Reforms of Japanese Corporate Governance: Convergence in the Eye of the Beholder

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I. INTRODUCTION

Japanese corporate governance has often been the subject of attention of foreign investors and scholars, particularly in debates on the comparative aspects of corporate governance.[1] Such interest is logical. For decades, Japan has been one of the world's largest economies and, perhaps more importantly, blazed the trail for the rise of Asia by being the first high-growth economy in history. Additionally, Japanese corporate law has come under the influence of both the civil law and the common law tradition, which provides an interesting window into the highly influential and contentious legal origins debate. Finally, the homogeneity of Japanese society and its unique business culture provide a valuable lens for examining the influence of social norms on corporate law and governance in this part of the world – which is a timely one with the shift of economic power from the West toward Asia. In sum, Japanese corporate law and governance provide a rich entry point into some of the most fascinating debates in comparative corporate law and governance, while at the same time revealing how companies in one of the world's most important economies are governed.

Even though in the postwar period Japan adopted corporate governance structures and rules based on US corporate law, the way Japanese corporate governance functioned in practice deviated substantially from the US model. Recent reforms of corporate governance in Japan following economic crises have raised several issues regarding the direction of changes. There is a broad agreement on the need for changes, but there is a disagreement about the scope and goals of the changes. This paper will try to answer a number of related questions: What is the impact of recent reforms on corporate governance? What are the nature and the scope of changes? Will or should Japan converge on the American model? How can reforms focusing on protection of shareholders be reconciled with a dominantly stakeholder model? Will or should greater

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1 For a comprehensive review of this literature, see L. NOTTAGE, Perspectives and Approaches: A Framework for Comparing Japanese Corporate Governance, in: Nottage / Wolff / Anderson (eds.), Corporate Governance in the 21st Century: Japan's Gradual Transformation (Cheltenham 2008) 21–52.

protection of shareholders be given at the expense of some stakeholders, particularly employees? What is the prospect of creating a hybrid model?

The first objective of this paper is to explain the reasons for the failed adoption of the US model in Japan, and this may also facilitate a better understanding of the Japanese model. In a wider context, the goal of this paper is to contribute to a better understanding of corporate governance as a whole by illuminating the Pandora's Box that may be opened by transplanting ill-suited black letter corporate laws onto foreign soil. The second objective of the paper is to analyze various potential alternatives for future development, including further convergence of the Japanese model on the "global standards," maintaining its distinctive features, and a "third way" that would combine these two alternatives. Various possible scenarios will be examined in order to draw conclusions on the nature, scope, and direction of changes to Japanese corporate governance in the coming years.

The paper will first introduce the process of the adoption of the US model in Japan in the postwar period and the main features of Japanese corporate governance. The paper will then examine causes for the deviations of the Japanese system from the US model. Particular attention will be given to non-legal norms and their impact on corporate governance in Japan. The potential for greater convergence of Japanese corporate governance in the future will then be explored by examining barriers to convergence as well as the factors that may contribute to it. The last part will evaluate various possible alternatives for corporate governance in Japan in the future.

II. ADOPTION OF THE AMERICAN MODEL

After Japan opened its doors to the outside world in the mid-19th century, she embarked on a process of modernization. As a part of this process, Japan undertook a comprehensive revision of the legal system during the *Meiji* period by adopting Western legal institutions.

The Japanese legal system is based on legal transplants originally imported from Germany.[2] In the postwar period, particularly in the area of corporate law, Japanese law made a distinct move toward the American model.[3] The genesis of the Americanization of Japanese corporate law came during the occupation period, when American law heavily influenced major revisions to Japan's black letter corporate law, which were aimed at implementing a US-style shareholder primacy model. American influence was also dominant after the economic "bubble burst" in the 1990s.[4] In Japan's post-bubble era, discussions surrounding a new approach to corporate governance often gravitated

2 There are several reasons for the choice of German law, related to suitability for Japan. See H. ODA, Japanese Law (3rd ed., Oxford University Press 2009) 18.

3 H. AOKI, Revisions of Corporate Law, in: ZJAPANR / J.JAPAN.L. 11 (2001) 97, 99.

4 *Id*., 101.

toward the need to adopt "global standards" in corporate governance reforms. The idea of adopting "global standards" was typically understood as a thinly veiled disguise for adopting US standards.[5] It can also be argued that Japan just "pretended" to adopt the US model to satisfy an international audience but still pleased a domestic audience by avoiding a real shift to the US model.[6]

In practice, the Japanese model has deviated substantially from the US one.[7] The main bank system, cross-shareholding, and the long-term employment system all developed in the postwar period when Japan was supposedly following the US model. Each of these essential features of the Japanese corporate governance model is in clear contrast to the US model. One of the paradoxes of the Japanese model is that during the period when the model was presumably under the influence of US-style black letter corporate law, it actually diverged from the American model. Some commentators have described this divergence as a puzzle.[8] This text will attempt to find answers to this puzzle.

III. MAIN FEATURES OF THE TRADITIONAL MODEL

The Japanese model of corporate governance, on its surface, resembles many other models. Although there are several differences between the models of corporate governance of the United States and Japan, they still maintain the same basic structure. According to one leading Japanese legal scholar, Japanese law more closely resembles the Anglo-Saxon shareholder-value model than the stakeholder model.[9] However, this similarity is just in form. Behind the façade of legal norms that purport to regulate corporate governance, there exists the real world of corporate governance, which is governed not only by legal norms but also by non-legal norms that are in many respects far more important.[10]

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5 C. AHMADJIAN, Changing Japanese Corporate Governance, in: Schaede / Grimes (eds.), Japan's Managed Globalization: Adapting to the Twenty-First Century (New York 2002) 222.

6 D. W. PUCHNIAK, The 2002 Reform of the Management of Large Corporations in Japan: A Race to Somewhere?, in: Australian Journal of Asian Law 5 (2003) 42.

7 For an explanation of how the corporate law provisions in the Commercial Code were redrafted during the American occupation period to reflect US corporate law, see T. L. BLAKEMORE / M. YAZAWA, Japanese Commercial Code Revisions: Concerning Corporations, in: American Journal of Comparative Law 2 (1953) 12. For an explanation of the significant gap between the US-style corporate law in Japan's Commercial Code and its application in practice, see Z. SHISHIDO, Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions, in: Delaware Journal of Corporate Law 25 (2000) 189.

8 M. D. WEST, The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States, in: University of Pennsylvania Law Review 150 (2001) 527.

9 T. ARAKI, Changing Employment Practices, Corporate Governance, and the Role of Labor Law in Japan, in: Comparative Labor Law and Policy Journal 28 (2007) 251, 263.

10 The author has analyzed the impact of non-legal norms on Japanese corporate governance in detail in C. PEJOVIĆ, Japanese Corporate Governance: Behind Legal Norms, in: Penn State International Law Review 29 (2011) 483.

While the legal form of corporate governance in Japan is similar to the common law "shareholders" model, a number of its features are closer to the civil law "stakeholders" model (though the differences between these two models are becoming increasingly blurred). The most typical features of the traditional Japanese model include the main bank system, cross-shareholding, and long-term employment.[11] The close relationship between the business elite and the government may also be added to this list.

1. Cross-Shareholding

The structure of a large publicly traded company is traditionally characterized by cross-shareholding (*keiretsu*), referring to mutual shareholding through which a number of companies are interconnected in a network where each of them holds shares in the other companies.[12] In addition, the shares are also held by banks, life insurance companies, individual shareholders, and foreign investors.

Keiretsu literally means "economic line-ups" and includes something more than what is just covered by the concept of cross-shareholding. *Keiretsu* is a structural arrangement of Japanese firms characterized by close business relationships intertwined with long-term commitments among members. There are various types of *keiretsu*, but the main type is the *keiretsu* corporate group (sometimes called *gurūpu*), with the main bank at the center.[13]

Banks used to have shares in their client companies as a part of a broader relationship that involved the management of financial transactions, while corporations held shares of their suppliers and clients as a part of their business strategy and cooperation. This pattern was well suited to the Japanese version of capitalism, which relied on stable

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11 There is a general consensus in the literature that the main bank, cross-shareholding (*keiretsu)*, and lifetime employment were the three central features of Japan's postwar system of corporate governance. However, two of the most prominent Japanese corporate governance scholars, Yoshiro Miwa and Mark Ramseyer, have recently published numerous articles and a book which suggest that all of the central features of Japanese corporate governance are "academic myths" (i.e., they do not exist). For an example, see Y. MIWA / M. RAMSEYER, The Fable Of Keiretsu (University of Chicago Press 2006); Y. MIWA / M. RAMSEYER, The Myth of the Main Bank: Japan and Comparative Corporate Governance, in: Law and Social Inquiry 27 (2002) 401. For a critique of Miwa and Ramseyer's contrarian research – which also supports the general view taken in this paper that the central features of Japanese corporate governance do indeed exist – see D. W. PUCHNIAK, A Skeptic's Guide to Miwa and Ramseyer's "The Fable of the Keiretsu," in: ZJapanR / J.Japan.L. 24 (2007) 273; D. W. PUCHNIAK, Perverse Main Bank Rescue in the Lost Decade: Proof that Unique Institutional Incentives Drive Japanese Corporate Governance, in: Pacific Rim Law and Policy Journal 16 (2007) 13.

12 *Keiretsu* is the term usually used in the English literature to denote cross-shareholding. In Japanese, cross-shareholding is usually called "*mochiai*" or "*kabushiki mochiai*" to denote stable shareholding for defensive purpose, while the term "*keiretsu*" usually refers to the network of companies based on cross-shareholding and long-term cooperation.

13 Six major *keiretsu* groups are Mitsui, Mitsubishi, Sumitomo, Fuyo, Dai Ichi Kangyo, and Sanwa.

purchase-supply transactions and lending sources, as well as lifetime employment. This also made sense from the perspective of government policy, since the goal was to enable companies to get capital at an affordable price and therefore be able to make long-term strategic decisions, while maintaining a high level of employment.

The beginning of the process of creating *keiretsu* goes back to the 1960s. After the initial period in the 1950s when the Anti-Monopoly Act of 1947 prohibited stockholding by companies, the circumstances changed. In 1964, Japan became a member of the OECD, and one of the conditions for membership was the deregulation of its financial market and liberalization of foreign investment policy. As the government relaxed the entry of foreign capital into the country, there was growing concern about possible take-overs of Japanese companies by foreign companies. As a response to the liberalization of the country's markets, large Japanese corporations created a defense mechanism by establishing a stable shareholding system with the participation of "friendly companies."[14] The Ministry of International Trade and Industry (MITI) was a strong supporter of restoring the old ways of doing things. This support became crucial during the period of liberalization.[15]

Following these developments, the Commercial Code was revised to allow the issuance of new shares to companies, leading to the concentration of shareholdings in the hands of banks and corporations and the creation of *keiretsu*, which contributed to the relatively stable and concentrated ownership structure of Japanese companies. Logically, this resulted in a substantial reduction of individual shareholdings as the shares became concentrated in a small group of financial organizations and corporations. Thus, *keiretsu* was made possible by government action, which was behind the regulations allowing shareholdings by companies.

Typically the shares held under these ongoing stable shareholding arrangements constitute the controlling portion of the firm's shares.[16] There is a mutual understanding between the companies that these shares are not to be traded but to be kept as a safety mechanism.[17] Member companies within a *keiretsu* offer each other preferential treat-

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14 T. ARAKI, Corporate Governance Reforms and Labor and Employment Relations in Japan: Whither Japan's Practice-Dependent Shareholder Model?, in: University of Tokyo Journal of Law and Politics 1 (2004) 45, 50.

15 When General Motors was trying to purchase a substantial part of Isuzu, the Minister of MITI, Miyazawa, encouraged participation of main banks in protecting the Japanese companies against "foreign invasion," K. MIYASHITA / D. W. RUSSELL, Keiretsu: Inside the Hidden Japanese Conglomerates (New York 1994) 41.

16 For an explanation of the efficiency of the *keiretsu* system, see R. J. GILSON / M. J. ROE, Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization, in: Yale Law Journal 102 (1992/93) 871.

17 In Japan, a distinction is made between investment shareholding and stable (mutual) shareholding (*antei kabunushi*). The first involves trading on the stock market, while the second means that shares are not traded but are used to cement the relationship and prevent takeovers.

ment in commercial and financial transactions. They may exchange information and, in times of crisis, they are expected to help each other. Long-term policy is one of the fundamental values of Japanese corporate governance. The creation of the cross-shareholding system enabled the managers of Japanese companies to pursue long-term business strategies.

2. Main Bank

The main bank system was one of the major characteristics of the Japanese traditional model. The main bank system originated from the wartime directives issued by the Ministry of Finance in the pre-war period. In the postwar period, the main bank system developed due to the close relationships the banks developed with their company clients.

The relation between main banks and customer firms in Japan is rather complex.[18] Banks and their customer firms deal in a number of different ways and transactions not limited to lending and often including bank's stockholdings in the customer firms. In contrast to the US where banks were explicitly prohibited from holding shares of other companies,[19] in Japan banks can own up to 5 % of the shares of other companies.[20] Banks can obtain information about their clients through account transactions they can follow and information on deposits. The main bank was closely involved with the internal affairs of the company and it was natural that the bank and the firm consult with each other, which allowed the bank to have access to inside information on the company's business. This gave the banks deep insights into their client company's business and performance, as well as access to information about the financial health of the companies.

The main bank played an important role in monitoring the company's management and was expected to intervene when things went wrong.[21] Bank participation in the monitoring process was made possible not only by their access to the relevant information, but also because of the leverage the banks had due to their substantial shareholding and debt and equity positions with client companies. Although the shareholding of banks in Japan is limited by law, the fact that a bank can own shares in other firms belonging to the same *keiretsu* substantially upgraded its status as a shareholder. Even more

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18 See H. KANDA, Trends in Japanese Corporate Governance, in: Hopt / Wymeersch et al. (eds.), Comparative Corporate Governance (Berlin 1997) 185 *et seq*.

19 The Banking Act, Pub. L. 73-66, 48 Stat. 162 (June 16, 1933) (known as "Glass-Steagal Act"). The Banking Act was repealed by the Gramm-Leach-Bliley Act of 1999 (GLBA).

