent director representation might seem minimalist to Anglo-American observers where in most jurisdictions a majority of the board is normally required to be independent. Yet in Japan, these apparently small steps toward reform of corporate governance are often interpreted as "undergoing dramatic change"[50] because they seem to involve a substantial philosophical shift. The resistance of corporate Japan to independent outside directors is partially informed by concerns regarding whose interests they might serve and for what purposes. While the Nikkei 225 companies move towards significant independence on their boards, in 2010, 48% of Tokyo Stock Exchange listed companies still had only one independent director or auditor.[51] By default, this reality now invests in the sole independent director or auditor in these companies some additional power, because if they were to resign, the company would be in breach of the stock exchange listing rules.

The Japanese government wanted to see a strengthening of corporate governance in Japan, with mandatory outside directors on all listed companies, but encountering corporate resistance, it simply recommended the stock exchange adopt the "comply or explain" principle in which companies without outside directors should explain to the market why they consider the practice appropriate. Meanwhile, government regulators continue to explore the potential role of independent directors in Japan and are examining how they might serve usefully in a monitoring role for investors and a performance role for the company without destabilizing the companies concerned.

The impact of foreign shareholders is reflected in many of the Japanese policymakers' initiatives. Instead of enhancing the roles of *kansayakus*, the attempt was made to enhance the role of directors. The government first tried this in early 2000 but without much success. Among the reasons cited for the lack of development of directorial roles was that this was a voluntary measure, and no attempt was made to encourage

49. *See* Nichol, *supra* note 11, at 276.

50. TOKYO STOCK EXCH., INC., TSE-LISTED COMPANIES WHITE PAPER ON CORPORATE GOVERNANCE 2011, at 84 (2011) [hereinafter 2011 TSE-LISTED COMPANIES WHITE PAPER], *available at* http://www.tse.or.jp/english/listing/cg/b7gje60000003y6y-att/20110613.pdf

51. TOKYO STOCK EXCH., INC., UPDATED CONSOLIDATED RESULTS OF INDEPENDENT DIRECTORS/AUDITORS NOTIFICATIONS 4 (2010).

companies to change. The second attempt, commencing in 2010, holds the promise to be gradually implemented, as every listed companies is now required to seriously consider if their corporate governance is acceptable to the new class of shareholders and stakeholders.

VI. THE UNDERLYING CONCEPT OF CORPORATE GOVERNANCE IN JAPAN

A central explanation for the caution of Japanese companies regarding the reform of boards by introducing independent directors is a fundamental difference in Japan of the understanding of the underlying concept of corporate governance compared to Anglo-American companies. When asked by the Tokyo Stock Exchange to state in their annual reports their basic policies and objectives for corporate governance, "[m]any companies expressed that the objective of corporate governance is enhancement of corporate value."[52] For example, three explanations offered by different companies were:

- The "[b]asic principle of corporate governance is to enhance efficiency and transparency of management and to maximize corporate value."[53]
- "We regard corporate governance as the key management issue to enhance corporate value as well as management transparency for shareholders."[54]
- "In order to continue to make profits from business activities and enhance corporate value, we consider it essential to develop corporate governance system as the framework to govern such activities."[55]

That "corporate value" did not at all equate with "shareholder value" in the minds of the respondents was demonstrated by the fact that only 6.4% of companies stated that shareholder value was the essential purpose of corporate governance (though the percentage nearly doubles to 11.8% in the few Japanese companies that have opted for Companies with Committees). In contrast, 59.4% of companies include serving stakeholders as a fundamental objective of corporate governance and 26.9% acknowledge the importance of corporate social responsibility.

