

# The Future of Japanese Corporate Governance

## Participation, Sustainability, and Technology

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### I. INTRODUCTION

Japan is the third largest economy in the world and has one of the most advanced technology industries. Its economy is critical to global economic growth, providing major foreign direct investment as well as financial stability for hedging. Its legal system has been influential in Asia Pacific, and corporate law has been a particularly important value benchmark for other economies. However, despite enjoying a very high living standard, Japan's corporate performance has not been regarded as competitive in recent years compared to that of other advanced economies such as the US and the UK. At the same time, Japanese companies have lost global market share to companies from neighboring economies such as South Korea. The geopolitical situation in the region, particularly with China's economic rise, has prompted Japan to re-think its corporate model. Domestically, an aging population means that there is an increased burden on pension providers due to lower productivity compared to that enjoyed during the post-war period until the early '90s. Because of this, Japan has launched several

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corporate governance reforms aimed at increasing corporate productivity at home and competitiveness abroad.

This paper looks at the development of corporate governance in Japan over the last fifteen years to understand what has changed and whether the intended results have been achieved. It then investigates the tools that have been used to catalyze reform and the degree of institutional support for, and resistance to, that reform. Finally, it discusses how the reforms can provide a pathway towards corporate digital governance and sustainability.

The findings of this research have policy implications. First, section II will demonstrate how corporate Japan is moving away from the post-war bank-dominated, heavy-industry led, and interlocked model. This provides a new corporate model for Japan for comparative research into law and economics. In addition, we will examine how reform was accomplished, considering the legal tools used as well as the dynamics among the various stakeholders; in other words, law-in-action. This can help other economies decide which laws and regulations are necessary by showing why they have been chosen and how they are enforced. Understanding the level of institutional support required to achieve reform and the risks involved can help reduce the cost of legal transplant for other economies. Secondly, section III shows how this new corporate model for Japan can catalyze sustainability through encouraging companies to be more purpose-based and through digital governance. Finally, we offer some concluding remarks in section IV.

## II. CHANGES TO POLICY, DIRECTION, AND STRUCTURE IN CORPORATE GOVERNANCE

Since the Japanese government embarked on corporate governance reforms in 2014, various changes have been implemented such as the establishment of a Corporate Governance Code (コーポレートガバナンス・コード *kōporētogabanansu kōdo*, CG Code) in 2015 (with revisions in 2018 and 2021), and the Tōkyō Stock Exchange's market restructuring.<sup>1</sup> The main aim of these changes has been to improve companies' earning power, including improving their profitability and restoring economic growth. The background is that Japanese companies' ratios of Return on Equity (ROE)

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1 Tōkyō Stock Exchange, which consists of four markets (1<sup>st</sup> Section, 2<sup>nd</sup> Section, Mothers, and JASDAQ (Standard and Growth)), restructures the market structure to three markets (Prime, Standard, and Growth) to improve the convenience for investors and incentives for listed companies to sustainability increase corporate value. See TSE, Overview of Market Restructuring (4 April 2022), <https://www.jpx.co.jp/english/equities/market-restructure/market-segments/index.html>, accessed 4 February 2022.

and Return on Assets (ROA) have remained lower than those of US and European companies and have stagnated for two decades.<sup>2</sup> To remedy this situation, Japan has developed an economic system in which sustainable growth of companies and improvement to their corporate value can distribute benefits to their stakeholders more widely, leading to economic growth through investment and expansion of consumption.<sup>3</sup> In such a system, lack of monitoring capability among board directors, ineffective engagement with shareholders, and inadequate group governance (for instance, within the *keiretsu*<sup>4</sup>) are seen as barriers to improving profitability and economic growth, so the Japanese government has therefore enhanced leverage for profitability and economic development through corporate governance.<sup>5</sup> To improve profitability and restore Japan's economic growth potential, the government introduced three significant reforms to strengthen management systems and group governance, to create an ideal environment for constructive engagement with shareholders, and to promote medium to long-term investment.<sup>6</sup>