20 Securities and Exchange Act, 15. U.S.C. § 78a, Art. 65 (1934); Art. 11 *Shiteki dokusen no kinshi oyobi kōsei torihiki no kakuho ni kansuru hōritsu* [The Antimonopoly Act], Law No. 54/1947, as amended by Law No. 42/2012; Engl. transl. available at *http://www.japaneselawtranslation.go.jp/law/detail/?re=02&dn=1&x=0&y=0&co=1&yo=%E7%8B%AC%E5%8D%A0&gn=&sy=&ht=&no=&bu=&ta=&ky=&page=1* (as amended by law No. 35/2005), last retrieved on 13 May 2013.

21 M. AOKI / H. PATRICK / P. SHEARD, The Japanese Main Bank System: An Introductory Overview, in: Aoki / Patrick (eds.), The Japanese Main Bank System (Oxford 1994) 3–5.

important was the fact that bank loans have been the most important source of corporate financing. As the largest creditor and an important shareholder, the main bank had a legitimate interest in ensuring the proper management of the company. The banks were in a position to influence management and would intervene in times of crisis in a company; not only was their money as a lender and a shareholder at stake, but also the loss of their client and their reputation. In a time of crisis, the main bank would take responsibility for rendering assistance, which might include such measures as the rescheduling of loan payments and the granting of new loans. The main bank would also take an active role in the management of the companies, placing the bank's personnel on the company's board. Because management is often replaced in this reshuffling of the board, the main bank system was said to substitute for the missing takeover market in Japan.[22]

3. Long-Term Employment

Long-term employment is another typical feature of the Japanese model. Under this system, an employee is recruited directly from school or university and is expected to remain in the company's employ for the length of his or her career. In return, he or she can expect not to be fired or discharged, except under some extraordinary circumstances.[23] The basis of this agreement is the commitment of employers to provide secure employment to their employees in return for loyalty and "lifetime" service. As a part of this system, the promotion of employees within the hierarchy of the company and the wages paid are based on the principle of seniority.[24] Employees tie their career with the company and expect to be fully compensated by the end of their career.

The origins of the long-term employment concept date from the early part of the twentieth century, when it gradually developed as a business strategy to avoid the high fluctuation of workers that created difficulties for companies, particularly in key industries such as iron and steel.[25] To solve that problem, companies started to offer incentives designed to encourage experienced workers to stay, such as increased wages based on seniority and hefty retirement allowances for long-term workers.[26] An ideological

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22 *Id.*, 3.

23 J. C. ABEGGLEN / G. STALK JR., Kaisha – the Japanese Corporation (Tokyo 1985) 183–188, 191–192, 194–206; see also ARAKI, *supra* note 14, 251–252; R. GILSON / M. ROE, Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance, in: Columbia Law Review 99 (1999) 508.

24 John O. Haley, a leading Japanese law scholar, has recently expressed the view that Japan's long-term employment system is *the* critical feature that defines Japanese corporate governance and makes it unique from other systems of corporate governance around the world, J. O. HALEY, Career Employment, Corporate Governance and Japanese Exceptionalism, Faculty Working Paper Series, Paper No. 04-04-01, 2004.

25 R. OKAYAMA, Industrial Relations in Great Britain and Japan from the 1880s to the 1920s, in: Nakagawa (ed.), Labor And Management: Proceedings of the Fourth Fuji Conference (Tokyo 1979) 207, 227.

26 K. TAIRA, Economic Development and Labor Market in Japan (New York 1970) 153–160.

justification for the long-term employment relationship developed afterward, tying it to Confucian notions of reciprocal obligations. At the start, however, long-term employment was, in fact, a new strategy based on rational economic choice by employers.[27] It should be noted that long-term employment did not exist as a firmly established system in the period between the two World Wars. The system was first institutionalized only in the 1950s and became widely used in the 1970s.[28] The modern long-term employment system was allegedly designed as the result of a compromise between management and unions aimed at overcoming existing labor problems. It was a mutually beneficial bargain rather than a solution imposed by social norms.[29]

Long-term employment does not mean a formal obligation of the company not to dismiss its employees, nor does it mean that the company does not dismiss employees, as this happens in practice. Rather, long-term employment is understood in the sense that the company will not resort to layoffs unless it is in deep economic crisis and layoffs are the only possible way to keep the company afloat and prevent bankruptcy.[30] Even in times of crisis, such as the oil shock crises, or more recently in the time of the so-called "lost decade," companies used other mechanisms aimed at avoiding layoffs, such as the reduction of overtime and assigning employees to affiliated companies.

While lifetime employment has never been regulated and guaranteed by law, the Japanese courts have supported this system by interpretation of law, which made termination of regular employment very difficult. The Japanese courts developed the doctrine of abusive dismissal to support long-term employment. According to this doctrine, a dismissal will be considered abusive if it lacks objectively rational grounds and is considered socially inappropriate. This legal doctrine has been present in a number of cases, starting in the 1950s, that have restricted the employer's power to dismiss employees.[31] The case law that crystallized protection of long-term employment was fully developed in the late 1960s/1970s.[32] On the other hand, the courts also give employers a substantial level of flexibility with respect to job assignments and transfers.

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27 *Id.*, 159–160.

28 *Id.*

29 M. AOKI, Information, Incentives and Bargaining in the Japanese Economy (Cambridge 1988) 116–119.

30 L. WOLFF, The Death of Lifelong Employment in Japan?, in: Nottage et al. (eds.), *supra* note 1, 53, 77.

31 Nagoya District Court, 4 December 1951, in: Rōminshū 2-5 (1951) 578, 579, quoted in T. FUKUI, Labor-Management Relations and the Law in Japan (1973); Tokyo District Court, 8 May 1950, Rōminshū 1-2 (1950) 230, 235–236.

32 L. WOLFF, *supra* note 30, 80. Tanaka v. Hitachi, Supreme Court, 28 Nov 1991, Case No. 1986 o 840: G. MCALINN / M. TERADA, Case No. 16 – Labor and Employment Law, in: Bälz et al. (eds.), Business Law in Japan – Cases and Comments (Alphen aan den Rijn 2012) 159–167; M. K. SCHEER, Case No. 17 – Labor Law, in: *id.*, 181–185.

Long-term employment, in the sense of spending one's whole career in the same company, is not really unique to Japan since such patterns exist in many other countries as well. However, relying on the numbers and statistics to prove that the Japanese model is not different from other long-term employment patterns misses the point. The essence of the Japanese model of long-term employment is not in the numbers but in its character. There are several features of the long-term employment system that are typical for Japan, such as the way of recruiting graduates,[33] seniority-based wages, deferred compensation programs such as "*nenkō*" compensation schemes[34] and payment of a lump sum amount at the time of retirement *(taishokukin)*,[35] the mandatory retirement (*teinen*) system, bonus compensation schemes,[36] internal transfers,[37] and on-the-job training, which result in firm-specific skills making it very difficult for employees to move to other firms. These features make Japanese long-term employment qualitatively different from the corresponding patterns in most other countries.

4. Role of the Government

The Japanese economic model has been described as a "developmental state."[38] The government plays an important role in designing industrial policy aimed at making Japanese firms more competitive in global markets while ensuring fair competition at home. It is similar, to a certain extent, to a planned economy, a kind of controlled capitalism with industrial policy as an important tool for directing development. Intervention of the state was given preference over free market and competition. The government supported the business through subsidies, credits, and various instruments of protection. The positive results of the government involvement were visible in the postwar period when Japan achieved high economic growth, while also ensuring a substantial level of social equality.

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33 The practice of simultaneous recruiting of new graduates *(shinsotsu-ikkatsu-saiyō)* and the way that students apply for jobs *(shūshoku katsudō)* seem to be unique to Japan and S. Korea. The firms recruit their permanent employees directly from high schools and universities, and all the new employees of a given year start working together on April 1 of that year.

34 The *nenkō* system provides an incentive for employees to stay in the company during the whole career, because the salary will rise in the years before retirement. This also gives an incentive to employers to invest in the education of employees.

35 The *taishokukin* retirement package refers to payment of a substantial amount to employees at the point of retirement and represents another incentive to remain loyal to the company.

36 Bonus compensation is based on the overall performance of the firm rather than on the individual performance of employees.

37 Internal transfer *(tenkin)* is a system of intra-company transfer based on a rotation system typically occurring in March-April.

38 "Developmental state" is a term used by political economy scholars to refer to the phenomenon of state-led macroeconomic planning in East Asia in the late twentieth century.

Some segments of the Japanese government, particularly the Ministry of Finance (MOF) and the Ministry of Economy, Trade, and Industry (METI), play active roles in regulating and monitoring the Japanese corporate world. The Diet is considered to be an extension of the bureaucracy. Japan is sometimes referred to as a "government of administration" rather than a government of laws.[39]

The Japanese business system is based on a partnership between politicians, bureaucrats, and businessmen, often termed the "Iron Triangle." Big business financed the political campaigns of the Liberal Democratic Party (LDP) members, who in turn drafted legislation that favored big business. Legislation was implemented by the bureaucracy, while big business provided lucrative post-retirement jobs to bureaucrats.

The Japanese government has been very successful in influencing private business through industrial policy, particularly through administrative guidelines. The government used administrative guidance to impose its policies on companies in order to achieve certain goals by offering incentives for those companies which comply and threatening with administrative sanctions in case of non-compliance with its non-binding advice. However, this policy allowed only actions approved by the ministries, which limited the freedom of companies to apply innovative business strategies. The Administrative Procedure Act of 1993 imposed restrictions on the use of sanctions against parties that refuse to comply with administrative guidance.[40]

Another segment of government involvement is the *amakudari* (天下り – "descent from heaven") system, referring to the practice whereby Japanese senior bureaucrats retire to join organizations linked with or under the jurisdiction of their ministries or agencies. While the practice of government officials moving to the private sector is not unique to Japan, what is typical is that government bureaucrats seek employment in the private sector only upon their mandatory retirement from their government position. The *amakudari* system serves the government to facilitate implementation of its regulations. The civil servants have their own interest in getting a lucrative position after their retirement. Corporations also have an interest as they can get access to information which otherwise may not be easily accessible. This also allows corporations to lobby for their interests with the government and receive favorable treatment. *Amakudari* binds together government officials and large corporations; the government officials have a personal stake, and while serving in ministries they will normally refrain from making decisions that may imperil their future as *amakudari*. In this way, the government bureaucrats are,

39 See C. JOHNSON, Japan: Who Governs? The Rise of the Developmental State (New York 1995) 140.

40 K. DUCK, Now that the Fog Has Lifted: The Impact of Japan's Administrative Procedures Law on the Regulation of Industry and Market Governance, in: Fordham International Law Journal 19 (1996) 1686–1763.

in fact, integrated into the Japanese corporate world as a kind of stakeholders.[41] This aspect is very important for the process of implementation of regulations based on the process of consultation and cooperation between the government and business.

IV. CAUSES FOR DEVIATION FROM THE US MODEL

While the legal form was adopted from the West, the way of doing things maintained a distinctive Japanese flavor. This was a part of the strategy to preserve her own values while importing Western technology under the slogan "Japanese spirit, Western skills" (*wakon yōsai*). This approach has been maintained to the present day with some variations. Being aware of the existence of such an approach is important for understanding how foreign models have been adopted in Japan and the reasons behind adopting the form, while the practice is often very different. As a result, the legal institutions adopted from the West have not operated in Japan in the same manner as they do in the West.

1. Mixed Model

Despite its "shareholder model" form adopted from the US, Japanese corporate governance is, in essence, much closer to the "stakeholder model," with particular attention being given to the protection of employees. While capital is certainly important, the Japanese system gives greater importance to labor and the efforts of employees. The idea that companies should be managed dominantly in the interest of shareholders is in conflict with the prevailing understanding of the role of companies in Japan. According to a survey conducted in firms in a number of countries, in Japan 97 % of respondents answered that the company belongs to all stakeholders, while only 3 % answered that it belongs to shareholders. In the US 24 % replied that the company belonged to stakeholders, while 76 % felt that it belonged to shareholders.[42] As a result of such an approach, Japanese companies tend to give low dividends to their shareholders, as the growth of the company is given greater importance than the profit of shareholders. According to the same survey, in Japan 97 % of respondents viewed job security as more important than dividends, while in the US only 11 % considered job security more important and 89 % viewed dividends as more important.[43]

The view that the management in Japan does not serve the interests of shareholders is misplaced. In Japan the shareholders just may have different interests in the company. On one side, there are shareholders who have interests that are typical for individual

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41 H. BAUM / U. SCHAEDE, Institutional Investors and Corporate Governance in Japanese Perspectives, in: Baums / Buxbaum / Hopt, Institutional Investors and Corporate Governance (Berlin 1993) 609, 654.

42 M. YOSHIMORI, Whose Company Is It? The Concept of Corporation in Japan and the West, in: Long Range Planning 28-4 (1995) 33–44.

43 *Id*.

shareholders, such as dividends; on the other hand, there is a different sort of shareholders who has interests that are often contrary to those typical interests of shareholders.[44] These interests may be the interests of a lender, employee, supplier, or customer, and they are more interested in the repayment of loans or stable profits than in their dividends. In the case of cross-shareholding, the main interests of shareholders relate to their stable business relationships. To summarize, the Japanese model cannot be put decisively in either the shareholders' or stakeholders' model; it more appropriately should be viewed as a mixed model that contains features of both main models. After all, the division between the "stakeholders" and "shareholders" models itself may not be fully appropriate, since the shareholders are the most important stakeholders. It can also be argued that the company and its wellbeing is the central focus of the Japanese system, and the company comes before both shareholders and employees (including managers). So, maybe it is more accurate to say that the Japanese system is focused on the wellbeing of the company itself, rather than on the wellbeing of the employees.

2. Structure of Ownership

The separation of ownership and control, which plays a key role in the US model, is not present in the same way in Japan. In Japan there is some ambiguity with respect to the ownership of companies. The prevailing view is that the company "belongs to the employees." This is in clear contrast with the US, where there is a dominant view that companies belong to shareholders.[45] This difference requires an explanation.

