

BERICHTE / REPORTS

Conference

“Independent Directors in Japan and Other Major Asian Jurisdictions”

Berlin, 17 and 18 July 2014

A steady trend towards ever more “independent” directors on the boards of companies has dominated the recent development of corporate governance. But, apart from branding, is there a conversion towards one globally applicable model? Does the introduction of independent board members necessarily constitute the best solution? And what exactly is the role these directors are meant to play in the corporate structure? The most recent reform of the Companies Act in Japan had inspired the Max Planck Institute for Comparative and International Private Law (MPI), the German-Japanese Association of Jurists (DJJV), and the Japanese-German Center Berlin (JDZB) to invite renowned scholars in the field of comparative commercial law from eight jurisdictions of the Asian region to a two-day public conference in Berlin on 17 and 18 July 2014.

Following introductory remarks by the Secretary General of the JDZB, Dr. Friederike *Bosse*, the Head of the Department of Japanese Law at the MPI, Prof. Dr. Harald *Baum*, and the President of the DJJV, Dr. Jan *Grotheer*, Prof. Souichirou *Kozuka* (Gakushūin University, Tōkyō) chaired the first part of the conference. He sought to provide a general introduction and theoretical framework of the concept of board independence. Prof. *Kozuka* emphasized that the goal was to enable participants to engage in discussions on the core issues instead of merely comparing different legal rules. Prof. Georg *Ringe* (Copenhagen Business School) then began the debate. He presented his critical view on the general trend towards an increasing number of independent directors, especially on – but not limited to – boards of US companies, despite their having proven to be “at best not very helpful” during the financial crisis. His call for a more functional approach towards independence and the agency problem provided the stage for a lively discussion moderated by Prof. *Kozuka*. Comments extended to the closely connected issues of board diversity, substitute models and the role of institutional investors, as well as the impact of ownership structures on the functioning of the board.

After a short break, Prof. *Baum* (MPI, Hamburg) provided the historical and comparative context of independent board membership in a highly engaging fashion, linking the agency problem back to the origins of the company as a business entity. He elaborated on the particular role of the corporate scandals that had triggered the call in the USA for independent directors as monitors. While the concept of boards had originated in Western Europe, promotion of independence spread from the USA throughout the rest of the world. The discussion which followed particularly dealt with the question of how the

concept of independence came to be accepted by the different stakeholders affected, and also covered the different legal mechanisms for promoting independence. Prof. Dan W. Puchniak (National University of Singapore) highlighted some of the different functions independent board members can perform (apart from monitoring), depending on the institutional preconditions.

After lunch, two presentations provided an understanding of the corporate governance structure in the Asian region, thereby narrowing the focus and preparing the ground for country-specific analyses. The first presentation was given by Prof. Kim Kon Sik (Seoul National University), who compared the typical share ownership structures of Japanese, South Korean, Taiwanese and Chinese companies. He not only provided important and detailed background information, but also illustrated the particular challenges encountered by each jurisdiction despite their economic, cultural and historical similarities. Prof. Puchniak and Prof. Luke Nottage (University of Sydney) extended the geographical scope of the conference by considering Hong Kong, India, Singapore and Australia. Prof. Puchniak's enthusiastic talk sought to show that, in terms of corporate governance structure, a generalization oriented at the antagonist division between common law and civil law jurisdictions would fall short of reality. Prof. Nottage took the opposing view. Notwithstanding the need to take into account the particularities of each jurisdiction, he identified similarities among countries of the same tradition, and pointed out the merits of considering the issues by grouping common law and civil law countries together.