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- 2 METI [経済産業省経済産業政策局産業資金課], *Jimu-kyoku setsumei shiryō* (事務局説明資料) [Secretariat Briefing Materials] (2019) 7, [https://www.meti.go.jp/shingikai/economy/sustainable\\_kigyo/pdf/001\\_05\\_00.pdf](https://www.meti.go.jp/shingikai/economy/sustainable_kigyo/pdf/001_05_00.pdf).
  - 3 PRIME MINISTER'S OFFICE [首相官邸], *Mirai tōshi senryaku 2018 – “Society 5.0” “dēta kudō-gata shakai” e no henkaku* (未来投資戦略2018 – 「Society 5.0」 「データ駆動型社会」 への変革-) [Future Investment Strategy 2018 –The revolution toward “Society 5.0” and “Data-driven Society”] (15 June 2018), [https://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/miraitousi2018\\_zentai.pdf](https://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/miraitousi2018_zentai.pdf).
  - 4 R. MORCK/M. NAKAMURA, Been There, Done that. The History of Corporate Ownership in Japan, Financial Working Paper 20/2003, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=422120](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=422120).
  - 5 Japan's Financial Services Authority (FSA) explains the necessity to expand the initiatives of listed companies towards sustainable improvement of “Earning power” to the entire corporate sector and subsequently distribute the expanded profits to rising wages, reinvestment, shareholder return, and subsequently comprehensive economic growth. Japan's Stewardship Code and Corporate Governance Code are positioned as mechanisms to boost sustainable “Earning power” in listed companies.  
See FSA [金融庁], *Kigyō no “kasegu chikara” no jizokuteki na kōjō ni muketa kōporēto gabanansu kaikaku no torikumi* (企業の「稼ぐ力」の持続的な向上に向けたコーポレートガバナンス改革の取組み) [The initiatives of corporate governance reforms towards sustainable improvement of “earning power” of companies], 19 October 2016, 7, [https://www.kantei.go.jp/jp/singi/keizaisaisei/miraitoshikaigi/suishin\\_kaigo\\_saihen\\_dai1/siryō4.pdf](https://www.kantei.go.jp/jp/singi/keizaisaisei/miraitoshikaigi/suishin_kaigo_saihen_dai1/siryō4.pdf).
  - 6 METI [経済産業省], *Kigyō no kasegu chikara kōjō ni muketa kōporēto gabanansu kaikaku no torikumi* (企業の稼ぐ力向上に向けたコーポレートガバナンス改革の取組) [The report of the initiatives of corporate governance reform for improvement in the earning power], 25 November 2019, 2, <https://www.kantei.go.jp/jp/singi/keizaisaisei/miraitoshikaigi/suishinkaigo2018/corporate/dai4/siryō3.pdf>.

### 1. *Strengthening Management Systems and Group Governance*

The new reform has paved the way for more decentralized participation in management and governance by giving more oversight power to outsiders and by reducing parent companies' power over their subsidiaries.

#### a) *Enhancement of board function through external oversight*

The Japanese government has encouraged listed companies to shift from management-oriented boards to monitoring-oriented boards.<sup>7</sup> This has resulted in the development of nomination and remuneration committees, a shift from report-based to discussion-based board meetings, and the empowerment of independent directors.<sup>8</sup> In previous Japanese board practice, chief executives had generally decided corporate strategy, the nomination of board members and their successors, and the remuneration of directors and executives without objective criteria. For example, a CEO would designate a successor from a pool of executive directors or managers, and the board would simply confirm the decision.<sup>9</sup> In many listed companies, the remuneration of executives was not necessarily linked to performance, but decided by the CEO in a non-transparent way.