The structure of shareholding in Japan is dominated by mutual ownership of shares among companies. The fact that most large Japanese companies are owned by other companies and banks, which are also owned not by the classic type of shareholders but by other companies in the same *keiretsu*, raises this question: Who really owns these companies and banks? In the case of mutual ownership between companies where each owns shares in the other, it might be difficult to identify individual shareholders. Consequently, the control over the management is not exercised on the basis of ownership by individual shareholders, but on the basis of mutual ownership of shares by the legal entities. So, the management does not, in fact, represent shareholders in a classical sense, but it represents companies that are stable shareholders. The structure is so complex that it might be very difficult to identify the ultimate owner of the company.

These differences in the nature and structure of shareholding naturally affect the control of corporations. The issue of "agency costs" is not as relevant in Japan as it is in the US. If the manager represents the individual shareholders, there might be a conflict of different ideas between them as to how the company should be managed, which represents the basis of the "agency costs" concept. But if the manager represents the compa-

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44 See *supra* note 17.

45 YOSHIMORI, *supra* note 42, 33–44.

ny, which has shares in another company of the same *keiretsu*, then it is far less likely that there can be such a dispute, because the company as such does not have its own will in the same sense as the individual shareholders have it. This is especially the case in a cross-shareholding scheme, where the interests of shareholders are to a certain extent intertwined and are very different from the interests of individual shareholders. The rationale for holding shares in other companies of the same *keiretsu* is not really to earn profit, or to interfere with the management, but to ensure stability.

Whose interests then represent the managers in the board of directors (BOD)? It can be argued that they are employees with a supervisory function. However, if the monitoring is performed by the company employees, this does not have to mean that those employees are representatives of employees. The management is not really selected by the employees, but by shareholders at the meeting of shareholders, so it is difficult to argue that the managers are representatives of employees. But then, the majority shareholders are companies controlled by other companies, and each of those companies is, in realty, controlled by the managers who are at the same time employees. In the end, it seems that the main beneficiaries of the Japanese model are the elite permanent employees: the managers.

In a sense, private ownership as an essential ingredient of capitalism is lacking in the Japanese model. If the private capital is not the dominant factor in organizing the economy, the employees play a more important role than the shareholders, and the prevailing view is that the company "belongs" to the employees, then what kind of capitalism is that? Obviously, it is not the same as in the US.

V. ROLE OF NON-LEGAL NORMS

Discussions on corporate governance usually focus on the legal rules. However, this focus is often misplaced because legal rules are only one segment of a legal system. This is the question that has not been sufficiently explored: In what way do non-legal norms influence the Japanese corporate governance system?[46] Despite various debates on Japanese corporate governance, there have been remarkably few analyses of the link between non-legal norms and how corporate governance functions.

Corporate governance should be considered in the context of Japan's environment that goes beyond formal legal norms. To a certain extent, black letter corporate governance regulations represent just the façade, behind which there exists a world that has its own life and logic far removed from the outside appearance. Consequently, there are two sets of rules in Japan that have co-existed for more than a century – legal norms import-

46 In the context of this text, the term "non-legal norms" is understood as norms that are not recognized as legal rules by formal institutions. They include social norms evolved through a social custom or tradition, as well as norms determined by economic and political interests that influence the law in action.

ed from the West and the traditional non-legal norms. There are various non-legal norms that operate in parallel to the legal norms and jointly determine the way corporate governance functions. For a thorough understanding of the Japanese corporate governance system, it is critical to understand how those non-legal norms impact the practice of corporate governance.

1. Social Norms

One of the reasons why many scholars in the West fail to properly understand how the law functions in Japan is due to the fact that they project the principles that apply in their states onto the Japanese legal system. While the black letter law may seem similar or even identical to the Western law, the way it operates in Japan is often quite different because it operates on the basis of different ideas about its functions and goals. In the same way that the Japanese language has a logic that is different from the Western languages, so the way the law functions in Japan has a logic that is different than in the West.[47]

The law plays a crucial role in designing a corporate governance system, but the role of law cannot be fully understood without considering the social and institutional aspect of a national legal system. Corporate governance systems in a particular country cannot be properly understood without examining first the features of that particular society. Legal systems are embedded in the social, economic, and political life of a society, and are naturally influenced by each society's unique culture, history, and tradition.[48] The legal rules should be placed in a wider context, as the same rules may not operate in the same way all around the world. Law is not just words we read on a page. A range of forces lie beneath the legal norms. Tradition, social norms, ideology, and economic and political interests play important roles in how a legal system operates.

While social norms can be covered by a wider concept of non-legal norms, they deserve special attention in any discussion of Japanese corporate governance. In societies where values, language, meaning, traditions, and customs are shared, social norms based on personal relationship play a more prominent role. These norms may also play an important role in determining the actual implementation of the formal legal rules. As

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47 In the Western languages, the meaning of words is more fixed than in Japanese, where the meaning of words is more ambiguous and the actual meaning is often determined by the context. For example, while the word "difficult" in English means just that something is difficult, in Japanese the corresponding word "*muzukashii*" very often means impossible, depending on the context. The meaning is often just suggested instead of clearly expressed. See T. KAWASHIMA, Japanese Way of Legal Thinking, IN: International Journal of Law Libraries 7 (1979) 127, 131. The fact that the Japanese language has a different logic indicates that instead of "social norms," the term "culture" might be more appropriate, since language is an important segment of culture.

48 K. PISTOR / P. A. WELLONS, The Role of Law and Legal Institutions in Asian Economic Development (Oxford et al. 1999) 1960–1995.

social norms become stronger and more important, the formal legal rules will become weaker and less effective.

In Japan there is a stronger emphasis on community interests at the expense of individual ones, and more importance is given to moral norms at the expense of legal norms.[49] Japanese corporate culture is often described as a family system, in the sense that the Japanese company is based on the principles of a traditional family. The seeds of this family concept of companies are deeply rooted in Japanese culture, based on obedience, deference to authority, hierarchy, group identity, and loyalty, which all make up important elements of Japanese culture.[50] "The company is the people" is a common saying in Japan.[51] By characterizing itself as a family unit, the company has achieved a greater level of loyalty between the management and the employees.

What is typical of Japan is a complex interplay of traditional and modern values, which often leads to original solutions based on both these influences.[52] Non-legal norms often play a more significant role in Japanese corporate governance than formal legal rules.[53] They are behind all of the key features of the Japanese model, such as *keiretsu*, the main bank system, long-term employment, and the role of the government.[54] These features are linked by the idea of cooperation and working together on the basis of trust rather than on the basis of legal commitments. *Keiretsu* and the main bank system are not an explicit organizational form, nor are they based on a legal contract between companies and a bank.[55] The arrangement is informal and there are no clearly defined rules that may serve as the basis for determining the existence of *keiretsu* and the main bank system in any particular case. In a similar way, long-term employment was not regulated initially by any particular law but was based on non-legal norms and practice. Finally, the government's involvement is also based on the idea of trust and mutual cooperation at various levels. The cooperation between the LDP, government, and large business was based on informal linkages outside the system based on legal norms. In Japan, in fact, there is a balancing between competition and cooperation among the competitors, with cooperation being the main principle. In addition to the

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49 C. NAKANE / S. OISHI (eds.), The Social and Economic Antecedents of Modern Japan (Tokyo 1990); H. BAUM (ed.), Japan: Economic Success and Legal System (Berlin 1997); TU WEI-MING (ed.), Confucian Traditions in East Asian Modernity: Moral Education and Economic Culture in Japan and the Four Mini-Dragons (Cambridge et al. 1996).

50 R. J. SMITH, Lawyers, Litigiousness, and the Law in Japan, in: Cornell Law Forum (Faculty ed.) 11-2 (1984) 53, 54.

51 C. NAKANE, Japanese Society (Berkeley/Los Angeles 1970) 3.

52 H. BAUM, Emulating Japan?, in: Baum (ed.), *supra* note 49, 24.

53 J. O. HALEY, The Spirit of Japanese Law (Athens 1998) 14.

54 The author provides more details on the impact of social norms on corporate governance in Japan in PEJOVIĆ, *supra* note 10, 484.

55 T. HOSHI, The Economic Role of Corporate Grouping and the Main Bank System, in: Aoki / Dore (eds.), The Japanese Firm – Sources Of Competitive Strength (Oxford 1994) 287.

government, an important role in this kind of balancing is played by business associations, which set the rules that are normally obeyed by the companies.

Long-term employment may be used as an illustration of the relevance of non-legal norms. One of the explanations for the development of long-term employment is that it is based on economic efficiency. Puchniak in his unpublished doctoral dissertation has argued that "[D]espite a myriad of partial explanations for lifetime employment, the most powerful and straightforward explanation for its emergence and longevity has largely been overlooked: lifetime simply makes economic sense."[56] If this is the case, why do we not find such a system in any other country in the West? After all, economic efficiency theory is normally presumed to be universally applicable. Puchniak's argument that "lifetime makes economic sense" may make sense in the case of Japan, but not at the universal level.

In addition to social norms, other factors also have a strong impact on the way corporate governance functions in practice. According to Milhaupt, "corporate norms may be the product of interest group dynamics."[57] This is one possible explanation that has some explanatory weight behind it. However, Milhaupt's explanation is incomplete as it fails to address why such norms arise in Japan, and whether the emergence of norms such as those related to long-term employment would be possible, for example, in the United States? If yes, then why is there a lack of such norms in the United States, at least in comparison to their prominence in Japan? If not, then why do such norms exist in Japan and not in the United States?

Based on previous discussion, the logical conclusion would be that an answer should be sought in the role of social norms. In contrast to the economic efficiency factors, social norms based on cultural patterns typically have a more limited scope since their application is restricted to a certain geographic area. However, an assessment of the role of non-legal norms should be made cautiously. While the role of non-legal norms in shaping the Japanese economic model is important, it should not be overestimated. Particularly, the theories that emphasize Japanese uniqueness (so-called *nihon-jin ron* theories) should be taken with a grain of salt.[58] The factor of culture is certainly important in explaining different patterns of behavior, but it is also critical not to overstate its importance and to avoid stereotypes.

Nottage offers a recipe for how to approach these complex discussions on Japanese corporate governance: "[t]hose engaged in debates framed primarily by law and economics can benefit from greater engagement with the work of sociologists and political

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56 D. W. PUCHNIAK, Rethinking Comparative Governance: Valuable Lessons from Japan's Post-Bubble Era (unpublished LL.D. Dissertation, Kyushu University 2008) 306 (on file with author).

57 C. J. MILHAUPT, Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance, in: University of Pennsylvania Law Review 149 (2001) 2083, 2124.

58 P. N. DALE, The Myth of Japanese Uniqueness (New York 1986).

scientists, and vice versa."[59] I fully subscribe to this view, as the approach should not be "either/or" but rather "both," in the sense that all relevant factors that determine the character and functioning of Japanese corporate governance should be explored and given adequate assessment.

Now, let us try to apply this recipe to the discussion on the impact of non-legal norms on long-term employment. Assuming that long-term employment made economic sense in Japan when it was introduced, why is it still present in companies in times when it allegedly no longer makes economic sense? True, there have been some adjustments, and the number of part-time employees has been substantially increased since the bubble burst, which is in line with law and economics arguments. But how do we explain the fact that long-term employment is still present in most large companies? Does it still make economic sense, or does it still fit social patterns? Probably both. Long-term employment certainly has some advantages. Terminating the system could cause serious problems for companies, as most talented young Japanese still give preference to security over risky challenges and might be reluctant to apply for a job in companies that do not guarantee permanent employment. Anecdotally, when Japanese students are asked about the job they would like to take after graduation, most of them say that they would like to work for the government as public servants (*kōmu-in*) because such a position guarantees employment security. As long as such attitudes are dominant in society, Japanese companies will have a strong incentive to maintain long-term employment.

2. "Interest Group Dynamics"

Milhaupt's argument that corporate norms "may be the product of interest group dynamics" is, essentially, accurate. Corporate norms are determined by the economic and political interests of the key players: business elite, politicians, the government, and labor unions in the case of long-term employment. Arguments that social norms are behind the creation of some key features of Japanese corporate governance, such as long-term employment and cross-shareholding, are not sustainable. Business decisions are based on interests, attempts to balance such interests, on compromises, and not on cultural considerations or social norms. This can be put in a different way by stating that business-related decisions are normally determined by "interest group dynamics" rather than by social norms. Differences between Japan and the US can be explained by different "interest group dynamics" that exist in these two countries. But what exactly is different? In the end, the differences lie in the different content, role, and impact of non-legal norms, which are, in fact, more closely related to the "interest group dynamics" than to social norms.

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59 NOTTAGE, *supra* note 1, 52.

On the other hand, social norms may influence the choice of particular corporate structures and legal rules out of a larger menu.[60] Those values are deeply embedded in people's minds and in social institutions. As a result, practices that are compatible with social preferences are more likely to work smoothly in a particular society.

Some scholars put in doubt the relevance of social norms. For example, they dispute the cultural roots of long-term employment by pointing out the fact that it did not exist as a firmly established system in the periods between the two World Wars.[61] Such an interpretation represents an oversimplification, as the features of a corporate model are too complex to be explained by a single factor, particularly if the relevance of such a factor is assessed selectively (e.g., within a limited time period).

Long-term employment fits well into Japanese social norms since the way it operates is familiar to employees based on their experiences and education outside the company. Therefore, they tend to easily adjust to their new environment due to the well-known patterns of conduct that they are accustomed to. However, this does not necessarily mean that employment patterns can be determined by social norms.

A number of different factors contributed to the long-term employment system.[62] In addition to the often-mentioned compromise between workers and management to end the unrest and strikes in the beginning of the 1950s and some other labor-related factors, another important factor is the structure of control in Japanese companies.[63] The management of Japanese companies is closely related to long-term employment, as the managers and members of the board come from the ranks of permanent employees. This pattern fits the needs of both the management and regular employees, so they create a kind of "community firm."[64] The managers are ensured of loyalty of regular employees, who also benefit from the loyalty of the company to them. In a similar way, cross-shareholding, the main bank system, and the role of the government correspond to the traditional patterns of cooperation in Japan, which enhanced their successful functioning in practice.

Reasons rooted in Japanese legal culture lie behind the way Japan has integrated foreign legal concepts, including those related to corporate governance, such as the organization of the firm and the way in which management functions. Even though social norms did not play a direct role in the process of creating the main features of Japanese corporate governance, they had an influence in the process of their acceptance and

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60 A. N. LICHT, The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems, in: Delaware Journal of Corporate Law 26 (2001) 147.