52. 2011 TSE-LISTED COMPANIES WHITE PAPER, *supra* note 50, at 3.
53. *Id.*
54. *Id.*
55. *Id.*

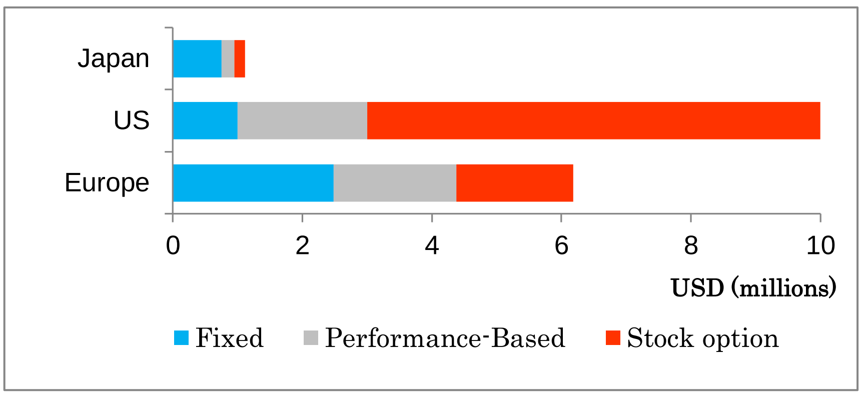
Table 7: The Underlying Concepts of Corporate Governance

		Corporate Value		Shareholders' value		Monitoring & Supervision		Execution	
		Ratio	Change from 2008	Ratio	Change from 2008	Ratio	Change from 2008	Ratio	Change from 2008
Total		52.4%	2.2%	6.4%	0.00%	38.4%	-3.4%	38.8%	-3.7%
Organizational Form	Companies with Statutory Auditors	52.2%	1.9%	6.3%	0.1%	37.4%	-3.4%	37.8%	-3.6%
	Companies with Statutory Committees	62.7%	15.5%	11.8%	-6.4%	80.4%	-1.4%	80.4%	-5.1%
		Decision Making		**Internal Control**		**Stakeholders**		**Social Responsibility**	
		Ratio	Change from 2008	Ratio	Change from 2008	Ratio	Change from 2008	Ratio	Change from 2008
Total		39.5%	-2.1%	18.8%	-1.1%	59.4%	1.5%	26.9%	-0.2%
Organizational Form	Companies with Statutory Auditors	39.1%	-2.0%	19.0%	-0.9%	59.5%	1.5%	27.0%	-0.1%
	Companies with Statutory Committees	52.9%	-8.9%	7.8%	-8.5%	52.9%	-1.6%	23.5%	-5.6%
		Compliance		**Transparency**		**Efficiency**		**Soundness**	
		Ratio	Change from 2008	Ratio	Change from 2008	Ratio	Change from 2008	Ratio	Ratio
Total		40.2%	-1.2%	69.0%	0.03%	20.0%	0.9%	23.5%	1.5%
Organizational Form	Companies with Statutory Auditors	40.6%	-0.9%	67.8%	0.2%	19.9%	0.9%	23.8%	1.5%
	Companies with Statutory Committees	25.5%	-12.7%	82.4%	4.2%	21.6%	0.2%	7.8%	0.6%

Japanese companies, while resistant to the stakeholder value philosophy, recognize to a greater degree other vital functions of corporate governance. Table 7 shows a significant number of companies recognized that monitoring and supervision (38.4%), execution (38.8%), decision making (39.5%), internal control (18.8%), efficiency (20%), and soundness (23.5%) are part of the purpose of corporate governance. The imperative for accountability is recognized to be very important by Japanese companies with 40.2% emphasizing compliance and 69% stating transparency as the key element (the highest scoring corporate purpose). It does appear that Japanese companies recognize the importance of accountability, but accountability to whom?

Though Japanese corporate executives could be accused of not only guarding their corporations but also their own powerful and high-status positions in the corporations, they are certainly not defending high rewards relative to their executive counterparts overseas. Traditionally, and up to the present day, Japanese executives earn a fraction of the compensation awarded to the senior executives of U.S. and European corporations, and this has long been recognized as problem when Japanese corporations operate overseas or acquire foreign corporations. One stark example reported in the *Wall Street Journal* was that when Mitsubishi UFJ Financial Group (MUFG), Japan's largest bank by market capitalization, acquired a 21% stake in Morgan Stanley in 2008, MUFG paid a total of $8.1 million to its top fourteen executives in the previous fiscal year, while Morgan Stanley had paid CEO John Mack alone five times this amount, a total of $41.4 million in 2006. It has to be appreciated that at that time, MUFG was helping to rescue Morgan Stanley from the ravages of the global financial crisis, not the other way around.[56] For CEOs of very large corporations earning over $10 billion in annual revenues, the compensation package of fixed salary, performance-based pay, and stock options is approximately $10 million in the United States, about $6 million in Europe, but a little over $1 million in Japan.[57]