Even when boards that operated in such a traditional way included independent directors, their contribution to board discussion was often limited by lack of background information and they were therefore unable to fulfil their monitoring function properly. Such a top-down approach, dominated by the CEO, eliminated constructive discussion and transparency and resulted in dogmatic judgements which could restrict corporate value and hinder corporate growth. It could even give rise to scandal and miscon-

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7 Japan's METI introduces two board types. One is the company oriented towards making the board specialise in monitoring. Another one is the company that emphasises the decision-making function of the board. METI expects that, in both models, the board of directors sets basic management policies and have a strong awareness of the necessity to enhance corporate value by strengthening its monitoring function, thereby encouraging appropriate risk-taking by management and internal management reform. See METI, Practical Guidelines for Corporate Governance Systems (CGS Guidelines), 19 July 2022, [https://www.meti.go.jp/english/press/2022/0719\\_02.html](https://www.meti.go.jp/english/press/2022/0719_02.html) and [meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/cgs/guideline2022.pdf](https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/cgs/guideline2022.pdf) (in Japanese).

8 METI, Executive Summary – About the Revised CGS Guidelines, 19 July 2022, [https://www.meti.go.jp/english/press/2022/pdf/0719\\_002a.pdf](https://www.meti.go.jp/english/press/2022/pdf/0719_002a.pdf).

9 METI, Practical Guidelines for Corporate Governance Systems (CGS Guidelines), 28 September 2018, [https://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/cgs/en180928csgsguideline.pdf](https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/cgs/en180928csgsguideline.pdf).

duct.<sup>10</sup> Thus, in implementing corporate governance reform, the Japanese government has focused particularly on the role and function of boards.

In order to strengthen the role and function of boards in Japanese listed companies and to discourage autocratic management, a number of changes have been implemented. Independent committees have been developed and agendas have been changed along with improvements to the allocation of time in board meetings. The number of independent directors, and their diversity, has been increased and this has created more consensus-led boards with increased input from shareholders and outside stakeholders. Nomination and remuneration committees and their role have increased significantly and Japan's corporate governance code now requires the establishment of committees with independent directors as main members.<sup>11</sup> As a result, the percentage of listed companies that have established a nomination committee has grown from 10.5% in 2015 to 83.6% in 2022, and to 92.0% in JPX-Nikkei 400 companies<sup>12</sup>. The number of listed companies

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10 A famous example is the Olympus scandal (2011). Olympus Corporation settled window-dressing financial statements to hide away the huge loss derived from the failure of asset management, which had been conducted mainly by successive presidents. British-born Michael WOODFORD, a president and a subsequent CEO, initiated his own investigation about the hindrance of huge loss after finding an article revealing it in a Japanese financial magazine. However, the board members, including ex-CEO KIKUKAWA, who mainly conducted hindrance of huge losses and his previous subordinates, strongly refused cooperation with his investigation and then suddenly removed WOODFORD from CEO when he approached to discover the fraudulence, which led to the plunge in stock price. Meanwhile, the independent directors and corporate auditors could not monitor anything of such inefficient management of the board. This scandal revealed the negative effects of top-down management and the malfunction of the board's monitor. See M. WOODFORD, *Kainin* (解任) [Dismissal] (2012).

11 Supplementary Principle 4-10-1 of Japan's CG Code prescribes that "If the organizational structure of a company is either Company with *Kansayaku* Board or Company with Supervisory Committee and independent directors do not compose a majority of the board, in order to strengthen the independence, objectivity and accountability of board functions on the matters of nomination (including succession plan) and remuneration of the senior management and directors, the company should seek appropriate involvement and advice from the committees, including from the perspective of gender and other diversity and skills, in the examination of such important matters as nominations and remuneration by establishing an independent nomination committee and remuneration committee under the board, to which such committees make significant contributions". There is no specific requirement for the proportion of independent directors nor the appointment of an independent chair.