61 See PEJOVIĆ, *supra* note 10.

62 R. DORE, Stock Market Capitalism: Welfare Capitalism; Japan and Germany Versus the Anglo-Saxons (Oxford 2000).

63 R. YAMAKAWA, The Silence of Stockholders: Japanese Labor Law from the Viewpoint of Corporate Governance, in: Japan Labor Bulletin 38-11 (1999) 6.

64 Z. SHISHIDO, Japanese Corporate Governance: The Hidden Problems of Corporate Law and their Solutions, Delaware Journal of Corporate Law 25 (2000) 189.

integration in the Japanese economic model. The nature of cross-shareholding, the main bank system, long-term employment, as well as the role of the government are perfectly congruent with the Japanese traditional ways of doing things. The long-term relationship is the common denominator of each of these features that contributed to the coherence of the traditional model.

VI. LEGAL REFORM OF CORPORATE GOVERNANCE

1. Legal Reforms

A sweeping reform of Japanese corporate governance laws was introduced in 2002. In contrast to major changes in the past – one during the Meiji period in the second half of the 19th century and the second in the aftermath of WWII – this new period of change that started in the last decade of the 20th century was motivated by different factors. The changes in this period derive from the poor performance of the Japanese economy in the aftermath of the bubble burst.

There are several important changes that have been introduced in the existing corporate management structure.[65] Under the new Corporation Law, which entered into force in May of 2006 and took the Company Law outside the Commercial Code,[66] Japanese corporations are given the option to select from two distinct corporate governance regimes – the Reformed Large Corporation, based on the traditional Japanese model, and the New Type Company, with committees and an executive officer (CEO), based on the US model.[67]

The new Corporation Law of 2005 allowed foreign companies some flexibility in acquiring Japanese target companies through acquiring the company's shares. Implementation of the new law was delayed for a year due to opposition from Japanese companies, which feared that the M&A provisions of the new law might allow hostile takeovers of

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65 A detailed analysis of reforms introduced by the Corporation Law 2006 is found in E. TAKAHASHI / M. SHIMIZU, Does the 2005 Reform Improve the Japanese Economy? The Current of Japanese Corporate Governance Reform, in: Journal of Interdisciplinary Economics 17-1/2 (2006) 25–56 (a special issue concerning international corporate governance). This text contains a useful chart on possible designs of corporate governance structure in joint stock corporations under the new law on page 31. See also PUCHNIAK, *supra* note 6, 42.

66 *Kaisha-hō* [Companies Act], Act No. 86/2005.

67 Article 2 of the new Companies Act provides (Definitions):
(10) "Corporation with a Board of Auditors" shall mean a *kabushiki kaisha,* which has established a Board of Auditors or a *kabushiki kaisha* in which the establishment of a Board of Auditors is required based on the provisions of this Law.
(12) "Corporation with Committees" shall mean a *kabushiki kaisha,* which has established a nomination committee, an audit committee and a compensation committee (hereinafter: The Committees).

Japanese companies by foreign firms.[68] Eventually, these provisions became effective on 1 May 2007 despite the opposition.[69]

An additional step was undertaken in 2009 by the Tokyo Stock Exchange (TSE) to include as a listing requirement the obligation that every listed company must have one independent – not just outside – director or corporate auditor. The concept of independence is similar to the US and includes conditions that exclude a possible conflict of interest. An importance difference, however, is that under the TSE listing requirements, a statutory auditor can be appointed as an independent officer. A large majority opted for the corporate auditor, which is understandable and represents just another circumvention of the stated goal.[70] Namely, auditors have no power to hire and fire managers, in contrast to the BOD. The TSE listing requirements were amended in 2012, after several new scandals involving companies that had independent officers in accordance with the listing requirements. Several new requirements were added, including enhancement of information disclosure related to independent directors in notices of shareholder meetings.

Most of the debate on reforms has revolved around the clash between the US model, which is geared toward placing primary importance on shareholders and relying on external control, and the traditional Japanese model, which is primarily a stakeholder model based on internal control. Some companies demanded revision of the corporate law so that Japan can adopt the "global standards." Greater protection of shareholders was advocated by institutional shareholders and various associations, such as the Japan Corporate Governance Forum (JCGF) and the Shareholders Ombudsman. The Ministry of Justice (MOJ) also supported the committee model.

This initiative met resistance in a large part of the business sector. The associations of large business, *Keidan-ren* and *Keizai Dōyū-kai*, strongly opposed any reform that would curb the power and autonomy of managers. They were more interested in reforms that would facilitate corporate restructuring. METI and MOF sided with *Keidan-ren* and put forward proposals to allow companies to adopt a model that was best suited to their needs rather than imposing a US-style model on them.

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68 On the new law on hostile takeover, see: H. BAUM, Takeover Defenses in Japan: Corporate Value Reports and Guidelines, in: ZJapanR / J.Japan.L. 21 (2006) 131; S. KOZUKA, Recent Developments in Takeover Law: Changes in Business Practices Meet Decade-Old Rule, in: J.Japan.L. 21 (2006) 5; C. MILHAUPT, In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan, in: Columbia Law Review 105 (2005) 2171; D. W. PUCHNIAK, Delusions of Hostility: The Marginal Role of Hostile Takeovers in Japanese Corporate Governance Remains Unchanged, in: J.Japan.L. 28 (2009) 89.

69 See at *http://www.japantimes.co.jp/news/2007/05/01/news/are-new-rules-kind-to-hostile-mergers/#.UZIMc0rLsik*, last retrieved on 14 May 2013.

70 According to the TSE report, 10.6 % of listed companies submitted notifications containing only outside directors, 70.7 % only outside auditors, and 18.7 % both outside directors and auditors, TOKYO STOCK EXCHANGE, Updated Consolidated Results of Independent Direc–tors/Auditors Notifications (21 July 2010), available at *http://www.tse.or.jp/english/rules/ls-improvements/b7gje600000044iq-att/100803_a*.pdf, last retrieved on 14 May 2013.

The arguments used by these two contrasting positions were often framed to conceal a deeper divide between those who would want to preserve present positions and privileges and those who believe that a different way of doing things would be more suitable for the Japanese economy. As in many similar situations, the final outcome might be somewhere in between; when a consensus cannot be reached, a compromise position is normally taken. This was demonstrated by the contents of the amendments to the Special Act to the Commercial Code (*Shōhō-tokurei-hō*) in 2002, which allowed two models of companies to exist in parallel. Japan decided to adopt a hybrid model, enabling companies to adopt the "global model" while also giving them an option to retain the traditional model. This was a compromise solution that tried to satisfy those who demanded more drastic changes and wanted to adopt the global standards, while at the same time trying to satisfy those who supported a more cautious approach aimed at restricting the changes to modification of the traditional postwar Japanese model.

2. Impact

Not much change is visible in Japan after all these reforms. The economy has not been improved and the companies have failed to restore their competitiveness. On the contrary, things became still worse with a strong yen, and many Japanese companies have lost their positions in the international market.

Similarly, the impact of reforms was rather limited in terms of changing corporate governance practices. The biggest innovation was the establishment of a totally new governance structure known as the "committee system," which was viewed by some scholars as a sign of the Americanization of Japanese corporate governance.[71] It may appear as such on paper. In fact, the reform has given a chance to companies to adopt the US model, but at the same time it also enabled companies to circumvent it. This provided some material to support the view that Japan just wanted to project to the world that it was following the US model when actually it was not. Most companies have selected a revised Japanese model rather than adopting the US model.[72]

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71 For more information on the 2002 Revision, see R. GILSON / C. MILHAUPT, Choice as a Regulatory Reform: The Case of Japanese Corporate Governance, in: Columbia Law and Economics Working Paper No. 251 (2004), available at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=537843*, last retrieved on 14 May 2013.

72 Statistics of the Tokyo Stock Exchange show a decline in the number of companies with committees and an increase in companies with statutory auditors. While in 2007 the ratio for large companies was 97 % to 3 % in favor of companies with auditors, TOKYO STOCK EXCHANGE, White Paper of Corporate Governance 2007 (March 2007), available at *tse.or.jp/english/rules/cg/b7gje60000003y6y-att/white_paper.pdf,* last retrieved on 14 May 2013, in 2011 the ratio was changed and now it is 97.4 % to 2.6 %, statistics available at *tse.or.jp/english/listing/cg/b7gje60000003y6y-att/20110613.pdf*, last retrieved on 14 May 2013. Similar trends exist in mid-size companies.

Reforms are made so that changes are facilitated rather than required. As a result, very few companies have embraced the US-type company model. For the moment, the corporate governance reforms have not led to radical changes in board structure, the presence of outside directors has not yet become the norm, and stock options and hostile takeovers are still a rarity in Japan.[73] Managers still commit wrongdoings and there are still cover-ups (e.g., Toyota and Olympus). According to Haley, recent reforms of corporate governance have not been designed to make any significant change in the patterns of corporate governance.[74]

One of the key points in the discussions on reform of corporate governance in Japan was whether the traditional model BOD dominated by insiders should be replaced by a more shareholder-oriented model with more outside directors. While outside directors are seen as a potentially powerful new element of monitoring, such expectations may prove to be too optimistic. Truly independent outside directors are still very rare in Japan, even among the companies that have adopted the committee model. Outside directors who are not really independent prevail, and they are treated more as advisers than as monitors.

In Japan, most outside directors come from interrelated companies or are "friends and well-wishers of the firm."[75] It is not realistic that a president would risk dismissal by the board where a majority of directors are appointed by profit-seeking shareholders with no other business relationship with the company.[76] It makes little sense to have outside directors who are not independent and have no real power to influence the decision-making processes.

Despite all the changes in the law regulating the boards, one of the crucial instruments for improving the performance of corporate management is missing: the threat of ousting the management by an independent-minded board of directors. Some companies may decide to incorporate outside directors precisely because they do not consider them a threat to the management power. According to Lawley, the committee system with outside directors may have a placebo effect in the sense that this model is perceived to provide a stronger and more transparent corporate governance system, even though this

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73 D. W. PUCHNIAK, The Efficiency of Friendliness: Japanese Corporate Governance Succeeds Again Without Hostile Takeovers, in: Berkeley Business Law Journal 5 (2008) 195.

74 J. O. HALEY, Heisei Renewal or Heisei Transformation: Are Legal Reforms Really Changing Japan?, in: ZJAPANR / J.JAPAN.L. 19 (2005) 5, 15.

75 R. DORE, Insider Management and Board Reform: For Whose Benefit?, in: Aoki / Jackson / Miyajima (eds.), Corporate Governance in Japan: Institutional Change and Organizational Diversity (Oxford 2007) 383.

76 *Id.*, 382.

is not supported by empirical evidence.[77] Reforms led to a greater diversity in the structure of boards but had less impact on how the decisions are actually made in practice.

Concerning corporate governance, the meetings of shareholders have become more relevant, indicating a greater readiness to accommodate the interests of shareholders. There is a growing tendency of individual shareholders to attend annual general meetings, and shareholders are becoming more active at those meetings, often asking questions. Asset management companies and trust banks are becoming more active at the annual general shareholders' meetings by voting against the management proposals.[78] In 2010, there was a 15 % vote against management proposals, in comparison with a 10 % vote against one year before.[79] Those proposals included retirement allowances to directors, nomination of management, and proposals for the issue of warrants aimed as defensive measures to protect against hostile takeovers. As a result, the duration of the shareholders' meetings has also increased and in 2012, the average duration of annual meetings was 53 minutes, 14 minutes longer than in 2001.[80]

It is still premature to make predictions about the impact of legal reforms of corporate governance. Time will tell whether the present legal reforms will end up in failure (i.e. just "formal convergence" that does not substantially change the way of doing things) or whether they will bring substantial change.

VII. PRESENT TENDENCIES

To make an assessment of the prospects for change of the Japanese system, it is important to examine the present tendencies of the system. In the present Japanese corporate governance system, some trends can be identified as a result of a number of factors, such as social change, the economic recession, and legislative actions. There are visible changes in all key features of the Japanese traditional model, but there are also clear signs of its persistence.

1. Cross-Shareholding

The decline of cross-shareholding in Japan seems to have stopped, and its demise will probably not happen anytime soon. The *keiretsu* system may not change significantly,

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77 P. LAWLEY, Panacea or Placebo? An Empirical Analysis of the Effect of the Japanese Committee System Corporate Governance Law Reform, in: Nottage et. al. (eds.), *supra* note 1, 154.

78 "*Kabunushi sōkai, 15 % ni hantai-hyō*" [At the Annual Meetings of Shareholders, 15 % voted against], Nihon Keizai Shinbun, 24 September 2010.

79 See *id.*

80 *Kabunushi sōukai o meguru dōkō, Beppyō 1* [Tendencies Regarding Annual Shareholders' Meetings, Additional Table 1], in: Shōji Hōmu 1983 (2012) 14. The information on the duration of annual shareholders' meetings is regularly published in the November issue of Shōji Hōmu. However, it indicates almost no change in the last seven years.

though some changes have occurred within the system. While banks have reduced their shareholdings in the companies, the *keiretsu* will probably retain its "safety level" that makes hostile takeovers difficult. Although banks may not be able to re-establish their participation in cross-shareholding, such obstacles do not exist in the case of firms, and they have been active in re-establishing stable shareholdings.

The main reason for this revival of cross-shareholding is the fear of hostile takeovers that increased after the deregulation of mergers and acquisitions in Japan. According to a Bloomberg columnist, "the old practice of cross-shareholdings between companies and takeover defenses made a roaring comeback" as a defensive mechanism against hostile takeovers,[81] though the level of cross-shareholding, even after the increase, was still below its bubble peak.

The hostile takeovers made a promising start and then – nothing dramatic happened. Companies created antitakeover defenses, taking advantage of new regulation that allowed companies to have poison pills; these are treated as a deterrent to bidders rather than as an instrument of the protection of shareholders' interests.[82]

Probably the most visible changes have occurred with respect to ownership structure. The shareholdings of banks and insurance companies that have been traditionally management-friendly have substantially declined in the last two decades.[83] During the same period, foreign shareholdings have substantially increased, though more recently some downward trends have also been reported.[84]

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81 W. PESEK, Japan 2028 May Put Bad Science Fiction to Shame, Bloomberg, 9 March 2008, available at *http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aZIuNeKsDOQ0*, last retrieved on 14 May 2013. On the recent resurgence of cross-shareholding, see K. NITTA, On the Resurgence of Cross-Shareholding – Data from the Fiscal 2008 Survey of Corporate Ownership Structure, NLI Research, 16 November 2009, available at *http://www.nli-research.co.jp/english/economics/2009/eco091116.pdf*, last retrieved on 14 May 2013. According to Nitta, pages 5–6, the recent resurgence of cross-shareholding is almost exclusively a result of actions by business firms, while banks remained passive.