Part two of the conference was titled "Focus Japan" and was chaired by Prof. Puchniak. It consisted of three more detailed presentations on the Japanese situation. They were set against the background of the reform of the Companies Act that had been passed as recently as 20 June 2014. Prof. Manabu Matsunaka (Nagoya University) gave an introductory empirical analysis of the specific development of independence on boards in Japan. Together with his co-author, Prof. Kozuka, he argued that Japan was experiencing a slow but steady shift from the traditional management role of the board to the monitoring model. This trend had reached its preliminary zenith with the adoption of the "Company with an Audit and Supervisory Committee" by the newly reformed law, providing stock corporations with a third option for their legal structure. Prior to this, companies had (since 2001) the choice between the traditional Japanese model and a "Company with Committees" model, similar to the US corporate legal structure. As a member of the respective reform subcommittee, Prof. Gotō (University of Tōkyō) provided a rare insider's view on the drafting process leading up to the recent reforms. He explained why the Japanese legislators had finally decided to implement a comply-or-explain approach with regards to the nomination of at least one "outside" director to the board of a listed stock corporation, but no mandatory requirement. Prof. Gotō also stressed that "outside" might not necessarily mean "independent." A compelling case study on the widespread resistance of major Japanese corporations against outside monitoring by Prof. Bruce Aronson (Hitotsubashi University, Tōkyō) paved the way for a summary discussion of the foregoing presentations. One major question was how Ja-

pan's "insider-based" governance system is compatible with an external corporate governance tool such as outsiders on the board.

The second day of the conference was opened by Prof. *Nottage*, chair of the following first round of country analyses. Prof. Kyung-Hoon *Chun* (Seoul National University) gave his view on the South Korean situation. While over time monitoring had come to be the dominant function of company boards, it was important to distinguish between the law on the books and the law in practice. There had been a statutory requirement for a majority of independent directors for listed companies since the late 1990s. However, more and more of these directors had come to be former government officials tending to fulfill a more relational role and thereby contradicting the intention of the legislative branch. The ensuing discussion revealed that Korea traditionally featured an institution similar to the Japanese *kansa-yaku* system, most commonly translated as statutory auditors. When foreign investors pushed for the introduction of an audit committee, business organizations unsuccessfully tried to defend the old model. Prof. *Aronson* pointed out that the *kansa-yaku* in Japan might be efficient when it comes to compliance monitoring, but were generally seen as an ineffective tool regarding performance monitoring.

Prof. Ying-Hsin *Tsai* (National Taiwan University) and Prof. Hsin-Ti *Chang* (National Taipei University) presented their paper on Taiwan, co-authored by Prof. Yu-Hsin *Lin* (National Chengchi University). Like Japan, Taiwanese companies may choose from different corporate structures. According to the authors, one of the major problems lay in the division of labour between independent directors and statutory supervisors, again an institution somewhat comparable to the *kansa-yaku* in Japan. Since ownership structure was concentrated and companies were most often family-owned, one might expect the board to monitor corporate activities for the protection of minority shareholders. However, the authors went on to explain, boards in Taiwan performed a rather executive role. Moreover, the authors pointed to a survey which reveals that a high percentage of so called independent directors had close ties with the controlling shareholder. This situation exemplifies the problem of transplanting a single legal mechanism into a different legal environment. It shows that different functions of directors and interdependence with ownership structures are at the core of the issue, but also that there is by no means a universal understanding of the term "independence."

After a short break, Prof. *Tang* continued with his take on the state of corporate governance and the concept of independence in mainland China. Against a background of dominant majority shareholders and weak institutional investors he identified undeveloped market mechanisms and weak market ethics coupled with poorly defined duties and enforcement problems as the main challenges facing China's corporate governance system. Regarding board independence, legal rules feature different independence levels, while the nomination of independent board members only requires the absence of financial relations with the company. Prof. *Chang* declared the question of the courts' ability to examine performance of directors *ex post* as the most significant issue brought by China to the conference and opened up the debate.