12 TÖKYÖ STOCK EXCHANGE [東京証券取引所], *Tōshō jōjō kaisha ni okeru dokuritsu shagai torishimari-yaku no sen'nin jōkyō oyobi shimei i'in-kai/hōshū i'in-kai no*

with remuneration committees has also grown significantly from 13.4% to 85.5% over the same period (92.8% in Nikkei 400).<sup>13</sup> In Nikkei 400 companies, more than 90% now have nomination and remuneration committees including a majority of independent outside directors. The annual activity of such committees generally involves establishing and/or revising the nomination policy and remuneration policy,<sup>14</sup> as well as the evaluation of each director's performance in accordance with those policies. They also prepare the final report for board meetings in which external directors take the initiative rather than executive directors. The development of such committees has increased the transparency and objectivity of the nomination and remuneration of directors to the extent that current practice is converging with that of the UK and US board model, and more executive powers are being devolved to external oversight. In order to ensure such an establishment of committees and their effectiveness, the disclosure rule<sup>15</sup> has been expanded in January 2023, which requires disclosure of activities of the nomination committee, remuneration committee and other committees in the Annual Securities Report.

Another significant change relates to board meetings. The Japanese government now requires listed companies to reform their board agendas away from operational matters such as deciding or reporting individual business execution to big-picture items such as medium- or long-term management plans and corporate strategies. As a result, Japanese companies are gradually changing the priorities for time allocation at their board meetings to

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*setchi jōkyō* (東証上場会社における独立社外取締役の選任状況及び指名委員会・報酬委員会の設置状況) [The appointment of independent outside directors and the establishment of the Nomination Committee and the Remuneration Committee in listed companies], 3 August 2022, <https://www.jpx.co.jp/equities/listing/ind-executive/nlsgeu000005va0p-att/nlsgeu000006jz11.pdf>. The target companies in 2015 are TSE First section companies, and the target companies in 2022 are TSE Prime market companies. JPX-NIKKEI 400 is the selection of companies with high appeal for investors provided by Japan Exchange Group, Inc., Tōkyō Stock Exchange, Inc., and Nikkei Inc. The selected companies meet requirements of global investment standards, such as capital efficiency and investor-focused management perspectives. See JAPAN EXCHANGE GROUP, JPX-Nikkei 400/JPX-Nikkei Mid Small, <https://www.jpx.co.jp/english/markets/indices/jpx-nikkei400/>.

13 TŌKYŌ STOCK EXCHANGE, *supra* note 12. The target companies in 2015 are TSE First section companies, and the target companies in 2022 are TSE Prime market companies.

14 The establishment of the remuneration policy had become mandatory in a certain range of companies such as listed companies by Japan's Companies Act (会社法 *Kaisha-hō*, Law No. 86/2005) revised in 2020 (Article 361 VII).

15 The Cabinet Office Ordinance on Disclosure of Corporate Affairs [企業内容等の開示に関する内閣府令], Ordinance of the Ministry of Finance No. 5/1973.

wards this goal. However, in 2020, the average time allocated to such business plans and strategies was still as low as 20%, while operational issues and reports still amounted on average to 69%.<sup>16</sup> Meanwhile, a significant number of directors consider that improvement to the management of boards and discussion about medium- and long-term management plans remain challenging issues.<sup>17</sup> Transitioning to the notion that boards have a monitoring function is still under development in Japanese listed companies and in this situation, evaluation techniques such as questionnaires and individual interviews to assess board effectiveness are being used to facilitate consistent board reform in Japan.<sup>18</sup>

Lastly, independent directors, who are expected not only to play a supervisory role, but also to advise on developing business strategies and plans, are establishing a firm position for themselves in the board room. On average, about 40% of board members of Nikkei 400 companies are independent but when it comes to their taking the chair of the board, however, although the number is gradually increasing, the percentage is still very low at only 4%.<sup>19</sup> There has been criticism that the introduction of external directors to boards is merely a formality which makes no contribution to sus-

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16 PRICE WATERHOUSE COOPERS AARATA LLC, *Kōporēto gabanansu ni kansuru ankēto chōsa* (コーポレートガバナンスに関するアンケート調査) [The Survey Research regarding the Corporate Governance], March 2021, <https://www.pwc.com/jp/ja/knowledge/thoughtleadership/2020/assets/pdf/corporate-governance-survey-1c2020mar.pdf>.