82 Livedoor Co. Ltd. v. Nippon Broadcasting System, Tokyo High Court, 23 March 2005, Case No. 2005 ra 429: T. FUJITA, Case No. 29 – Corporate Law, in: Bälz et al. (eds.), *supra* note 32, 313–322; Bulldog Sauce Co. Ltd. v. Steel Partners, Supreme Court, 7 August 2007, Case No. 2007 kyo 30: Hiroshi Oda, Case No. 30 – Corporate Law, in: Bälz et al. (eds.), *supra* note 32, 323–330.

83 Stock ownership by banks declined to 4.1 % in 2011, from 13.7 % in 1999. In the same period, stock ownership by financial institutions declined to 29.7 % from 41.0 %. However, a slight reverse trend is noticeable in the last few years. See TOKYO STOCK EXCHANGE, Fact Book 2012, available at *http://www.tse.or.jp/english/market/data/factbook/b7gje60000003o32-att/b7gje6000000y9uq.pdf,* last retrieved on 14 May 2013.

84 According to the TSE's "Fact Book 2012", *supra* note 83, foreign shareholding in 2009 was 23.5 %, down from 27.8 % in 2007; recent years, however, show a new tendency of rising foreign shareholding, and in 2011 it increased to 26.7 %.

2. Long-Term Employment

Since the collapse of the bubble economy in the 1990s, long-term employment has come under pressure as a result of economic recession. Economic decline has required Japanese companies to be more flexible in hiring and firing employees than the traditional system allowed. Many companies have decided to lay off a substantial number of employees in the process of restructuring while, in the same period, the number of part-time employees has substantially increased.[85] In fact, the largest difference in long-term employment in the last 10 years has been the increase in part-time employees.[86] Since Japan has always had part-time employees in large companies, this is a change in scale and not in form.

Japanese firms have gradually revised the traditional practice of seniority-based promotion and remuneration with increasing importance being given to individual performance and ability. Increased foreign shareholding may have contributed to this change, but there is no conclusive evidence of this. Japan's seniority system is not sustainable with its aging society, regardless of economic or other incentives that may reinforce it. In fact, most firms have introduced merit based pay in the context of long-term employment.[87]

An increase in the number of temporary workers, gradual elimination of seniority pay, and promotion patterns have failed to change the basic structure of long-term employment, and the labor market remains underdeveloped. A major factor in preserving the long-term employment system is the insider character of Japanese management, the relatively egalitarian distribution of rewards between regular employees and managers, and social norms associated with these practices.[88] Some employees do not even want the status of regular employees, because in addition to benefits this status also assumes a number of important obligations (e.g., working overtime or being transferred to a different job at distant locations).

It has been repeatedly argued that long-term employment is disappearing, or even that it does not exist anymore.[89] Wolff has summarized the present status of long-term

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85 According to the Ministry of Health, Labor, and Welfare (MHLW) figures, there were 34.18 million regular employees in Japan at the end of 2007 (average for October-December), while non-regular employees numbered 17.38 million or 33.7 % of the total. See Ministry of Health, Labor, and Welfare at *www.mhlw.go.jp*.

86 The key characteristic of part-time employment in Japan is that the employee is not a regular employee, regardless of the number of working hours. Part-time employees are often hired by a fixed term contract, and they are disposable according to the fluctuation of business. The same is true of other fixed-term employees (often called *kikan jūgyō-in* or *keiyaku-shain*) who may work full time but are definitely non-regular workers.

87 G. JACKSON, Employment Adjustment and Distributional Conflict, in: Aoki et al. (eds.), *supra* note 75, 298.

88 *Id*., 306.

89 See WOLFF, *supra* note 30.

employment in Japan in a few words: "[L]ifelong employment is alive – and not well."[90] Despite such claims, many employees still believe today that they are employed for the rest of their working life at their company unless something goes very wrong. Although employment customs are said to be changing, there is still a pervasive belief that it is only really morally acceptable to resort to layoffs when the company faces bankruptcy.

The government has taken several actions to dispel doubts about its attitude toward long-term employment. A number of pieces of legislation adopted recently have reinforced the protection of employees. The Labor Standards Act was revised in 2003, and the new revised law came into effect in 2004.[91] One of the key provisions of this revision is Article 18-2, which reads: "A dismissal shall be considered an abuse of the right to dismiss and therefore null and void if it is not based on objectively reasonable grounds and may not be recognized as socially acceptable." This provision is clearly based on the "abuse of right" doctrine. The tendency to reinforce the protection of employees has continued in the following years. In 2007, a number of other labor statutes were adopted to further protect employee rights. The Part-Time Workers Act of 1993 was revised in 2007 in an effort to improve the working conditions of part-time workers. This revision substantially increased protection of part-time employees, particularly the provisions that for the first time introduced the prohibition of discrimination against part-time employees.

In 2007, the Labor Contract Act was implemented.[92] The main reason for enacting this statute was the rise of temporary labor contracts, as well as the increase in labor disputes between employees and employers. This statute fills the gap by specifically defining the principles governing labor relations that were previously based on judicial precedents only, including the prohibition of the abusive exercise of the employers' rights.[93]

Long-term employment persists, and has only been revised by increasing the number of part-time employees. Core employees continue to enjoy the status of long-term employment. Although the economy will probably further suffer as a consequence of the global financial crisis that started in 2008, it is unlikely that long-term employment will be abandoned, though it may be further modified. Employment practices will probably remain one important segment of the Japanese model of corporate governance that has

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90 *Id.*, 78.

91 *Rōdō kijun-hō*, Law No. 49/1947, as amended by Law No. 147/2004 (latest amendment by Law No. 42/2012); Engl. transl. available at *http://www.japaneselawtranslation.go.jp/law/detail/?re=02&dn=1&x=0&y=0&co=1&la=01&yo=labor+standards+act&gn=&sy=&ht=&no=&bu=&ta=&ky=&page=1* (as amended by Law No. 147/2004), last retrieved on 20 May 2013.

92 *Rōdō keiyaku-hō*, Law No. 128/2007; Engl. transl. available at *http://www.jil.go.jp/english/laborinfo/library/documents/llj_law17.pdf*, last retrieved on 14 May 2013.

93 Article 18-2 of the revised Labor Standards Law 2003 was incorporated into the new Labor Contract Act 2007.

not converged with the American model, and it is not likely to converge in the foreseeable future.

3. Main Bank

The changes in the main bank system after the bubble burst were probably the most visible and drastic. Financial deregulation played an important role in changing the status of the main banks. The role of bank loans in corporate financing declined and the bank-firm relations became weaker as companies were given more options in corporate finance.[94]

A primary reason for changes in the banking sector was the problem of huge bad debts that caused problems in the whole banking sector, as it proved impossible to get proper returns on investments into so-called "zombie" companies. Many such companies were kept alive by the appearance of profitability through continuous bank loans, which contravened the basic economic rationale that banks should not grant loans if they are aware that those loans will never be repaid.

The main bank relationship created perverse incentives. Once a main bank gave a large loan to a firm, the main bank could not let the firm go bankrupt even if the firm faced serious financial difficulties.[95] The main banks had a choice: to foreclose the mortgage or to rescue the firm through the reorganization process. Typically the banks used the second option: by paying off the debts, they were in a position to control the restructuring process. According to Puchniak, this kind of bank policy was motivated by the "self-interested bank managers" who had an interest in keeping their jobs in the banks and the "self-interested Japanese government officials" who wanted to avoid the political consequences of massive bank and industry failures.[96]

As a consequence of the crises caused by bad debts, the banks had to dispose of a substantial portion of the shares they had in other companies. With the bubble burst, a corporate governance vacuum was created. The main banks lost the capacity to play the monitoring role as large firms relied on capital from elsewhere, while the banks had to deal with their own survival. With reduced shareholding, the role of main banks in the monitoring of management has been diminished substantially, and it will be very difficult to restore. This has raised a question which is crucial for Japanese corporate governance: How shall the role of the main bank be replaced in the monitoring of companies?

4. Role of the Government

Things changed after the defeat of the Liberal Democratic Party (LDP) in the elections held in 2009. The Democratic Party of Japan (DPJ) won the elections by using new

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94 E. FELDMAN, Legal Reform in Contemporary Japan, in ZJAPANR / J.JAPAN.L. 25 (2008) 5.

95 Z. SHISHIDO, The Turnaround of 1997: Changes in Japanese Corporate Law and Governance, in: Aoki et al. (eds.), *supra* note 75, 311.

96 D. W. PUCHNIAK, Perverse Rescue in the Lost Decade: Main Banks in the Post-Bubble Era, in: Nottage et al. (eds.), *supra* note 1, 103.

rhetoric based on social justice and deploring the idea of a free market promoted by the previous government. The DPJ introduced several reforms that were based on a stronger social welfare policy.[97]

The 2009 election produced a seismic crack in the Iron Triangle structure. The change in the government affected the traditional relations between big business and government. For decades, big business relied on its relations with the LDP and never tried to develop relations with the opposition parties. Naturally, the change in government in 2009 disrupted those traditional ties. The changes introduced by the DPJ undermined the relationships that had kept the triangle in place. While bureaucrats continued to protect the interests of Japan's major corporations, the power of bureaucrats diminished as a result of the DPJ's efforts to shift power away from them and strengthen ministerial responsibility and authority. The DPJ also pledged to take further steps against the *amakudari* practice.[98]

The general election held on 16 December 2012 led to the defeat of the ruling DPJ and the return of power to the LDP. It remains to be seen what impact this election will have on corporate governance in Japan. The victory of the LDP may thwart corporate governance reforms due to strong links between LDP and the business elite in Japan. One effect is that introduction of the proposed revisions to the Companies Act to the Diet has been delayed, and there is no set timetable at the moment.

VIII. FACTORS CONTRIBUTING TO CONVERGENCE

Over the years, there have been gradual changes aimed at meeting the new trends and challenges brought about by the globalization process and the rapidly changing environment. The most visible changes related to corporate governance are increased foreign shareholding, reduced role of the banks in the monitoring, increased potential for market control, changes in the structure of employment, strengthening of the shareholders' position, and an increase in the number of outside directors. The process toward "global standards" seems to be irreversible, as it is driven by a number of different factors.

1. Globalization Effects

In recent years, the informal practices of corporate governance based on non-legal norms have come under pressure as a result of globalization, which brought about

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97 See "Kan Urges Opposition Parties to Join Talks on Social Security Reform," The Mainichi Daily News, 24 January 2011.

97 See "Japan Post to Make 65,000 Non-Regular Employees Full-Time Workers," Japan Today, 10 May 2010.

98 "The Civil Service Serves Itself," The Economist, 27 August 2010, available at *http://www.economist.com/blogs/asiaview/2010/08/japans_revolving-door_problem*, last retrieved on 14 May 2013.

various changes in the Japanese business and social environment. Japan has been gradually transformed, especially in the urban part of society and among the younger generation, which is naturally more inclined to accept changes and foreign influence. Younger Japanese have ideas about their careers that are different from those of their parents. They are less committed to the long-term employment system and are more likely to change companies if others offer better conditions. Even though young Japanese are very much concerned about their employment security, it can be said that this is not really Japanese, but rather a common attitude of young people around the world.

In the process of restructuring, employees and managers have gradually adjusted to the previously painful experiences brought about by mergers.[99] This also indicates the gradual modernization of Japanese society from being group-oriented toward an individual-oriented society that is gradually adopting Western standards.[100] Japanese society and the attitudes of the people are likely to change as society becomes increasingly commercialized and exposed to the globalization process. Although the significant changes in values and attitudes are likely to happen slowly, they carry a potential for change that may undermine the traditional ways of doing things in Japan.

2. Increasing Role of Law

The role of law in Japan has not been so visible during a long period despite its existence on the books. Derivative suits remained dormant for several decades after being introduced into Japanese corporate law, despite the fact that many opportunities for such suits existed in response to various managerial abuses. The sudden increase in shareholder derivative suits almost immediately after a reduction in the filing fees in the early 1990s, as noted by Mark West,[101] illustrates the importance of the legal rules. Similarly, securities laws existed, but were not often used in practice, despite widespread insider trading practices and market abuses.[102] Anti-trust laws existed, but did little to

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99 The identification with the company was one of the causes for problems with mergers in Japan, and difficulties in full integration between two companies. Dai-Ichi Bank and Nihon Kangyo Bank, which formed Dai-Ichi Kangyo Bank, are often quoted as an illustration of those difficulties, since employees of these two banks continued to identify themselves with their original banks long after the merger, and the banks continued to have two separate branches operating side-by-side under the same roof.

100 See M. ISHII-KUNTZ, Collectivism or Individualism? Changing Patterns of Japanese Attitudes, in: Sociology and Social Research 73 (1989) 174–179.

101 M. D. WEST, Why Shareholders Sue: The Evidence from Japan, Journal of Legal Studies 30 (2001), 351, 353. See also, B. E. ARONSON, Reconsidering the Importance of Law in Japanese Corporate Governance, Cornell International Law Journal 36 (2003) 11.

102 See "Insider Trading Spike Linked to Close Confidants," The Japan Times, 4 September 2010, available at *http://www.japantimes.co.jp/news/2010/09/04/news/insider-trading-spike-linked-to-close-confidants/#.UZJHPkrLsik*, last retrieved on 14 May 2012.

prevent widespread bid rigging and cartels.[103] The legal infrastructure for hostile takeovers existed, though not well developed, but Japan has remained largely free of hostile takeovers.[104] However, recently there have been several court cases concerning hostile takeovers (in terms of proxy fights, inspection of target company's books, selling out dissenting shares at a fair value, etc.).[105]

Despite some skepticism, there should be no doubt that the law plays a very important role in modern Japan. If the law did not matter, why would Japanese legislators spend so much time and energy in revising something that was not relevant? It can be argued that functioning of corporate governance depends more on practices than on legal rules. On the other hand, even if not vigorously enforced in all situations, the law has an important persuasive effect. The law itself cannot change things immediately, but its existence is still important for creating a legal framework that will legitimize one kind of behavior and prohibit others.