Figure 3: International Comparison of Executive Remuneration 2010 in $ millions. Large Listed Corporations with over $10 billion in Annual Revenues[58]



As Table 8 reveals, the level of compensation for executive directors of all listed companies and for directors of Top 200 companies by market capitalization in Japan is modest relative to their contemporaries overseas and similarly modest for board members. This lends support to the belief that in Japan, both for executives and boards, it is the enduring

56. Yuka Hayashi & Phred Dvorak, *Japanese Wrestle with CEO Pay As They Go Global*, WALL ST. J. (Nov. 28, 2008, 12:01 AM), http://online.wsj.com/article/SB122782362228562381.html.

57. *See* Figure 3.

58. Nakanishi & Seki, *supra* note 29.

success of the corporation that is paramount, rather than the accumulation of great personal wealth. This is an admirable aspect of Japanese corporate governance. Meanwhile, the boards of Western corporations devote increasing time and resources on devising increasingly elaborate executive performance incentives, which arguably could be claimed to prove a recurrent source of goal displacement from the strategic objectives of the corporation towards the tactical reward of the executives concerned.

Table 8: Level of Japanese Executive Remuneration[59]
Annual Compensation in Yen millions*

	All Listed Companies (circa 3,500)	Top 200+ Companies by Market Capitalisation
Directors	21.4	38.5
Of Whom Are Outside	3.5	7.6
Audit & Supervisory Board Members	9.1	20.6
Of Whom Are Outside	2.3	2.6

*Amount in million yen divided by 100 to obtain approximate U.S. dollar equivalent.

VII. The Continuing Relevance of Berle and Means

In many ways, the reform of Japanese corporate governance is following a path navigated previously by Anglo-American corporate governance but encountering significant institutional barriers from a system in which different corporate values and definitions of business purpose exist. The question left unanswered is whether Japan may negotiate a more acceptable route to integrating accountability to shareholders and responsibility to wider stakeholders. Japan is presently living and working through economic debates concerning corporate purpose and accountability, initiated by Berle and Means, the resolution of which will determine the future direction of Japanese corporations.

Berle and Means typified the modern U.S. corporation that emerged in the early part of the last century as manifesting a separation of ownership and control where professional managers were in a position to de-

59. *Id.*

termine the direction of the enterprise, and shareholders had "surrendered a set of definite rights for a set of indefinite expectations."[60] After the New Deal and the end of the Second World War, many U.S. corporations in the 1950s and 1960s increased massively in scale and market domination, achieving preeminent positions in world markets.

A new managerial and corporate mode of coordination of enterprise based on organization and planning had arrived as analyzed by Coase in 1937 and later by Chandler in 1977, transcending the market.[61] This was an era celebrated in Galbraith's *New Industrial State* in which corporate growth and brand prestige apparently had displaced profit maximization as the ultimate goals of technocratic managers, as planning and administration in close cooperation with government had displaced market relations as the primary corporate dynamic.[62] In this technocratic milieu, the shareholder was "a passive and functionless figure, remarkable only in his capacity to share, without effort or even without appreciable risk, in the gains from the growth by which the techno-structure measures its success."[63]

The Galbraithian idyll began to disintegrate with the severe recession of 1973–1975, with the incapacity of U.S. corporations to compete effectively with Japanese and European products in key consumer market sectors, and the push towards conglomerate formation by Wall Street, which was interested in managing multiple businesses by financial performance. Subsequently, in successive waves, U.S. corporations were subjected to further financial imperatives, and in a curious inversion of priorities, financial interests overwhelmed the commitment to the production of goods and services. Over time, "purely financial interests have increasingly asserted their influence over these hybridized giant corporations"[64]

A fertile scene was set for Michael Jensen, his colleagues in the Business and Law Schools at Harvard, and the Chicago School of Economics to develop a finance-based theory of corporate governance that was to envelop Anglo-American policy and practice. While agency the-

60. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 277 (McMillan Co. 1933).

