Do Corporate Law Reforms Increase Profitability?

The Japanese Context

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I. Introduction: A Goal for Japanese Corporate Governance Reforms

This article gives an overview of the Japanese Companies Act Reform as well as new soft laws in Japan, namely the Corporate Governance Code and the Stewardship Code. Originally, a new bill containing reforms of the Japanese Companies Act Reform had been scheduled to be published during the ordinary parliamentary session in January 2019. However, the majority political party, the LDP, gave up on submitting it at that time because Japan had another election for the Upper House in July, and the LDP wanted to prepare for the election. Therefore, the bill has not yet been published, with only the outline proposal having been published last January.[1] Consequently, this article cannot introduce the unpublished bill.

This article will nonetheless introduce the fundamental goal behind the Companies Act Reform and behind the Corporate Governance Code and the Stewardship Code in Japan. As is true in most countries, there are various ongoing discussions relating to corporate governance. However, the goal of Japanese reforms might be different from the goals voiced in European discussions. In addition, recent reforms are also of a different nature than traditional Japanese reforms. This article highlights these differences.

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1 *Kaisha-hō kaisei yōkō-an* [Proposal for Companies Act Reform (relating to Corporate Governance)] (16 January 2019) available at *http://www.moj.go.jp/shingi1/shingi04900394.html.*

Generally speaking, the goals of corporate governance can be classified into two categories: 1) Compliance and 2) Efficiency.[2] The incumbent cabinet led by Prime Minister Abe has set the second of these two categories – and in particular the included aims of increasing corporate income and innovation – as the primary goal of corporate governance reforms.

Prime Minister Abe has made restoring Japanese companies' ability to earn profits as one of the most important agenda items since commencing his second term of prime minister in 2012.[3]

Most any European knows of Toyota and Honda, both of which are Japanese companies which have succeeded in their business around the world. These companies were highly innovative from the 1960s to the 1980s, and their names became familiar all over the world.

By contrast, nobody hears about innovative Japanese companies in 2019. The word innovation probably leads people to think of GAFA: Google, Amazon, Facebook and Apple. All of them are US companies. These days, Chinese companies, like Baidu, Alibaba, and Tencent, are also famous. Conversely, nobody recalls any Japanese companies today.

This means that Japan continues to suffer from a lack of innovation and from the economic downturn. Presently, Japanese companies are failing to innovate and launch new businesses. This is one of the largest problems facing Japan. This problem has been endured by the Japanese government since the 1990s after the bursting of the economic bubble.

Accordingly, the current Japanese government is trying to promote and restore innovation in Japanese companies through corporate governance reforms. This might seem strange, because generally speaking legal rules can only lead to compliance. By contrast, the free market is seen as having the capability to increase efficiency and trigger innovation.

In addition, and relatedly, the Japanese government has emphasized efficiency in the sense of income. Specifically, efficiency can be paraphrased as increasing profit. Profit is the result of income minus costs. Corporate governance could reduce costs by, for instance, restraining managers from

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2 G20/OECD Principles of Corporate Governance (2015), I.A. requires efficiency and I.B. requires compliance (rule of law). The American Law Institute's Principles of Corporate Governance: Analysis and Recommendations (1992) set enhancing corporate profit and shareholder gain as a goal of the corporation at § 2.01 (a). The Principles also set acting within the boundaries set by law as another goal at § 2.01 (b)(1). As understood in this article, the former refers to efficiency and the latter refers to compliance.

3 *Nihon saikō senryaku kaitei 2015* [Growth strategy revised in 2015] (30 June 2015) *(http://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/honbunJP.pdf)* at 4, and *Nihon saikō senryaku kaitei 2014* [Growth strategy revised in 2014] (24 June 2014) *(http://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/dai1jp.pdf)* at 4.

wasting corporate assets. Authors routinely write that the goal of corporate governance is reducing "agency costs".[4] "Agency costs" are the most typical example of corporate costs. However, we usually think that increasing income and achieving innovation can be done solely through the market.

Increasing income and innovation requires not just a free but also a fair market. Generally, a fair market is designed mainly by anti-trust law and securities law, but it is not related to tightening the Companies Act. To the contrary, tightening the Companies Act would, generally speaking, seem to create an adverse effect on increasing income and innovation.