The role of law is becoming more prominent in parallel with the process of globalization and modernization of Japanese society. An important step toward a greater role for law in Japan was taken by the establishment of the Justice System Reform Council in 2001. The Council recommended substantial reforms to the Japanese legal system, including changes in legal education and increasing the number of lawyers.

The experience with legal reforms in Japan has shown that even if the reforms do not bring immediate changes, they may still bring results at a later stage. Law often serves as a complement rather than as a substitute for non-legal norms. That is a sign of a gradual process of changes in a society, changes that enable a smooth transition from a society governed by social norms toward a society governed by legal norms.

Legal reforms relating to Japanese corporate governance have been numerous and often comprehensive, affecting many aspects of corporate governance. While the chang-

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103 As of 2008, thirteen lawsuits were still pending over 1990s' bid rigging for local government contracts to supply incinerator plants, "Builders Settle Damages Suit over Bid-Rigging," The Japan Times, 4 April 2009, available at http://www.japantimes.co.jp/news/2009/04/04/news/builders-settle-damages-suit-over-bid-rigging/#.UZJIDErLsik, last retrieved on 14 May 2013.

104 D. W. PUCHNIAK, *supra* note 73, 195.

105 The greatest attention was attracted by the famous "Livedoor" case: Nippon Hōsō K.K. v. Raibudoa K.K., Tokyo High Court, 23 March 2005 (Appeal from Injunction Against Issuance of Warrants), in: Hanrei Taimuzu 1173 (2005) 125. In this case, the court ordered a provisional injunction against the issuance of stock acquisition rights to a third party, for the reason that the relevant takeover action was not found to be abusive. Another important case was Steel Partners Japan Strategic Fund (Offshore) L.P. v. Bull-Dog Sauce Co. Ltd., Supreme Court, 7 August 2007, Shōji Hōmu 1809 (2007) 16. In this case, the court recognized that almost all shareholders other than the acquirer had judged that the acquisition of control by the acquirer would be detrimental to the company's interests and thus the shareholder interests, and affirmed the implementation of the takeover defense measure.

es introduced by the new legal reforms are significant, the companies may need some time to digest those changes and make the necessary adjustments.

3. Increase of Foreign Shareholding

The increase of foreign shareholding is probably the most important change that brings a potential for deeper changes. This was the result of a new policy that gave priority to foreign investment. This policy was implemented by various measures aimed at encouraging foreign investment by removing a number of restrictions. New laws were introduced aimed at facilitating M&A, acquisition of shares by institutional shareholders, and promotion of the use of stock options. Economic factors also contributed to the increase of foreign investment. Following the bubble burst in the 1990s, the value of shares dramatically dropped, making it attractive for foreign investors to enter the Japanese stock market.

Foreign shareholding had an impact on corporate governance because the rationale of foreign shareholding is rather different from the traditional Japanese stable shareholding. Foreign investors were motivated by reasons very different from those of the Japanese stable shareholders and had different priorities.[106] Changes generated by foreign shareholders are reflected in the introduction of shareholder-friendly policies, such as increasing the dividends, enhancing transparency and disclosure requirements, giving more attention to the share value, and demanding greater board independence.[107] The California Public Employees' Retirement System (CalPERS) demanded changes similar to those it had sought in the US, though at a later stage there was a change in the attitude from a shareholders-activist stance toward a firm-specific focus.[108] Many foreign shareholders have decided to focus only on their profit in the companies they invested in. This illustrates that foreign investors may have only a limited impact on corporate governance in Japan.

4. Domestic Factors

The pressure also came from inside Japan. According to Dore, in addition to the substantial increase of foreign shareholding, the true reasons for the reform of corporate governance were the loss of national self-confidence caused by poor performance of the Japanese economy after thirty years of high growth performance, and as a consequence the loss of pride in Japanese institutions, as well as the increasing influence in the gov-

106 C. AHMADJIAN, Foreign Investors and Corporate Governance in Japan, in: Aoki et al. (eds.), *supra* note 75.

107 *Id*., 144–145.

108 S. M. JACOBY, Principles and Agents: CalPERS and Corporate Governance in Japan, in: ZJapanR / J.Japan.L. 23 (2007) 23.

ernment, universities, and business of the "brainwashed generation" of American-trained MBAs and PhDs.[109]

Some Japanese corporations demanded deeper legal reforms to develop new businesses, attract foreign investors, and become more competitive. One part of the large business also showed a readiness to embrace new ways of doing things. A notable example is Sony, which introduced its *shikkō-yakuin* (Executive Officer) system in 1997, which served as a model for the New Type Company.[110]

Activist shareholders have attracted media attention by their unprecedented actions. The appearance of some shareholder activists – such as Takafumi Horie (known as "Horiemon"), the founder of Livedoor corporation, and Yoshiaki Murakami, an outspoken investment fund manager – is an illustration of the change of attitudes within Japan. Both of them were in the center of a number of highly publicized corporate events, such as the attempted hostile takeover of NBS (Nippon Broadcasting System), which represented a sign of departing from the traditional and accepting new ways of doing things.[111]

Some non-profit organizations are also active in promoting corporate governance reforms. One such organization is the Kabunushi (Shareholders) Ombudsman (KO), which is comprised of lawyers, accountants, academics, and shareholders. It aims to reform Japanese management practices to incorporate the views of all shareholders in Japanese companies.[112] While this kind of organization might be visible in mass media, their actual power and influence are rather limited. Nevertheless, their impact on shareholder litigation and in turn corporate governance has been important.[113]

IX. Barriers to Convergence

Analysis of the legal reforms made in Japan indicates that, despite comprehensive legal reforms and adopting some elements of the American corporate governance system, traditional patterns endure and Japan has retained the most important features of its traditional model.[114] Firms continue to be controlled by their top management, while shareholders are still deprived of effective mechanisms of control over the corporation. Some of the legal reforms in Japan have had only a symbolic effect, while some reforms brought changes only many years after they were introduced. There are several factors that contributed to the slow pace of reforms.

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109 R. Dore, Shareholder Capitalism Comes to Japan, in: ZJapanR / J.Japan.L. 23 (2007) 209.

110 See Corporate Governance Reform Report 2003, available at *http://www.sony.net/SonyInfo/csr/issues/report/2003/qfhh7c00000dlrp8-att/e_2003_03.pdf*, last retrieved on 14 May 2013.

111 Tokyo High Court, *supra* note 105.

112 See generally *http://www.kabuombu.sakura.ne.jp*.

113 D. W. Puchniak / M. Nakahigashi, Japan's Love for Derivative Actions: Revisiting Irrationality as a Rational Explanation for Shareholder Litigation, Vanderbilt Journal of Transnational Law 45 (2012) 1.

114 Haley, *supra* note 53.

1. Cultural Barriers

Cultural barriers often posed obstacles or delayed the changes. Informality and non-legal norms have some advantages because they allow a certain flexibility, particularly for those who can use this flexibility to achieve certain goals based on give-and-take practices. Taking away such flexibility may create serious problems for those who relied on informal norms and may suddenly be exposed to abstract rules that are impersonal and universal, as this may open the way to individuals to challenge their positions. This is of essential importance in a society were consensus is cherished and dissent is suppressed. This linkage between the Japanese traditional model and Japanese culture was one of the factors that contributed to the reluctance to change it despite economic stagnation.[115]

The issue of independent directors offers an illustration of the hindrances that limit the effect of changes. Japanese companies may find it difficult to integrate independent-minded outside directors, at least in the initial period. A board of directors consisting of employees who have spent their whole career in the firm is unlikely to give priority to the shareholders' interests over those of the employees. It is unlikely that Japanese companies will adopt a system in which outside directors will play the dominant role. This would be contrary to Japanese corporate culture, which is inherently biased against the idea of allowing outsiders to play a dominant role in a group given the tradition of board members having longstanding and close personal relationships with each other.

The recent Olympus scandal demonstrated the potential for conflicts with outsiders who dare challenge the way business is done in Japan. Michael Woodford, one of the very few foreigners who were promoted to a high position in Japanese companies, was sacked as the CEO of Olympus only two weeks after being appointed to this position, because he questioned huge fees Olympus had made to obscure companies.[116] The company explained that Mr. Woodford was sacked "because of his inability to grasp Japanese corporate culture."[117] A cynical view would be that disclosure of the wrongdoings has caused more damage to Olympus than the wrongdoings themselves. From the short-term perspective of the shareholders' interests, this may be so. However, this kind of cover-up cannot be in the long-term interests of Olympus, or generally of any company, and is certainly damaging for the international reputation of Japanese companies. Still, the Olympus incident may adversely affect the chances for having more outside directors in Japan, because it sent a warning to the business elite of what may happen if

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115 C. AHMADJIAN / A. OKUMURA, Corporate Governance in Japan, in: Mallin (ed.), Handbook on International Corporate Governance: Country Analyses (2nd ed., Cheltenham 2011) 252.

116 In fact, Woodford was not an outsider, but he was employed on a long-term basis at Olympus, C. AHMADJIAN / A. OKUMURA, *supra* note 115, 252.

117 "Big Trouble in Tokyo," The Economist, 12 November 2011, available at *http://www.economist.com/node/21538154*, last retrieved on 14 May 2013.

independent-minded persons take high positions in the management.[118] Having outsiders as key decision makers also contravenes the traditional decision-making process based on *nemawashi*[119] and *ringi-sho,*[120] where the key role is played by a consensus rather than by individuals.

Another related practice in Japanese companies is that the president of a company (*shachō*) chooses his successor, which contravenes the express provisions of the Companies Act 2005. As in a number of other cases, this informal practice based on Japanese business culture prevails in practice over the formal legal norms. It is easy to imagine that a powerful *shachō* would consider the role of nomination committees as interference with his right to select his successor, notwithstanding the fact that formally he does not have such a right.

It can be presumed that non-legal norms will continue to act as a hindrance to the convergence of corporate governance, despite legal reforms. No legal reform can easily change the traditional ways of doing things, such as *nemawashi.* How then can the Japanese model converge with the US one when the process of making decisions remains quite divergent? Also, it may not be easy to adopt reform providing for introduction of the nomination committee, which would deprive the president of the power to select his successor. Even if such a reform is adopted, it would probably not bring to an end the existing informal practices; they are deeply rooted in the Japanese way of doing things and cannot be changed overnight through legislation.

2. Business Elite

Cultural factors posed a particularly strong obstacle to reforms when they were aligned with the interests of the business elite. This can be viewed from a different perspective, suggesting that cultural arguments were used as rhetoric to mask the actual interests of the business elite that opposed the changes.

The opposition to outside directors is, in fact, related to the interests of the business elite rather than being determined by cultural factors, even though such an attitude fits cultural patterns toward outsiders. Why would powerful senior managers adopt a system that would reduce their power by placing some key decisions under the authority of

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118 "Back to the Drawing Board," The Economist, 3 November 2012, available at *http://www.economist.com/news/business/21565660-after-olympus-scandal-japan-inc-wants-less-scrutiny-back-drawing-board*, last retrieved on 14 May 2013.

119 *Nemawashi* literally means "digging around the roots of a tree to prepare it for a transplant." It represents an informal process of decision-making by talking to the people concerned, gathering support in order to reach a consensus; see *http://www.japanese123.com/new_page_2.htm*, last retrieved on 15 May 2013.

120 A *ringi-sho* is a circulation document used to obtain agreement, so that by taking part in the decision-making process by all relevant persons a common decision based on consensus can be reached; see *http://www.japanese123.com/ringisho.htm*, last retrieved on 15 May 2013.

outside directors? The importance of this aspect of Japanese business culture may prove to be a stumbling block for a system of external control based on outside directors.[121]

In this context, the attention can be drawn to actions taken against activist shareholders who openly challenged the traditional system. Some of them are sentenced to prison terms for corporate crimes,[122] which is quite unusual in Japan. Such harsh sentences might be interpreted as a warning message, though the Japanese court system is independent enough to prevent it from being exploited for such purposes.

The business elite as the main beneficiary of the existing system is probably the strongest opponent to changes that would mean stricter monitoring and enhanced transparency. The business elite opposes legislation that would lead to a more transparent way of doing things in corporations and any reform that would reduce the power and autonomy of managers. So far the business elite has been able to stall real reform that would go in that direction.

Managers and the business elite played an important role in designing legal reforms. *Keizai Dōyū-kai, Keidan-ren*, and similar business associations exercise pressure to preserve some of the key features of the traditional model. The result of this pressure was the optional model adopted in the text of the Company Act. *Keidan-ren* in its interim report published in 2009 argued for maintaining the present framework of corporate governance and expressed opposition to the idea of imposing formal requirements for independent directors.[123]

The reaction to the interim report of the MOJ, which provided for a more drastic move toward "global standards," can serve as an illustration of the attitude of the business elite toward the changes. Yasuhisa Abe, director of *Keidan-ren'*s business infrastructure bureau, was quoted as saying on the MOJ proposal of reform: "We will smash it!"[124] As will be shown below, the proposal may not have been smashed, but it has been watered down.

3. Legal Transplant Effects

A note of caution is needed when legal norms and principles, as applied in one country, are transplanted into the legal system of another. In a new environment, legal transplants may behave in a different way from the place they were originally created. People often

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121 This is illustrated by the extremely small percentage of Japanese companies that have adopted the US-style board structure, which requires a minimum of two outside directors.

122 The Supreme Court decision of April 25, 2011 finalized the 30-month prison sentence for Takafumi Horie; "Horie's Jail Sentence Finalized," The Japan Times, 22 May 2011, available at *http://www.japantimes.co.jp/text/nn20110522a3.html,* last retrieved on 15 May 2013.

123 NIPPON KEIDAN-REN, Towards Better Corporate Governance, 14 April 2009, available at *http://www.keidanren.or.jp/english/policy/2009/038.pdf*, last retrieved on 15 May 2013.