61. *See generally* R. H. COASE, *The Nature of the Firm*, ECONOMICA, Nov. 1937, at 386; ALFRED D. CHANDLER, Jr., THE VISIBLE HAND: MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (Belknap Press ed., 1977).

62. DOUG HENWOOD, WALL STREET 259 (Verso 1998).

63. JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE 394 (Houghton Mifflin Co. 1967).

64. HENWOOD, *supra* note 62, at 262.

ory and shareholder value were the most enduring principles of the Jensen legacy, they were preceded and accompanied by other financial innovations including leveraged buy-outs, junk bonds, and "disgorging" free cash flow.[65] For Jensen, "the stock market is always axiomatically the ultimate arbiter of social good."[66] However, the result of eliminating the free cash flow of companies in leveraged buy-outs and in loading up companies with debt left U.S. companies without capital to invest in research and development at a time of increasing competition from overseas companies engaged in continuous product development.[67]

This financial innovation amounted to Jensen as "the eclipse of the public corporation."[68] Jensen's article received a robust response. Peter Róna, head of Schroder Bank in New York, maintained that by exclusively privileging shareholder interests, Jensen preempted "thoughtful analysis of the very question that is at the heart of the issue—what *should* be the rights and privileges of shareholders . . . ."[69] Róna questioned Jensen's assumption that shareholders are better judges of capital projects than managers and corporate boards as an "ideologically inspired assertion [that] lacks empirical support."[70] The increasingly aggressive market for corporate control in the United States in the 1970s and 1980s was not primarily efficiency-enhancing as Jensen maintained, and there was little support for the "'inefficient management displacement' hypothesis."[71]

Japan followed a very different trajectory than the United States in the development of corporate governance, finance, and strategy in the second half of the twentieth century. At the height of the Japanese economic miracle in the 1980s, Western corporations constantly were urged to emulate the successful management of their Japanese counterparts with whom they apparently could not compete. With a keen focus on product development, high quality, and growth in market share for the long-term, Japanese corporations turbo-charged their way to market dominance in major sectors of Western economies in the 1970s and

65. *See generally* William Lazonick, *Controlling the Market for Corporate Control: The Historical Significance of Managerial Capitalism*, 1 INDUS. & CORP. CHANGE 445 (1992).

66. HENWOOD, *supra* note 62, at 269.

67. *See generally* THE DEAL DECADE: WHAT TAKEOVERS AND LEVERAGED BUYOUTS MEAN FOR CORPORATE GOVERNANCE (Margaret M. Blair ed., 1993).

68. *See generally* Michael C. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.–Oct. 1989, at 61 (emphasis in original).

69. Peter Róna, Letter to the Editor, HARV. BUS. REV., Nov.–Dec. 1989, at 198.

70. *Id.*

71. David J. Ravenscraft & Frederic M. Scherer, *The Profitability of Mergers*, 7 INT'L J. INDUS. ORG. 101, 105 (1989).

1980s. Japan maintained a much higher rate of GDP growth than Western economies from the 1960s through 1990, and rivaled the United States in GDP per capita in the 1990s even after the Japanese speculative bubble had burst. Japan has retained a current account surplus, which in 2010 was $196 billion, compared to the United States' current account deficit of $471 billion.[72] The Japanese economic miracle inspired (and invested in) the rapid economic development of the East Asian economies.