Therefore, the Japanese government at first implemented "de-regulation" to respond to this problem. Beginning in 2000, the Companies Act implemented various acts of de-regulation.[5] It launched various new M&A methods (spin-offs, stock swap mergers, and cash-outs), and it abolished various strict restraints for stock options and stock repurchases.

However, Japan failed to launch innovations even in that period. There is little room in corporate governance for de-regulations. Subsequently, the Japanese government started to plan a tightening of corporate regulations for corporate income and innovation. One example is encouraging companies to introduce independent/outside directors. Similarly, the Companies Act Reform 2014 introduced a new regulation requiring listed companies to give reasons if it does not have any outside directors (Art. 327-2 Companies Act). Rules of this nature are not designed for compliance but for efficiency and increasing profit (See, Part IV.).

This goal is one difference in today's reforms as compared to earlier reforms in Japan.

However, one big question remains: Do corporate law reforms increase profitability? This is the title of this article. Put differently, does corporate governance matter? It is apparently one of the academic goals voiced around world. In the Japanese context, the question becomes "do corporate law reforms increase income and innovation?"

In Japan, this problem gathered large attention in connection with Professor Kenjiro Egashira's paper, though this problem had also already been discussed to some extent in the past. Its suggestive title was "Corporate law reform cannot change Japanese companies".[6] He clearly pointed out that

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4 R. KRAAKMAN et al., The Anatomy of Corporate Law: A Comparative and Functional Approach (3rd ed., Oxford 2017) 2.

5 M. NAKAHIGASHI/H. MATSUI (eds.), *Kaisha-hō no sentaku* [The Choice of Companies Act] (Tōkyō 2010).

6 K. EGASHIRA, *Kaisha-hō kaisei ni yotte nihon no kaisha ha kawaranai* [Corporate law reform does not change Japanese companies at all] Hōritsu Jihō 86 (11) (2014) 59, 59.

tightening corporate law cannot change Japanese companies at all. Rather, he showed that the cause of a lack of innovation was the Japanese companies' managers' abilities. Traditionally, managers of Japanese listed companies have often been chosen from among employees. Most of them are usually good at balancing the interests of stakeholders but not good at taking business risks geared to innovation.

Thus, it is the managers of listed companies who are to be blamed for Japan's economic downturn. In fact, Japanese government reports have reached the same conclusion. Though Prof. Egashira rejected the proposition that corporate law reform clearly had a positive effect on incomes and innovation, many Japanese corporate law scholars and government officials were of the view that corporate governance reform might be useful in responding to managers' abilities, even after Egashira's paper.

In fact, even Prof. Egashira indicates three areas to be reformed, though he argued that any reform is ultimately useless. One is the system for choosing managers. As mentioned above, he describes that the managers of employees do not have the skills for innovation because innovation sometimes, or often, means harming the position of current employees or stakeholders. Managers are averse to abolishing any current position or firing any employee because they are chosen and supported by employees and stakeholders, though the Companies Act attributes the authority to nominate director and managers to shareholders.

The second area is institutional investors. Traditional institutional investors in Japan, like commercial banks and life insurance companies, tend to vote exclusively for incumbent management because they would like to maintain the existing business relationship. Egashira pointed out that they should instead vote based on corporate performance.

The third area is the courts. Japanese courts and judges prefer a rule-based approach over a principle-based approach. A rule-based approach requires formality. According to Egashira's paper, managers have no incentive to try new things because new things tend to not obey existing formal rules.

Despite Prof. Egashira's clear thesis, the three areas he specifies are definitely candidates for necessary reform. Just the third among them has not been addressed, whereas the others have been the subjects of various rules.

For instance, the Stewardship Code of 2014 was a response to the second problem relating to institutional investors. It is soft law. It requires even traditional institutional investors to implement stewardship responsibilities for ultimate beneficiaries.[7]

But also in the third area, i.e. the courts, there are small indications of change, though no reform has yet occurred. The Tōkyō District Court is

7 EGASHIRA, *supra* note 6, at 65.

planning to establish a new court just for business law, physically separated from the ordinary Tōkyō District Court.[8] The Supreme Court has plans to build in 2021a new court building in *Nakameguro* (about eight kilometers distance from the original Tōkyō District Court); it is currently envisioned that the Intellectual Property Division, the Commercial Law Division (including shareholder's derivative actions, appraisal rights, and other corporate law cases), and the Bankruptcy Division will be aggregated in this new court. Though it is just a physical separation plan, and not formally a special court at all, the plan might be a first step toward establishing business law specialization for some judges. Physical separation might lead to a different attitude for judges in their interpretation of laws.