124 L. SIEG / Y. KUBOTA, Analysis: Little Appetite in Japan for Major Post-Olympus Reform, Reuters, 12 December 2011, available at http://www.*reuters.com/article/2011/12/12/us-olympus-governance-idUSTRE7BB0HN20111212*, last retrieved on 15 May 2013.

wrongly assume that "if rules are made to resemble each other something significant by way of rapprochement has been accomplished."[125]

The assumption that the transplanted model is identical with the model used in practice is often wrong. In order to have an effective legal transplant, the law has to fit well in the new environment, so that it can be absorbed by the society and implemented into practice. Otherwise, the so-called "transplant effect" may be expected, which means that the law transplanted in this way would not be widely used, at least in the initial period. As Alan Watson stated, "[t]he act of borrowing is usually simple […] building up a theory of borrowing on the other hand, seems to be an extremely complex matter."[126] Most typically, effects of legal transplants are not felt immediately, as time is needed to digest foreign legal concepts.

One possible explanation of the slow adoption of legal transplants in the case of Japan and some other countries in East Asia is that the Western law is based on concepts that are, to a certain extent, alien to the traditional norms of those societies. The key features of Western culture that influenced its legal culture are individualism and rationalism. Individualism means that the personal autonomy and rights of individuals must be protected, often against the larger group, the state, and the society. This idea is in fundamental contradiction to the idea of collectivism and submission of an individual to the community, which is a typical feature of Confucian philosophy. Dan Henderson argued that for Americans, "individualism means legalistic rights implemented by justiciable law, lawsuits, and lawyers," while the Japanese "are normally submerged in, and highly disciplined by, their social groupings, family, school, company, nation, and the like outside the justiciable law."[127] This may explain why legally non-binding administrative guidance used to be such an effective instrument in Japan and why the role of bureaucrats was so important; on the other hand, the Americans rely more on law, lawsuits, and lawyers. The fact is also that Japan is increasingly moving away from the informal norms and is aiming to rely more on "law, lawsuits, and lawyers."[128]

Under the concept of rationalism, the conduct of people should be governed by the rule of reason, meaning an objective standard of conduct based on reality and usefulness. In the Japanese context, rationalism has a different meaning and is related to "*giri*"

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125 J. MERRYMAN, On the Convergence (and Divergence) of the Civil Law and the Common Law, in: Cappelletti (ed.), New Perspectives for a Common Law of Europe (Leiden 1978) 223.

126 A. WATSON, Aspects of Reception of Law, in: American Journal of Comparative Law 44 (1996) 335.

127 D. F. HENDERSON, Security Markets in the United States and Japan: Distinctive Aspects Molded by Cultural, Social, Economic, and Political Differences, Hastings International & Comparative Law Review 14 (1990/91) 263, 264.

128 See T. GINSBURG / G. HOETKER, The Unreluctant Litigant? An Empirical Analysis of Japan's Turn to Litigation, Journal of Legal Studies 35 (2006) 31.

– a kind of obligation that arises from a social interaction with other persons.[129] Baum and Schaede argue that "law in Japan does not rule as much as it provides a rather loose framework" and that what appears to be consensus finding is really "a rational give-and-take process."[130] It can be added to this argument that this "rational give-and-take process" is, in fact, relational and that rational and relational are intertwined in Japan; the give-and-take process, in fact, indicates that "rational" is understood as "relational." The same pattern of rational-relational is applicable to cross-shareholding, main bank, long-term employment, and business-government relations, as each of them is based on long-term relationships that involve the give-and-take process.

The rationale of regulation in Japan is also different than in the West. For example, in contrast to the US, there is not much of a concern about free-market theory. In Japan, regulation is merely a tool to achieve certain goals. Regulations are driven by specified goals, and behavior is guided by goals rather than by ideology. Of course, regulation has a similar function in the West. What is different is that Japanese regulators give more attention to consultation and cooperation between government and business to ensure smooth implementation of stated goals and bring changes in a way that would not cause unwanted rocking of the boat. This is a third way, the Japanese way. As Milhaupt wrote, "Japan does support the conclusion that how a country *adapts* its laws to current needs is far more important than how and from whom it inherits them."[131] I would just replace "adapts" by (or add) "implements," but the essence is in Milhaupt's words.

These differences in the way the law functions derive from a contrast between the law-driven Western model and the relationship-driven Japanese model. They help explain why the transplantation of Western law into Japanese society resulted in a Japanese legal system that functioned very differently from its Western counterpart.

Even when a legal transplant is not absorbed completely, some effect is created. In the context of corporate governance, while a majority of companies have decided not to adopt the committee model, legal reforms have still made some impact on those companies. Many of those companies have introduced a number of changes that are similar to the committee model; most of them have reduced the size of boards and some of them have introduced executive officers, separating management from monitoring, while some of them have increased the number of the outside directors.

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129 For a detailed explanation of *giri,* see Y. NODA, Introduction to Japanese Law (Tokyo 1976) 174–183; also M. DEAN, Japanese Legal System (2nd ed., London/Sidney 2002) 17–20.

130 See BAUM / SCHAEDE, *supra* note 41, 617.

131 C. MILHAUPT, Historical Pathways of Reform: Foreign Law Transplants and Japanese Corporate Governance, in: Hopt / Wymeersch / Kanda / Baum (eds.), Corporate Governance in Context: Corporations, States and Markets in Europe, Japan and the US (Oxford 2006) 71.

4. Lack of Consensus

While in Japan there is a broad agreement on the need to reform, there is also disagreement about the scope and goals of the reform. One of the major factors that contributed to the slow pace of reforms was disagreement as to what was the most suitable form of corporate governance.

Reforms were slowly adopted and implemented. According to Shishido, the reason for this has been that the reforms have been "policy pushed" rather than "demand pulled."[132] Policy-push reforms are launched by the legislature to change the market practices, while demand-pull reforms are initiated by the business sector to get approval of new practices that were not possible under the existing rules. Policy-push reforms typically did not have a strong impact on the business practice, with some exceptions, while demand-pull reforms were far more successful.[133] Demand-pulled reforms came mainly from the management of large corporations, typically through *Keidan-ren*, which is a business lobby group.

The impression is that sometimes coordination among various parts of the government was lacking and ministries were promoting their own goals, which probably reflected different interests behind the scenes and a lack of consensus among various actors belonging to the political and business elite. METI has been actively involved in corporate governance reform, often working together with the business community: It has supported a number of market-oriented reforms, which represented "demand-pulled" reforms. On the other hand, MOJ mainly supports "policy-pushed" reforms. So, there is a kind of competition within the government (which might be just apparent and not real!).

The Interim Proposal on the Revision of the Company Act prepared by the Legislative Council of the MOJ can serve as an illustration of the problems caused by the lack of consensus.[134] Part 1 of this report contained proposals related to corporate governance. Proposed changes included the right of shareholders to sue board members at subsidiaries and stricter requirements for the independence of external board members.

The proposal for revising the corporate law launched by MOJ included "a separate proposal not to amend the existing corporate law in the face of objections from the business sector."[135] While MOJ apparently aimed at deeper reforms, it was expected that

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132 Z. SHISHIDO, Reform in Japanese Corporate Law and Corporate Governance: Current Changes in Historic Perspective, in: American Journal of Comparative Law 49 (1999) 653.

133 Z. SHISHIDO, The Turnaround of 1997: Changes in Japanese Corporate Law and Governance, in: Aoki et al. (eds.), *supra* note 75, 313.

134 The text of the Interim Proposal is published on the website of the Tokyo Stock Exchange: MINISTRY OF JUSTICE (Counselor's Office, Civil Affairs Bureau), Interim Proposal concerning Revision of Companies Act (December 2011), available at *http://www.tse.or.jp/english/news/09/b7gje6000000tk7a-att/b7gje6000000tkaj.pdf*, last retrieved on 15 May 2013.

135 "Corporate Law Change Eyed for Investor Suits," The Japan Times, 24 November 2011, available at *http://www.japantimes.co.jp/text/nn20111124a2.html*, last retrieved on 15 May 2013.

the business elite and business associations such as *Keidanren* would try to prevent such reforms or water them down, probably relying on some sections of the government, such as METI.[136] Representatives of the business sector argue that there is no evidence that outside directors would improve corporate governance and performance of Japanese companies, while there is evidence that outside directors were not able to prevent wrongdoings in countries where such a system has been adopted. Ultimately, the Legislative Council did not include the proposal for the compulsory appointment of outside directors, and as an alternative it proposed a requirement for companies that do not have an outside director to disclose in their annual reports reasons why they consider it inappropriate to have outside directors. This is similar to the "comply-or-explain" approach adopted in the UK, and it is very different from the US model. The present proposal falls short of the original idea of more drastic restructuring of corporate governance. It is just another compromise derived from a lack of consensus.

In order for real change to occur, there should be a consensus in society that those informal ways of doing things are outdated and that a new way of doing things is needed. So far, no such consensus has been achieved. This is probably the biggest obstacle to change. One high-ranking employee of an electronic firm was quoted in *The Economist* as saying: "Everyone knows we need to change, and no one can make the changes."[137]

X. POSSIBLE FUTURE DIRECTIONS

The impact of reforms in Japan should not be underestimated, even though the patterns of behavior and structures have not changed much.[138] Despite the persistence being demonstrated by the traditional and informal ways of doing things in Japan, it would be misleading to believe that the Japanese corporate culture remains static and inflexible. There are visible tendencies toward greater convergence with the "global standards," but the elements of divergence persist and the existing differences may lead toward a hybrid system.

1. Potential for Convergence

Retaining the traditional model is no longer a solution. Times have changed. There are new circumstances that made the preservation of the old system unrealistic: the main bank lost its position, cross-shareholding and long-term employment also lost some of

136 METI has established its own Study Group on corporate governance, which produced its report in June 2009. The report takes a cautious approach and warns against replacement of the "outside" requirement by an "independence" requirement; see "The Corporate Governance Study Group Report," Ministry of Economy, Trade and Industry, 17 June 2009, available at *http://www.meti.go.jp/english/report/downloadfiles/200906cgst.pdf*, last retrieved on 15 May 2013.

137 "From Summit to Plummet," The Economist, 18 February 2012, available at *http://www.economist.com/node/21547815,* last retrieved on 15 May 2013.

138 HALEY, *supra* note 74, 7.

their previous importance, and increased investment by foreign shareholders led to new priorities. The changes in these key features of the system that are closely related to each other raise doubts about the feasibility of preserving the traditional model. It might be difficult to have changes in only a few segments of the system and maintain its performance without also changing the other segments that were dependent on these. By having changes in virtually each of the key features of the traditional model, its coherence has been disrupted, and in order to have a viable economic model more drastic changes might be necessary. Since each of the changes moved toward "global standards," the further changes of the whole model are expected to move in the same direction.

With the collapse of the main bank system, and all other elements of the traditional model being affected to a certain degree, the issue is whether the remnants can continue to operate smoothly. When a part of a machine is broken and the same part is no longer available, in order to fix the machine the missing part has to be replaced by a part which can perform the same function. With the power of the main bank diminished and bank loans being replaced by the stock market, the natural consequence should be replacement of the main bank as the monitor by monitoring of shareholders – either through a market for corporate control, or through independent directors, or through shareholder litigation. This naturally should lead in the direction of convergence. However, it should also be pointed out that the role of the main bank in monitoring was rather limited to circumstances when a company was in crisis, so the gap that may appear by the absence of monitoring by the main bank may be relevant only when a company enters a crisis. In any case, with so many key features of the traditional model being challenged, it is beyond doubt that significant changes will have to be made.

Changes in the monitoring of management might provide some material for assessing the potential for convergence. As the ties among the companies and the main banks weaken and cooperation is increasingly replaced by competition, there is a need for a different kind of monitoring that will be more focused on the interests of shareholders. There are some elements which indicate that the Japanese model might move in the direction of the US model with respect to monitoring. One of these changes is a significant shift in the objectives of the managers toward greater priority being given to the interests of shareholders. These changes were caused by a number of factors, including a greater participation of foreign shareholders, but also by a change in Japanese society and an ideological shift toward the rights of property.[139] The increase in the number of derivative suits is an indicator of this change.[140]

The trend to liberalize corporate law logically flows from the global trends to liberalize the economy. Japan is moving toward a market type of capitalism, as the prevailing

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139 R. DORE, *supra* note 75, 371.

140 WEST, supra note 101; H. BAUM / D. PUCHNIAK, The Derivative Action: An Economic, Historical and Practice-Oriented Approach, in: Puchniak / Baum / Ewing-Chow (eds.), The Derivative Action in Asia: A Comparative and Functional Approach (Cambridge 2012), 64–74.

view is that market competition has proven to be a more efficient model than the traditional way of doing things where the state intervened to protect companies. This seems to be inevitable as a result of global trends coming from abroad, but also by internal changes within Japan. These two trends are not really unrelated, though, as internal changes in Japan are also influenced by the global trends. Companies are increasingly exposed to the impact of the market and, as a result, instead of long-term-oriented governance, short-term governance aimed at improving the value of shares may become more important to companies.

The path of change brought by modernization in Japan seems to be different than in the West. In Japan, reforms were based on collective efforts motivated by pragmatic goals rather than an ideology. Most of the reforms related to corporate governance represented imitations of the American model aimed at enhancing performance of the companies, while at the same time preserving the privileges of the business elite. Depending on further developments, those reforms may eventually bring a change from the system based on solidarity and cooperation to the system based on competition, which may undermine the traditional ways of doing things. While there may be no signs of a single event that signals a dramatic institutional change, the cumulative effects of incremental changes are substantial and irreversible; it is the process of gradual changes that will continue.[141]

2. Potential for Divergence

Japan has moved in the direction of the shareholders' model. Still, there are substantial differences in comparison to the US or the UK models. And while there is no doubt that the changes are moving in the direction of the US model, it is not certain how far the changes will go. Should Japanese firms adopt the US model? Not necessarily. Japan lacks some important infrastructure elements that are present in the US, such as effective stock markets and a liquid labor market. The US model cannot function properly without a liquid labor market, and its absence in Japan poses a serious obstacle to the adoption of the US model. Also, there is a continuing opposition toward independent directors, which is one of the essential elements of the US-style model. Powerful actors within the Japanese business elite are unlikely to agree to changes that may undermine their position. Taking into consideration the generally negative perception of the shareholders' model among the population, it is unlikely that the current stakeholder model will convert into a shareholders' model in the near future.