For Lazonick, the combination of stable shareholding, permanent employment, and main-bank lending had placed Japanese executives in a unique position to guide the strategic direction of their companies during the period of the Japanese economic miracle:

> Stable shareholding has ensured that salaried managers who were committed to the growth of their companies, and who understood the technological, market, and competitive conditions in their particular industries, would have the power to allocate the firm's resources to those investments in products and processes with, according to their judgment, innovative potential. The exercise of strategic control by salaried managers has not meant that the investment strategies that they have chosen have always been successful. It has meant, however, that people who have had the power to determine a firm's investment strategy are those who have understood the technological, market, and competitive uncertainties that had to be overcome for a particular investment strategy to succeed.[73]

The immense success of the Japanese export drive and the vast revenues earned overseas helped fuel a speculative bubble in property, equity, and other investments, supported by a pliant financial system, that ultimately unwound. The bursting of the Japanese bubble in the early 1990s coincided with the revival of the U.S. economy around software industries in the 1990s and finance in the 2000s. The "lost decade" of the 1990s was a time of critical reflection about the Japanese economy. It is argued that

---

72. William R. Cline, *Japanese Optical Illusion: The "Lost Decades" Theory Is a Myth*, INT'L ECON., Spring 2003, at 57, *available at* http://www.international-economy.com/TIE_Sp13_Cline.pdf; Paul Krugman, *The Japan Story*, N.Y. TIMES (Feb. 5, 2013, 10:12 AM), http://krugman.blogs.nytimes.com/2013/02/05/the-japan-story/; Eamonn Fingleton, *The Myth of Japan's Failure*, N.Y. TIMES (Jan. 6, 2012), http://www.nytimes.com/2012/01/08/opinion/sunday/the-true-story-of-japans-economic-success.html?ref=opinion&pagewanted=all—&_r=0.

73. William Lazonick, *The Institutional Triad and Japanese Development*, UNIV. MASS. LOWELL, 2–3 (June 22, 2005), http://www.uml.edu/centers/CIC/Research/Lazonick_Research/Lazonick_Recent_Research/Institutional%20Triad.pdf.

Japanese economic institutions were well suited for both postwar reconstruction and "catching up" with other advanced economies, but not surpassing them.[74] Japan essentially completed its "catch up" by the late 1980s. The business–government cooperation and bank-centered corporate governance that served Japan well for decades was now ill suited in critical ways to guide Japan further forward, it was claimed. Yet these institutions continued with an inertia that reduced Japan's ability to find and invest in new economic opportunities, including new enterprises. If equity markets are to play a fuller role in the dismantling of inter-corporate equity holdings, systems need more transparent corporate decision making and corporate governance that is more responsive to shareholder pressure.[75]

VIII. THE ONGOING GOVERNANCE DEBATE IN JAPAN

The arrival of shareholder value and a market for corporate control gives rise to a tension in Japan between the concept of the company as a community and the company as property:

> On one side was 'traditional' Japanese corporate governance, characterised [sic] by features such as the power of internally promoted management to run large, listed companies with minimal external supervision, concern with the company as a continuing community, and a lack of direct attention to shareholder interests. On the other side was the view that in order to restore the national economy to good health, Japanese business needed to adhere to an emerging global consensus in corporate governance.[76]

In the past, the growing contrast between the United States' emphasis on shareholder value and the Japanese indifference to shareholder rights was observed but had few practical implications because the two systems had few opportunities to impact one another. Although there were some ear-

74. *See generally* RANDALL K. MORCK & BERNARD YEUNG, JAPANESE ECONOMIC SUCCESS AND THE CURIOUS CHARACTERISTICS OF JAPANESE STOCK PRICE (2002), *available at* http://bschool.nus.edu/Departments/Finance/Bernard%20Yeung%20Publications/japanese%20economic%20success%20and%20curious%20characterisitics%20of%20stock%20prices.pdf.