The present article focuses on the responses to the first problem, considering specifically the Japanese government's having established various rules in the Companies Act, the Corporate Governance Code, and the Stewardship Code – among others – in order to promote companies' innovation. This situation is completely different from that of the EU. EU countries, including Germany, are frontrunners in corporate governance reforms. However, the goal of the EU is different than in Japan. After the financial crisis in 2007, EU countries initiated corporate governance reforms with the aim of controlling, or restraining, the taking of excess risk.[9] By contrast, Japanese corporate governance reform is trying to promote taking risk. EU and Japan are thus moving into opposite directions.

Before the explanation of specific reforms, I have to add one comment. The Companies Act Reform Proposal covers various other items. Based on the outline for reform published last January, for instance, it would introduce an online invitation for the shareholders meeting. However, this article focuses on changes related to increasing income and innovation because this is one of the largest efforts of the Japanese government.

II. Reforms of Boards (1): The Monitoring Board

Previously, boards of directors in Japanese companies were called *management boards.*[10] In management boards, in which directors constitute the majority, members of the board also include senior employees and the staff

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8 *"Bijinesu saiban-sho, chizai ya hasan shūyaku, saikō-sai, 21nen medo shinchōsha,"* [Business law court to aggregate intellectual property court and bankruptcy courts –, Supreme Court plans to launch a new building in 2021], Nihon Keizai Shinbun, 3 September 2014, 1.

9 OECD, Corporate Governance and the Financial Crisis: Conclusions and emerging good practices to enhance implementation of the Principles (2010) 5; The Kay Review of UK Equity Markets and Long-Term Decision Making (2012) 5; G20/OECD, *supra* note 2, 7.

of managers. Management boards can be called a "team" for managing the companies.

By contrast, *monitoring boards* were established in the 1980s in the US.[11] A monitoring board is based on the idea that the board should monitor the president's management. This idea has been dispersed all over the world. Today, this model is in the mainstream internationally (global standard). In a monitoring board, most directors, except for the CEO (representative director in Japanese law), should be outside, or independent, directors.

Between the management board and the monitoring board, there is the *advisory board.*[12] In an advisory board, directors are not staff for the president. Rather, directors are expected to advise managers as to key management policy from an independent and broader perspective.

Among the three models, the monitoring board is recognized as the best for Japanese companies' ability to earn income.

Why is a monitoring board the key for Japanese companies' ability to enhance income and innovation? In order to answer this question, it is first necessary to explain the meaning of a "monitoring board".

In fact, there are mixed opinions about the meaning of monitoring done by the board of directors. At an overview level, there are two different standpoints regarding the aim of monitoring: (i) promoting *efficiency* or (ii) promoting *compliance.*[13] Previously, only the compliance aspect seemed important in Japan.

As mentioned, however, efficiency has received increasing attention in Japan because the corporate ability to earn profit is one of the largest problems today.[14]

Even based on the efficiency aspect, the meaning of monitoring is not fixed, with understandings including: (a) *evaluating the performance of managers,* (b) *regulating conflicts of interest,* or (c) *reviewing the adequacy of individual transactions by managers*.[15] There are various opinions.

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10 Even in the US, management was traditionally the task of the board of directors. See, S. BAINBRIDGE/T. HENDERSON, Outsourcing the Board: How Board Service Providers Can Improve Corporate Governance (Cambridge 2018) 33-37.

11 The idea of a "monitoring board" has been taken from M. EISENBERG, The Structure of the Corporation: A Legal Analysis (Boston 1976) 162.

12 BAINBRIDGE/HENDERSON, *supra* note 10, 40–42 and EISENBERG, *supra* note 11, 157–158, explain the advisory board.

13 W. G. RINGE, Independent Directors: After the Crisis, European Business Organization Law Review 14 (3) (2013) 401, 408, writes that the goal of Japan's reform was responding to the accounting scandal at Olympus.

14 G. GOTŌ/M. MATSUNAKA/S. KOZUKA, Japan's Gradual Reception of Independent Directors, in: Puchniak et al. (eds.), Independent Directors in Asia: A Historical, Contextual and Comparative Approach (Cambridge 2017) 135.