Following lunch, Prof. *Baum* chaired the second round of country analyses. Prof. *Vivienne Bath* (University of Sydney) started off by reporting her experience with Hong Kong. After explaining Hong Kong's regulatory background as being significantly shaped by its former status as a UK colony, she identified controlling shareholders and their monitoring as a key issue. Many companies had boards of which independent directors comprised at least a third but, only in singular cases did companies have a majority of independent directors. In addition to common issues that had already been carved out, Prof. *Bath* added the role of the nomination committee and the nomination process to the debate. The organization of this process and, in the case of Hong Kong, the lack of a cumulative voting system, played a decisive factor in shaping the actual role and performance of independent board members.

In India, in contrast to most or all other jurisdictions represented at this conference, companies themselves had exercised pressure on the legislator to impose mandatory rules on independent directors for attracting foreign investment. Prof. *Vikramaditya Khanna* (University of Michigan) explained that only the latest reforms of 2013 and 2014 were spurred by corporate scandals. At least for India, however, not much monitoring could be expected from independent directors. Prof. *Khanna* also emphasized that future research should give more attention to ownership structures to precisely stipulate the role of independent board members and enable monitoring limited to certain areas, if possible. He also drew attention to a possible trade-off between independence and the expertise necessary to perform meaningful monitoring. Moreover, the best candidates might be deterred by high liability and low pay.

Prof. *Puchniak* gave an interesting talk on Singapore, a country which has adopted the US concept of independent directors in its pure form. For example, there is no stipulation regarding independence from controlling shareholders even though shareholdings are concentrated. Prof. *Puchniak* elaborated on his view that the regulator had refrained from implementing such a stipulation by design. In his opinion, the legislator had done so in order to signal compliance with the dominating independence paradigm while at the same time letting families and government keep their structures. At first blush this seemed to prevent independent directors from performing any meaningful work. In practice, however, independent board members had an impact through either a mediating or advisory role in family-owned businesses or through monitoring in companies where the government as a controlling shareholder followed a "hands off" approach. A new code, said to be triggered by a fear of Chinese companies entering the market, requires independence from controlling shareholders, but still contains loopholes. Drawing conclusions, Prof. *Puchniak* also emphasized the relevance of shareholder structures, and made clear that these not always aligned with the definition of independence. Speaking of "faux" convergence, he stated that Singapore had a good working corporate governance system – although not for the reasons for which she is highly regarded – but for alternative solutions.

Australia, being a continent of her own, but lying in the Asia-Pacific region, was the last of the countries to be presented. Prof. *Nottage* introduced her corporate governance structure as being traditionally characterized by fairly concentrated shareholdings. Nevertheless, independent board members tended to be elected by controlling shareholders. Talking about the board of directors, historical milestones and the current definition of independence in Australia, Prof. *Nottage* hit upon another important issue: empirical data on board independence. Although there were, at best, mixed results regarding the positive effect of independent directors on firm performance and certain board actions, a return to the past, at least for Australia, might not be a feasible option. This aspect, once again, stressed the importance of the regulator's function in clarifying the intended role of independent board members as well as the need for further extensive empirical work.

With the conference drawing closer to its end, Prof. Moritz *Bälz* (Goethe University, Frankfurt) chaired the concluding panel discussion. He confronted the panel with a challenging question: "After these two days, can we be more specific than saying that independent directors are, most often, a monitoring device which, in its form and function, is dependent on the institutional environment?" The comments which followed made it clear that there is no single independent director mechanism transferable to different jurisdictions and functioning in the same fashion wherever applied. What certainly exists, however, are cross-themes, which were identified during this conference. Even though different institutional environments and complex corporate and financial market structures limit meaningful comparative work to some extent, the conference succeeded in identifying the common factors influencing the role and efficiency of independent board members in different jurisdictions. In conclusion, future research on the topic should take a step back from the US monitoring model and concentrate further on core issues such as the precise function to be played by independent directors, the influence of the ownership structure, and substitute mechanisms.

Michael Pfeifer und Torsten Spiegel***

* Research Associate, Goethe University, Frankfurt a.M.

** Research Associate, Max Planck Institute for Comparative and International Private Law, Hamburg.