75. *Id.*

76. John Buchanan & Simon Deakin, *Japan's Paradoxical Response to the New 'Global Standard' in Corporate Governance* 1 (Eur. Corp. Governance Inst., Law Working Paper No. 87, 2007), *available at* http://papers.ssrn.com/ sol3/papers.cfm?abstract_id=1013286 (citing Christina L. Ahmadjian, *Changing Corporate Governance in Japan*, *in* JAPAN'S MANAGED GLOBALIZATION: ADAPTING TO THE TWENTY-FIRST CENTURY 215, 222 (Ulrike Schaede & William Grimes eds., M.E. Sharpe 2003)). *See generally* JOHN BUCHANAN ET AL., HEDGE FUND ACTIVISM IN JAPAN: THE LIMITS OF SHAREHOLDER PRIVACY (Cambridge Univ. Press 2012).

lier incidents with T. Boone Pickens, who acquired 25% of the shares in the automotive parts company Koito Manufacturing but failed to secure a seat on the board, and other Western investors who were often dismissed as adventurers, the more recent emergence of hedge fund activism in Japan provided the context for a classic contest of governance principles: "American activist hedge funds were often confrontational investors who targeted companies which they believed were squandering shareholder value."[77]

This strategy proved successful for U.S. hedge funds in generating above-market rates of return for the funds and their own investors, and they turned to other markets in Europe and in Japan hoping to release value from the cash and assets of conservatively managed corporations. "In Japan, the approach of the funds came into immediate conflict with the idea and practice of the community firm that still retained widespread support . . . ."[78]

As the drive for change in Japanese corporate governance accelerates, fundamental questions are asked in Japan similar to those posed by Berle and Means: "Whose interests should a company serve? Is it the property of shareholders, for them to do whatever they want with it, or does it have a wider social purpose?"[79] This amounted to a contest of principles between U.S. hedge funds and Japanese corporations:

> Managers of the targeted companies, for their part, had little interest in shareholder value; they barely understood what the words meant. What mattered to them, and what constituted 'corporate value' in their view, was not the share price or any other financial measure, but the ability of the company to prosper and to grow over the long term.[80]

A philosophical divide of significant dimensions separated the Japanese executives determinedly committed to the long-term development of their companies from overseas investors committed to securing what they perceived as their right to increase shareholder value:

---

77. BUCHANAN ET AL., *supra* note 76, at 4.

78. *Id.* at 4–5.

79. Famously Berle and Means had raised the possibility that with the separation of ownership and control, "passive property rights should yield before the larger interests of society. The management of corporations should develop into a neutral technocracy, balancing the claims of various groups, employees, customers, shareholders and the community and assigning to each according to a transparent policy." BERLE & MEANS, *supra* note 60, at 306; Geoffrey Owen, *When US Investors Took on Japan's Executives*, FIN. TIMES (June 27, 2012), http://www.ft.com/intl/cms/s/0/871df304-bed0-11e1-8ccd-00144feabdc 0.html#axzz2gtj26E5u.

80. Owen, *supra* note 79.

> What followed was a tournament of corporate governance beliefs. Activist hedge funds, often of foreign origin, but sometimes Japanese, used the formal legal rights conferred on shareholders by Japanese company law and by companies' own articles of association to mount a fundamental challenge to the core of management practice in the community firm. In doing so, they drew out into the open a range of issues that had previously been uncontroversial concerning managerial autonomy and accountability, the balance in dividend policy between the distribution of income and the accumulation of reserves, and the optimal level of financial gearing for companies.[81]

In recent years notable takeover jousts have occurred—a foretaste perhaps of larger battles to come. In 2007, when activist fund Steel Partners attempted to acquire Bull-Dog Food Company, Bull-Dog adopted a defense strategy and amended its articles of incorporation to allow its shareholders the power to issue free stock-acquisition rights for each owned share, with the intention to reduce the shareholding of Steel. Steel claimed this was illegal, but the Tokyo High Court ruled the U.S. hedge fund an "abusive acquirer." Steel had claimed the defensive measure infringed the principle of shareholder equality under Article 109 of the Corporation Law and could be characterized as grossly unfair under Article 247 of the Corporation Law. An appeal by Steel to the Supreme Court did not succeed. "[T]he Supreme Court held that the discriminatory treatment of a shareholder could not be deemed to contravene the principle of 'shareholder equality' where a shareholder was attempting a takeover and this could potentially damage the existence or development of the company."[82]

A similar contest between the British hedge fund The Children's Investment Fund (TCI) in its intervention in J-Power demonstrated aggressive tactics by activist investors not likely to succeed in Japan. When the Japanese government blocked TCI from its attempt to double its stake in J-Power to 20% as a potential threat to national security, TCI bought shares in two other major investors in J-Power. TCI called on other investors to support its demands of J-Power to raise dividends, appoint outside directors, and dismantle the web of crossholdings it maintained with other companies.