From the perspective that the manager takes risks and makes business judgments, evaluating performance is the most important among the three.[16] If review of individual transaction were always done by the board, managers could not take risks in exercising business judgment.

Based on performance evaluation, the board of directors can choose managers. A board can be expected to choose managers who will increase corporate profit.

The idea of a monitoring board of directors appears in various specific reforms. The Japanese Corporate Governance Code stipulates in Principle 4 that: "Given its fiduciary responsibility and accountability to shareholders, in order to promote sustainable corporate growth and the increase of corporate value over the mid- to long-term and enhance earnings power and capital efficiency, the board should appropriately fulfill its roles and responsibilities, including:(1) Setting the broad direction of corporate strategy;(2) Establishing an environment where appropriate risk-taking by the senior management is supported; and (3) Carrying out effective oversight of directors and the management […] from an independent and objective standpoint." Though there are mixed opinions, a scholarly evaluation suggests that this responsibility for fulfilling these tasks is to be assumed by the monitoring board.[17]

However, there is no consensus about the meaning of the monitoring board. The Japanese Corporate Governance Code contains the provision "(1) Setting the broad direction of corporate strategy." This statement relates, however, to advising rather than evaluating performance.

The Principles of Corporate Governance published by the American Law Institute (ALI) states further that it is the responsibility of board of directors "to review corporate financial accounting, fundamental project and activity and, if necessary, to accept them," in addition "to choose significant senior officers, to evaluate them regularly, to determine remuneration, and, if necessary, to fire them" (3.02). The provision is not limited to evaluating performance. It can also be seen as relating to the review of individual business judgments.

However, at least in Japan, the specific reforms were designed to change the behavior of managers by limiting the responsibility of the board of directors to a evaluating performance.

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15 K. TAKEI, *Kōporēto gabenansu kōdo he no taiō* [The Response to the Corporate Governance Code], Jurisuto 1484 (2015) 60, 64, emphasizes that the board should act as a coach for management's strategies and proposals.

16 H. KANDA, *Kaisha-hō* [Corporate Law] (21st ed., Tōkyō 2019) 185 note 2; EISENBERG, *supra* note 11, 165.

17 W. TANAKA, *Kaisha-hō* [Corporate Law] (2nd ed., Tōkyō 2018) 226.

III. Reforms of Boards (2): A New Structure of Corporate Organization

The specific reform of the monitoring board is adding a new structure of corporate organization.

Since 1950, the organizational structure of corporations has consisted of two main organs, the board of directors and general auditors (*kansayaku*). The shareholders meeting chooses both directors and general auditors. Then, the board of directors chooses a representative director (CEO). General auditors are designed to monitor management by directors (Art. 381 para. 1 Companies Act). However, managers are chosen by the board, not by general auditors. General auditors do not have any authority to choose management.

Traditionally, monitoring has fallen to general auditors in Japanese companies. However, general auditors without the power to choose management cannot evaluate performance. If they evaluated performance, they cannot choose managers.

Therefore, monitoring, or evaluating, performance should be done by the board of directors. Pursuant to this approach, the *company with three committees* was introduced in 2002 as one option.[18] Three-committee companies have a nominating committee, a remuneration committee, and an auditing committee on the board like US-style listed companies. The majority of members of committees must be outside directors (Art. 400 para. 3 Companies Act). The nominating committee chooses the candidates for directors who will stand for election at the shareholders meeting (Art. 404 para. 1). The remuneration committee determines the remuneration of individual directors (Art. 404 para. 3).

A three-committee company has not been introduced by many companies. In 2019 March, the number of companies with three committees was just 70 among 3,600 listed companies in Japan.[19] This is less than 2%.

Therefore, the 2014 Reform of the Companies Act introduced another new structure, *companies with an auditing and monitoring committee*. Previously, in most Japanese listed companies, general auditors external to the board of directors monitor the directors' management. By contrast, a company with an auditing and monitoring committee does not have auditors. Instead, it has an auditing and monitoring committee within the board.

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18 M. Shiseki (ed.), *Q&A Heisei 14-nen kaisei shōhō,* [Q&A 2002 Commercial Code Reform] (Tōkyō 2003) 66; K. Egashira, *Kabushiki kaisha-hō* [Stock Companies Act] (7th ed., Tōkyō 2017) 555.