No substantial change in the direction of the US model will happen as long as the main features of the Japanese business culture remain unchanged. It is unlikely that the majority of Japanese companies will adopt the US model company, and even those companies that have adopted it may soon realize that such a model may not be effective

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141 M. AOKI, Whither Japan's Corporate Governance? In: Aoki et al. (eds.), *supra* note 75, 428.

when operating within the traditional Japanese business environment. There will certainly be some adjustments to the Japanese model, but those will probably be more cosmetic rather than radical changes.

Dore argues that a silent shareholders' revolution that occurred in the last decade has undermined the traditional community firm and will eventually lead to its demise. One of his arguments is that there is a growing gap between executives and employees.[142] It is true that the gap in wages has widened. But this does not have to mean that a gap has been created in the relationships between executives and employees. Community consciousness is still strong, "at least among executives and regular employees."[143]

The Japanese corporate governance system will be influenced by labor law legislation and factors such as the level of protection of non-regular employees and the redistribution of resources between regular and non-regular employees and between labor and capital. One possible instrument in retaining the relational model is through labor law legislation, which can limit the power of the shareholders' model. A number of recently adopted laws which reinforced the protection of employees have created an obstacle for a more radical penetration of the shareholders' model. The security of employment for regular employees and the readiness of managers to link their careers to the same company are of essential importance for preserving the traditional model. If these two can be ensured, giving greater protection and a more prominent role to the shareholders would not endanger the preservation of the traditional model. The end of long-term employment and emergence of a market for managers would undermine the traditional model, but that has not yet happened and is unlikely to happen anytime soon.

3. Potential for a Hybrid System

The Japanese business system has become more diversified. The question is whether this is just a temporary stage in transition with the ultimate goal of converging with the global standards to be reached after this stage, or whether this diversity may become permanent. If it is just a temporary stage, then what should be the next stages toward the final goal? If diversity remains permanent, what would be the impact of such diversity on the business system as a whole: is it sustainable to have different forms of corporate governance within the same business system?[144]

Japan has to look for proper balance between protection of shareholders and employees. This may lead toward a competition between diverse models that will focus not only

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142 R. DORE, Japan's Shareholder Revolution, in: LSE Centre for Economic Performance, CentrePiece 3-11 (2006) 22–24, available at *http://cep.lse.ac.uk/pubs/download/CP220.pdf*, last retrieved on 15 May 2013.

143 T. INAGAMI, Managers and Corporate Governance Reform in Japan: Restoring Self-Confidence or Shareholder Revolution?, in: Whittaker / Deakin (eds.), Corporate Governance and Managerial Reform in Japan (Oxford 2009) 182.

144 *Id.*

on profit for shareholders, but also on creating better balance between shareholder and employee interests.[145] Shareholders' interests may have to be addressed in a way that is compatible with the traditional model. A kind of compromise-searching *nemawashi* approach may ensure support of shareholders by giving them some concessions through a compromise rather than confrontation.

In a previous article, I questioned whether Japan may have made a mistake by trying to adopt the US-style model and integrate it in its own system, which is essentially a stakeholder model – in contrast to the US model.[146] My answer: not necessarily. Japan may maintain some of its typical features by creating a kind of hybrid model, which would combine relationship-oriented aspects of corporate governance with a greater role of the stock market.[147] That would not be unusual, as Japan has proven on a number of occasions a capacity to integrate and reconcile contradictory principles; this probably derives from the strong emphasis in Japan on compromise and consensus, as well as a pragmatism typical for this part of the world. Combining some elements of the traditional model with some of the "global standards" may be one possible way to improve performance.[148] Although shareholder and stakeholder systems are often contrasted as two different styles of capitalism, Japan may well be able to create a hybrid system that can integrate elements of both models.

Normally, the goal of reforms is to make things work better. In the case of corporate governance this does not have to mean that the performance of companies will improve by improvement of the position of shareholders. This may work in some countries; it may even work in most countries; but it may not work in all countries. So far there is no evidence that improvement of shareholders' rights has led to improvement of Japanese companies' performance. The strength of the Japanese model that contributed to the Japanese miracle was not in the protection of shareholders' interests – the strength was in the cooperation between various stakeholders, it was in working together for the common benefit. Things have changed, however, and Japan can no longer rely on the old system that many consider outdated. The examples from Japan's neighborhood suggest that better protection of shareholders may contribute to a better performance of the companies.

As indicated above, the lack of consensus represents a serious obstacle for adopting "global standards." On the other hand, this may open the way for a hybrid model based on a compromise. The issue is whether there will be a hybrid model that integrates elements of both models, or whether there will be two models existing in parallel. At the

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145 T. ARAKI, Changes in Japan's Practice-Dependent Stakeholder Model and Employee Centered Corporate Governance, in: Whittaker / Deakin (eds.), *supra* note 143, 251.

146 C. PEJOVIĆ, *La gouvernance d'entreprise japonaise et l'acculturation du modèle américain,* in: Revue International De Droit Compare (R.I.D.C.) (2012) 415, 447.

147 G. JACKSON / H. MIYAJIMA, Change of Corporate Governance in Japan, in: Aoki et al. (eds.), *supra* note 75, 1.

148 H. MIYAJIMA, The Performance and Determinants of Corporate Governance Reform, in: Aoki et al. (eds.), *supra* note 75, 363.

moment, the fact is that there are two models, with a revised traditional model being dominant. This may be a transition stage toward a possible compromise solution in the form of a hybrid model that would have a few, but not a majority of, outside directors, who have better access to the relevant information necessary for enhancing monitoring, which would lead to a further switch toward the shareholders' model. On the other hand, this hybrid model would retain some elements of the traditional model, e.g., long-term employment limited to core employees and, possibly, a revised auditor system. This would meet the expectations of investors related to improved monitoring and disclosure of information, while also satisfying, to a certain extent, the business elite's demand to maintain the present framework. One of the key issues is what kind of compromise can be reached on the issue of outside directors.

The proposal of the MOJ contains, in fact, a third model: the company with a management and auditing committee. As information about this new model is scarce, it is difficult to make an assessment on the character of this type of company, which seems to combine a committee model with statutory auditors, but it might be considered a kind of hybrid model. One possible reason for introducing this new type of company would be to give a boost to the "global standards" following a low adoption of the "committee" model. Another issue is whether this proposal will be accepted and what the reaction of the Japanese companies would be.

4. Changes Are in the Eye of the Beholder

There are different views not only about the prospect for change, but also about the achievements of reforms so far. There are views that ambitiously look at the prospect of change and hope that the law may function in the same way as in the West. There are also more cautious views about actual changes the reforms may bring. The difference is more about the impact of reforms and how far or deep the changes will go, rather than whether there will be a change.

An issue that is open to discussion is to what extent the Japanese legal system has already converged on the US model. There is no doubt that some steps have been made in that direction. However, this does not mean that, today, the law in Japan plays an identical role as in the US, or that corporate governance functions in the same way as in the US.

In the context of corporate governance, a number of issues have to be examined in order to make a proper assessment. Instead of focusing on changes in law, it may be more appropriate to consider the changes in practice. For example, do the BOD and the meeting of shareholders perform their functions in the same way as in the US? Do they strictly follow legal norms, or are they still under the influence of informal bodies and practices, such as *jōmukai* and *nemawashi*? Have *keiretsu* and the Japanese pattern of long-term employment ceased to be important features of Japanese corporate governance? Until clear evidence is produced that such informal bodies and practices have ceased to play an important role in Japanese corporate governance, the argument that the Japanese model operates in the same way as in the US will remain questionable. Much

depends on the angle from which the process of convergence is observed and whether the focus is on the changes made so far or on the hindrances to change; the level of convergence is in the eye of beholder.

XI. CONCLUSION

Japan's corporate governance history demonstrates a continuous importation of foreign models but also deviations from these models in practice, representing a peculiar combination of elements of convergence and divergence. Legal regulation of corporate governance in the postwar period in Japan has been continuously influenced by the US model. In the same period, the way corporate governance functioned in practice has significantly deviated from the US model. Differences were not only in particular features of Japanese corporate governance, such as the main bank system, *keiretsu*, and long-term employment. The model of capitalism in Japan is also different from that in the US, as shareholding in Japan has a different logic and structure.

The differences between the US and the Japanese model derive from differences in historical and social conditions in which these two systems of corporate governance have developed and operate. In principle, it is very difficult to implement legal reforms that would transform the stakeholder (manager) model into a shareholder model. The social role of corporations is too deeply rooted to be easily changed. A better approach would be to adopt only those elements of the US model that can be easily integrated and would contribute to the greater efficiency of the Japanese model. In fact, at least to a certain extent, Japan has already used this approach by giving options between the "committee" and the "auditor" systems.

The question is whether behind the façade of Westernization Japan has undergone a significant transformation and whether she has accepted the idea of law and justice as they are understood in the West. It can be argued that there is a friction between the imported Western legal system on one hand and traditional Japanese values on the other. This friction may not, however, be as strong as some people may think. In line with the "*wakon yōsai*" slogan, Japan has made a successful merger of Western legal concepts while at the same time preserving its own traditional values. While the globalization process has had an impact on Japanese society and the attitudes of Japanese people, some distinctly different Japanese attitudes have continued, and will continue to exist and influence various aspects of Japanese society, including the way in which corporate governance functions in practice.

Japan will have to make further changes in its corporate governance model in order to cope with the new challenges in this increasingly globalized world. The changes are necessary not only in law but also in practice, as Japan has already lost some ground in term of economic competitiveness with countries in East Asia, such as South Korea and China, which have taken much bolder measures to restructure their corporate govern-

ance systems. Of course, corporate governance is not the only important factor that plays a role in the economic success of a country, but it is undoubtedly an important one.

There is a consensus of the need for change, though there are still disagreements of the way or the scope of the change. While the trend of change toward "global standards" may not be reversible, Japan may have to reconsider the scope of change and to what extent it should adopt "global standards." After all, Japan's success has not been based on those standards, but on a genuine Japanese model. The Japanese type of companies and their environment may not be suitable for US-type standards. Japanese managers are still a product of a long-term employment system, and in Japan there is not yet a developed executive labor market. The widening income gap between managers and workers is not really something that can make the company more efficient and better. What can be done and should be done is in the area of transparency, as this may contribute to a better image and performance of the Japanese companies.

From a broader perspective, it is essential to have an adaptable legal framework that allows flexible implementations of diverse measures taken by companies. As long as different ideas with respect to corporate governance persist, individual companies should be able to choose voluntarily what governance organizations they want to take. What is even more important is to ensure that adopted changes are fully effective and are directed toward substantiality rather than formality. Japan has had enough of cosmetic changes that create the impression of change; what is really needed are the changes that will be effective and will bring positive results.

Japanese corporate governance is changing in a significant and often unpredictable way. The existing uncertainty is more about the scope and pace of change rather than whether the changes are necessary and in what direction the changes will move. Based on the assessment of various factors analyzed above, it can be expected that in the coming years, the non-legal norms will gradually weaken at the expense of the increased importance that will be given to the formal legal norms. It can also be predicted that the changes will be gradual rather than radical. The way changes occur in Japan represents a pragmatic adaptation to the new circumstances without undermining the basic structure; the Japanese way of change represents "continuity under change" rather than a convergence with the US or any other system.[149] In Japan, traditional and modern values co-exist in apparent harmony or apparent contradiction, depending on the angle of observation. According to traditional wisdom, in Japan things are not often what they appear to be. The Japanese model so far has maintained its distinctive character despite all changes.

149 U. SCHAEDE, Change and Continuity in Japanese Regulation, in: ZJapanR / J.Japan.L. 1 (1996) 21.

SUMMARY

Corporate governance may be analyzed from different perspectives, one of which is its legal aspect. Instead of examining legal norms that regulate corporate governance, this paper analyzes the relationship between non-legal norms and corporate governance, focusing on the influence that non-legal norms have on the way corporate governance functions in Japan. The objective of this paper is to examine the reasons for deviations from the American corporate governance that has been used as a model in the postwar period in Japan. In fact, this research belongs to the area of comparative law because it relates to the issues of legal transplants and world legal cultures. Japanese corporate governance is used mainly as a case study. The goal of the research is wider than simply analyzing Japanese corporate governance; it is hoped that the results of this research will be applicable to other segments of the Japanese legal system and be helpful in analyzing the role of both legal and non-legal norms in Japanese society. A further goal is to explore the need for giving more attention to law and society, and to an inter-disciplinary approach to legal research. By exploring new research agendas, the research horizon can be expanded, and it is hoped that this paper may contribute to achieving that goal.

ZUSAMMENFASSUNG

Corporate Governance kann aus verschiedenen Blickwinkeln betrachtet werden, unter anderem aus rechtlicher Sicht. Anstatt Rechtsnormen zu untersuchen, welche Corporate Governance regeln, analysiert dieser Beitrag die Beziehung zwischen nicht-rechtlichen Normen und Corporate Governance. Der Schwerpunkt liegt dabei auf dem Einfluss nicht-rechtlicher Normen auf die Funktionsweise der Corporate Governance in Japan. Ziel des Beitrags ist es, die Gründe für Abweichungen vom US-amerikanischen Modell der Corporate Governance zu untersuchen, welche in Japan in der Nachkriegszeit als Vorbild diente. Die Untersuchung fällt dabei in der Tat in den Bereich der Rechtsvergleichung, da sie mit den Fragen der Transplantation von Recht und den verschiedenen Rechtskreisen dieser Welt zusammenhängt. Die japanische Corporate Governance wird hierbei hauptsächlich als Fallstudie verwandt. Der Zweck der Untersuchung geht über die bloße Analyse der japanischen Corporate Governance hinaus, und es besteht die Hoffnung, dass die Untersuchungsergebnisse auf andere Bereiche des japanischen Rechts anwendbar sind und dabei helfen können, die Funktion rechtlicher wie nicht-rechtlicher Normen in der japanischen Gesellschaft zu analysieren. Ein weiterer Zweck ist es, den Bedarf für eine vermehrte Befassung mit Recht und Gesellschaft und dem interdisziplinären Ansatz in der rechtlichen Forschung zu ermitteln. Durch die Erschließung neuer Forschungsziele kann der Forschungshorizont erweitert werden, und dieser Aufsatz kann hoffentlich zur Erreichung dieses Ziels beitragen.

(Übersetzung durch die Redaktion)