A *Financial Times* report revealed the kinds of pressure companies face in *Dividends to Reap: Shareholder Activists Begin to Make Their*

81. BUCHANAN ET AL., *supra* note 76, at 5.
82. KODATE & FUKUDA, *supra* note 14, at 261.

Mark in Japan, in which Toshikazu Nakanishi, chairman of Japan Shareholder Services argued, “Companies are no longer as certain of the loyalty of their shareholders as they have been . . . . The really positive thing that has come out of these developments is that the companies have become aware that they need to explain [their strategy] to shareholders.”[83]

“The ‘content of conversation’ between managers and their Japanese investors has changed,” claimed Eizo Tomimura, chief portfolio manager at Nissay Asset Management.[84] “More companies are discussing return on equity and margins, where in the past they have focused on the size of the company and revenues.” Two years ago, when Mr. Tomimura started investing in Japanese equities, he could not recall a company that had a policy of returning 100% of its free cash flow to shareholders. He estimates that about 10% do so now.[85]

Japanese companies are concerned that the new wave of shareholder activism is similar to the greenmail they faced from T. Boone Pickens and others in the 1980s when it was assumed that overseas investors were more interested in extracting money from the companies they invested in than seeing the businesses succeed into the future. Japanese executives are now worried activist investors are more interested in relieving Japanese corporations of their substantial cash funds than their strategic futures.[86] However, the Japanese system has become more shareholder friendly during this period and dialogue is taking place about higher standards of governance and accountability.[87] But “[t]he survival of the company as an enduring organization still remains a more important consideration in Japan than the investors who happen to hold the shares at any given time.”[88]

IX. CONCLUSION

Japan has much to learn from the West about corporate governance, board leadership, directors’ duties, transparency, and accountability. Similarly, the West has much to learn from Japan about the conception of the corporation as a community, the sense of long-term business

83. Nakamoto & Burgess, *supra* note 25.
84. *Id.*
85. *Id.*
86. *See generally* D. Hugh Whittaker & Simon Deakin, *On a Different Path? The Managerial Reshaping of Japanese Corporate Governance*, *in* CORPORATE GOVERNANCE AND MANAGERIAL REFORM IN JAPAN 1 (D. Hugh Whittaker & Simon Deakin eds., 2009).
87. Owen, *supra* note 79.
88. *Id.*

strategy, and director and executive commitment to enduring business success.[89] In the West, the conception of fiduciary duty is often constrained to the simple relationship between company directors and shareholders (agents and principals). Conversely, in Japan, there is a deeper sense of the communal nature of fiduciary duty as:

1. Employees are answerable to Managers.
2. Managers are answerable to Executives.
3. Executives are answerable to Directors.
4. Directors are answerable to Shareholders.
5. Shareholders are answerable to Employees.[90]

Simon Learmount recently discussed the development of the power balance in Japanese corporations and suggests there is a more social process of accountability in Japan than in the United States.[91] This social accountability includes closer accountability of Japanese managers to employees and highlights the accountabilities of investment institutions to their own constituencies of ultimate owners and beneficiaries, central among whom are the employees of the corporations that institutions invest in. What is required is a better understanding between companies and institutional investors, and while calling for the accountability of corporations, investment institutions should be aware of their own accountabilities to ultimate beneficiaries. Yet, as in other economies, Japanese company directors find it increasingly difficult to establish relationships with short-term investors.

89. Whittaker & Deakin, *supra* note 86.
90. *See generally* LEARMOUNT, *supra* note 1.
91. *Id.*