19 Tokyo Stock Exchange (*hereinafter,* TSE), Corporate Governance Information Service, available at *http://www2.tse.or.jp/tseHpFront/CGK010010Action.do.*

A member of the auditing and monitoring committee must also be a member of the board of directors (Art. 399-2 para. 2 Companies Act). The majority of the auditing and monitoring committee consists of outside directors (Art. 331 para. 6 Companies Act). The responsibility of the auditing and monitoring committee is not only auditing the directors' management (Art. 399-2 para. 3 no. 1 Companies Act), like general auditors, but also to give an opinion about the selection, firing, and resignation of directors (Art. 344-2 para. 4 Companies Act) as well as about the remuneration of directors (Art. 361 para. 6 Companies Act) at the shareholders meeting (Art. 399-2 para. 3 no. 3 Companies Act).

Compared with the three-committee company, the company with an auditing and monitoring committee does not have exclusive power to determine remuneration and to list the candidates for a directorship; it solely has the power to make a statement in relation to them. It has been thought that this is the reason why the company with three committees has not been employed by many companies, namely that most companies are reluctant to give an outside director the exclusive power to determine candidates and pay. Therefore, the responsibility of the audit and monitoring committee was limited to stating opinions relating to candidates and pay.

Though the power covers only the providing of opinions, choosing a director candidate and determining pay are intimately relating to evaluating performance. Therefore, it fits in the activities of the monitoring board.

In addition, the board of an auditing and monitoring company is allowed to delegate the power to determine important business judgements to some individual directors under a special provision of the corporate charter (Art. 399-13 para. 6 Companies Act). It is not required that the majority of the board members are outsiders (Art. 399-13 para. 5 Companies Act).

For a board to focus on monitoring, or the evaluation of performance, it is especially important to segregate challenging tasks so as to allow for an assessment of business judgement in individual cases. It is difficult for a board to review a business determination it has made itself. Outside directors usually do not have enough time to play the role of directors. They do not have enough time to do everything relating to a company. This delegation from the board to individual directors is to be regarded as the key to understanding the function of the monitoring board.

Accordingly, an auditing and monitoring company can be evaluated as a new organizational structure designed to encourage Japanese companies to employ the monitoring model.

Before enforcement of the 2014 reform, the auditing and monitoring company structure was seen as being suitable just for small companies. By 2019, however, 918 out of 3,600 listed companies in Japan employed the

auditing and monitoring company model.[20] That means more than 25% of the listed companies have introduced auditing and monitoring committees. These include Yahoo, Dentsu, TV Asahi Holding, Cosmo Oil, Nomura Estate Holdings, and Kyushu Electric Power. Overall, many large listed companies employ the auditing and monitoring committee structure.

This evidence suggests that the monitoring board employed by a Company with an auditing and monitoring committee is evaluated positively even by large listed companies. It is also the evidence that the monitoring model is dispersed throughout Japanese listed companies.

IV. Reforms of Boards (3): Mandatory Outside Directors

The company with three committees and the auditing and monitoring company require an outside director on the board. Conversely, the traditional company with general auditors did not need to include an outside director; it was only required to have outside general auditors. However, if a company with general auditors employs a monitoring board, it must also have an outside director.

The 2014 Reform of the Companies Act requires a listed company to explain the reason why having an outside director is inappropriate; if it does not have any outside directors, the company is a company with general auditors (Art. 327-2 Companies Act).

This is a "comply or explain" type regulation. The provision does not require the reason why a company does not choose any outside director, demanding instead the reason why setting an outside director is "inappropriate". That means a company should explain the reason why setting an outside director could harm the company.[21] Most companies cannot assert such a strong reason. Therefore, this rule is seen as a "de facto" duty to set an outside director.

The Japanese Corporate Governance Code is a "comply or explain" type of soft law. It similarly encourages listed companies to employ two or more outside officers (Principle 4-8).

In addition, the Proposal to Reform the Companies Act contains a rule about mandatory outside directors.[22] It mandates that a listed company have at least one outside director. This proposal aims to move from a situation of a "de facto mandatory outside director" to a legally mandatory outside director.

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20 TSE, *supra* note 19.

21 S. Sakamoto, *Ichimon ittō heisei 26-nen kaisei kaisha-hō* [Questions and Answers, Reform of the Companies Act 2014] (2nd ed., Tōkyō 2015) 91; Gotō et al., *supra* note 14, 157–158.

22 *Kaisha-hō kaisei yōkō-an, supra* note 1, 10.

The proposal contains a new rule allowing a company to delegate conflict-of-interest determinations to outside directors. This is designed to utilize outside directors for purposes of corporate governance.

Of course, there are opinions opposing the mandatory outside director regulation. In its initial version, this regulation requires just one outside director. Critics have argued that just one outside director cannot do anything when the other directors are insiders or the staff of managers. There is another argument against the regulation as well, contending that law should not intervene in the structure of corporate organizations because this should be left to market competition.[23]

V. Reforms of Boards (4): Individual Director Remuneration

The Japanese Companies Act stipulates that the remunerations of directors in stock companies is to be determined by the shareholders meeting (Art. 361 para. 1 Companies Act). As an exception, in a company with three committees, a remuneration committee determines remuneration of individual directors (Art. 404 para. 3 Companies Act). By contrast, at the other companies, the shareholders meeting determines the pay of directors.

However, it should be observed that even though the Act stipulates that the shareholders meeting determines pay, the meeting does not determine the pay of individual directors. Rather, the shareholders meeting determines only the sum and limitations regarding the payment of all directors in the company. Subsequently, and in practice, the shareholders meeting delegates to the board the authority to determine individual pay. In addition, boards usually delegate this authority further to the representative director (manager). In this way, the pay of individual directors is determined substantially by a manager.

Such a common practice is often criticized because it makes the Companies Act rule useless. However, how should individual director pays be determined? Under the Companies Act provision, should the shareholders meeting determine individual director pay in a listed company where there are many shareholders. Would this be practical?

From the perspective that managers should take appropriate business risks, remuneration should be determined based on her or his performance evaluation. Is the shareholders meeting a good place to discuss performance evaluation? Listed companies have too many shareholders to allow for a meaningful discussion regarding the evaluation of managers. Where a mon-

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23 Y. Miwa/J. M. Ramseyer, Who Appoints Them, What Do They Do? Evidence on Outside Directors from Japan, Journal of Economics & Management Strategy 14(2) (2005) 299, 332.

itoring board exists, it is designed to evaluate the performance of directors. Therefore, it is appropriate for the board, and not for the shareholders meeting, to determine the remuneration of individual directors. However, delegating this task to a manager is inappropriate because a manager is not a subject who should evaluate but an object who should be evaluated.

Therefore, the reform proposal by the Ministry of Justice requires that in listed companies and in auditing and monitoring companies, the board determines the general policy to determine the remuneration of individual directors.[24]

This proposal has been designed to fit in the monitoring model. It corresponds to the idea that the monitoring board encourages managers to take appropriate business risks.

The Corporate Governance Code also adds another requirement for remuneration. The Code, a soft law for corporate governance whose application has been included in the listing requirements of the Tokyo Stock Exchange, was amended in June 2018. After the last revision, Supplemental Principle 4.10.1 requires companies without a board of majority independent directors to establish within the board independent advisory committees on the issues of nomination and remuneration. This serves as a sign that the Corporate Governance Code adopts the monitoring model for the evaluation of performance.

VI. Reforms of Boards (5): The Process of Nominating Directors

According to Egashira's paper, of utmost importance is the question of how to choose a manager. However, the proposal for the new Companies Act Reform does not contain any amendments in this field. As I mentioned, just two new type companies, the company with three committees and the auditing and monitoring committee, guarantee that independent directors will be involved in the determination and nomination of directors. Traditional *kansayaku*-companies – the majority type among listed companies – are not required to have the process set out in formal regulations.

However, with Supplemental Principle 4.10.1, the Corporate Governance Code requires that even Kansayaku companies without a majority-independent-director board establish optional independent advisory committees as regards nomination within the board. A majority of the independent committee is required to be independent directors.

As in the situation mentioned above, this indicates that the Corporate Governance Code employs a performance evaluation monitoring model.

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24 *Kaisha-hō kaisei yōkō-an, supra* note 1, 6.

VII. CONCLUSION

Japanese corporate law is aiming to improve the quality of managers and increase corporate revenue and innovation through monitoring boards.

There are two challenges voiced to this approach. First, opponents criticized that a monitoring board does not always lead to corporate profit or benefit. Does a monitoring board lead to corporate profit and innovation? This problem must be left for empirical studies. There are no empirical studies about the monitoring board itself. However, there are many empirical studies relating to outside directors, or independent directors, which is one of the most important elements of a monitoring board.

The trend of current corporate finance literature has shifted from a discussion on whether or not independent directors add value to a firm to the discussion whether independent directors play some role in specific situations. For instance, does an independent director play certain specific roles in certain specific contexts, like the replacement of managers or in M&A? When does an independent director play some role?[25]

According to these studies, when the board of directors in US companies is more independent, the possibility that the company employs an outside CEO becomes higher. Consequently, employing an outside CEO brings a positive effect on the stock price.[26] Other empirical studies suggest that, in respect of Australian companies, when the board is more independent, the correlation between CEO replacement and corporate performance becomes higher.[27] These can be seen as evidence of the role that independent directors could perform in the process of choosing managers in foreign countries. We should conduct empirical studies for cases involving Japanese companies

The more important objection is the second. Should the law force managers to take appropriate risks and increase corporate profit? The Abe cabinet has emphasized economic growth in Japan. And the Japanese business circle agrees on this direction – increasing corporate profit – though it disagrees on the tightening of regulation.

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25 K. UCHIDA, *Nihon kigyō no torishimari yakukai no shinka to kokusai-teki tokuchō* [The Evolution and International Characteristics of the Board of Directors in Japanese Companies], Shōji Hōmu 2007 (2013) 41, 42.

26 K.A. BOROKHOVICH/R. PARINO/T. TRAPANI, Outside Directors and CEO Selection, Journal of Financial & Quantitative Analysis 31 (1996) 335–337 (The empirical studies for US listed companies).

27 J.-A. SUCHARD/M. SINGH/R. BARR, The Market Effects of CEO Turnover in Australian Firms, Pacific-Basin Financial Journal 9 (2001) 1 (The empirical studies for Australian companies).

However, even now, there remains another powerful trend, one suggesting that compliance is more important than increasing profit. Especially today, the Carlos Ghosn scandal is gathering a great deal of attention in Japan,[28] and probably in Europe.[29] He was one of the most famous and highly-evaluated managers in Japan, but on 19 November 2018 he was arrested after being accused of understating his income. Though there are various news reports on the Ghosn scandal, we are not sure whether the news is correct in terms of detail because the case is presently the subject of criminal proceedings. However, the Ghosn scandal leads more Japanese to devote attention to compliance rather than to efficiency. Do corporate law reforms increase profitability? The Japanese challenge is most certainly an interesting experiment. However, due to the Ghosn scandal this experiment might be cancelled before it can achieve any results.

SUMMARY

This article surveys the fundamental goals behind the Japanese Companies Act Reform and two new soft laws, the Corporate Governance Code and the Stewardship Code. Generally speaking, corporate governance could be classified as meeting one of two aims: compliance or efficiency. Japan's incumbent cabinet has set efficiency – particularly increasing corporate income and fostering innovation – as the goal of corporate governance reforms. Efficiency can be paraphrased as increasing profit. Profit consists of income minus costs. Traditionally, corporate governance is designed to reduce costs, especially agency costs, e.g. by preventing managers from wasting corporate assets. Conversely, it was seen as common sense that only the market can increase income and prompt innovation. However, the Japanese reforms aim at achieving these latter results by tightening regulation.

This situation is completely different from corporate governance reform in EU countries. After the financial crisis of 2007, EU countries undertook corporate governance reforms to control, or prevent, the taking of too much risk. By contrast, Japanese corporate governance reform looks to promote risk taking. Thus, EU and Japan face in opposite directions.

This article considers five examples that help to illustrate the goal of Japan's reform of corporate governance: (I) monitoring boards, (II) a new corpo-

28 M. RICH/J. EWING, Nissan Chairman, Carlos Ghosn, Is Arrested Over Financial Misconduct Allegations, New York Times, 19 November 2018, available at *https://www.nytimes.com/2018/11/19/business/nissan-carlos-ghosn-misconduct.html.*

29 "Renault/Nissan: Ghosn, Ghosn, gone," Financial Times, 20 November 2018, available at *https://app.ft.com/content/b9b1afda-ec01-11e8-8180-9cf212677a57.*

rate organizational structure, (III) mandatory outside directors, (IV) individual director's remuneration, and (V) the nominee director process. Of these five areas, the article argues that Japanese corporate law sees the use of monitoring boards as key to improving the quality of managers and increasing corporate income and innovation.

Japan's efforts at reform face a question: Do corporate law reforms increase profitability? This is related to the question of whether corporate governance matters or not. The Japanese experiment entails unique challenges and features a variety of interesting aspects. Yet after the Carlos Ghosn scandal of November 2018, the notion that compliance is more important than increasing profit has become more powerful. Thus, this experiment might be abandoned before achieving any results.

ZUSAMMENFASSUNG

Der Beitrag untersucht die grundlegenden rechtspolitischen Ziele, die der Reform des Gesellschaftsgesetzes und der Schaffung zweier selbstregulativer Instrumente, dem Corporate Governance Code und dem Stewardship Code, in Japan zugrunde liegen. Allgemein ausgedrückt, dient die Corporate Governance der Umsetzung mindestens eines der folgenden beiden Ziele: Compliance oder Effizienz. Die amtierende japanische Regierung hat die Effizienz, insbesondere in Form einer Profitabilitätssteigerung und Innovationsförderung, zum Ziel der Corporate Governance Reformen erklärt. Effizienz kann als gleichbedeutend mit einer Steigerung der Gewinne angesehen werden. Gewinne resultieren aus den Einnahmen abzüglich der Ausgaben. Traditionell ist Corporate Governance so ausgestaltet, dass die Ausgaben verringert werden, insbesondere die sogenannten „agency costs", wie etwa dadurch, dass die Unternehmensführung daran gehindert wird, die Ressourcen des Unternehmens zu verschwenden. Damit korrespondierend galt es als ausgemacht, dass nur der Markt die Einnahmen erhöhen und Innovationen fördern könne. Im Gegensatz dazu versuchen die japanischen Reformen jedoch, letzteres durch eine Verschärfung der Regulierung zu erreichen.

Diese Situation unterscheidet sich fundamental von den in Europa durchgeführten Corporate Governance Reformen. Nach der 2007 einsetzenden Finanzkrise haben die europäischen Staaten Corporate Governance Reformen eingeleitet, die das Ziel hatten, ein Eingehen übermäßiger Risiken durch die Unternehmen zu verhindern oder zumindest zu kontrollieren. Die entsprechenden japanischen Reformen scheinen demgegenüber jedoch gerade darauf ausgerichtet zu sein, das Eingehen von Risiken zu erleichtern. Europa und Japan bewegen sich mithin in entgegengesetzte Richtungen.

Der Beitrag diskutiert fünf Beispiele, um das Ziel der Corporate Governance Reform in Japan zu illustrieren: (I) ein Verwaltungsrat mit Überwa-

chungsaufgaben („monitoring board"), (II) eine neue Organisationsstruktur für Aktiengesellschaften, (III) die zwingende Ernennung außenstehender Verwaltungsratsmitglieder, (IV) die personenbezogene Genehmigung von Managementgehältern und (V) das Verfahren zur Ernennung von Verwaltungsratsmitgliedern. Von diesen fünf Möglichkeiten qualifiziert das japanische Gesellschaftsrecht den Einsatz eines Verwaltungsrats mit Überwachungsaufgaben als den Schlüssel für eine Qualitätsverbesserung des Managements und eine Steigerung von Einnahmen und Innovationen.

Die Reformanstrengungen Japans sehen sich mit folgender Frage konfrontiert: Erhöhen gesellschaftsrechtliche Reformen die Profitabilität der Unternehmen? Dies hängt mit der weiteren Frage zusammen, ob Corporate Governance diesbezüglich überhaupt eine Rolle spielt. Das japanische Experiment bringt spezifische Herausforderungen mit sich und zeigt eine Reihe von interessanten Aspekten auf. Allerdings hat im Zuge des Skandals um Carlos Ghosn im November 2018 die Erkenntnis an Gewicht gewonnen, dass Compliance wichtiger als eine Gewinnsteigerung ist. Dies könnte zur Folge haben, dass das japanische Corporate Governance Experiment abgebrochen werden wird, bevor es überhaupt Erfolge zeitigen konnte.

(Die Redaktion)