17 83% of the respondents answered that the agendas regarding the Medium- and Long-term Management Plans are increasing importance, whereas the proportion of the companies which consider the discussion about the Medium- and Long-term Management Plans to be a challenge is a massive 56%. See PRICE WATERHOUSE COOPERS AARATA LLC, *supra* note 16.

18 Both the UK CG Code 2018 and Japan's CG Code require annual Board Evaluation. Simon WONG considers board evaluation as one of the measures to help boards reach their potential and improvement of their effectiveness. See S. C. Y. WONG, *Elevating Board Performance: The Significance of Director Mindset, Operating Context, and Other Behavioral and Functional Considerations* (2011), Northwestern University School of Law, Law & Economics Research Paper No. 11–12.

In Japan, Board Evaluation has been introduced as the mechanism to assess whether the board properly functions and how the board contributes to the corporate success and growth. See Y. TAKAYAMA, *Torishimari yakkai hyōka to kōporēto gabanansu – keishiki kara jikkō-sei no jidai e –* (取締役会評価とコーポレートガバナンス—形式から実効性の時代へ—) [Board Evaluation and Corporate Governance – toward the era of effectiveness from formality –], 商事法務 *Shōji Hōmu* 2043 (2014) 15.

19 See PRICE WATERHOUSE COOPERS AARATA LLC, *supra* note 16.

tainable corporate growth or to the enhancement of corporate value.<sup>20</sup> To address this issue, the Ministry of Economy, Trade and Industry (METI) issued “Guidelines for the Nature of External Directors,” which set out the ideal functions of external directors.<sup>21</sup> In practice, however, since the effectiveness of external directors is greatly influenced by the mentality of management, any change has been slow and the situation is only gradually improving as initiatives such as board evaluation are introduced. In addition, although Japan’s CG Code has required board diversity in terms of gender and international experience,<sup>22</sup> movement towards board diversity such as the appointment of female directors and foreign directors has been slow and has met with resistance in many Japanese companies. In particular, the percentage of foreign directors is still low at only 26.6% in 2021 Nikkei 225 companies, and the number of female directors in Nikkei 225 companies is even lower at a mere 4.4%.<sup>23</sup> One issue that has emerged relates to the background of foreign directors. This sometimes includes experience in hedge funds which is thought to encourage a short-term approach to strategy that can influence decision-making by the board and result in a lack of effective monitoring for long-term success.<sup>24</sup>

Despite the instigation of such various initiatives, Japanese listed companies still face challenges in the enhancement of board function in terms

20 METI, *Shagai torishimari-yaku no arikata ni kansuru jitsumu shishin* (社外取締役の在り方に関する実務指針) [Guidelines for the Nature of External Directors], 31 July 2020, <https://www.meti.go.jp/press/2020/07/20200731004/20200731004-1.pdf>.

21 METI, *supra* note 20.

22 Revised Japan’s Corporate Governance Code additionally requires diversity of work experience and age as well (Principle 4-11).

23 SPENCERSTUART, 2021 Japan Spencer Stuart Board Index (2022) 17 [https://www.spencerstuart.jp/-/media/2022/february/japanbi/ssbi\\_japan\\_board\\_index\\_2021.pdf](https://www.spencerstuart.jp/-/media/2022/february/japanbi/ssbi_japan_board_index_2021.pdf).

24 In terms of activist directors from hedge fund, Anna CHRISTIE contends that “hedge funds may demonstrate longer-term investment horizons and a stronger commitment to improving operations and corporate strategy when they seek board representation, compared to when they pursue more traditional types of hedge fund activism”. See A. CHRISTIE, The New Hedge Fund Activism: Activist Directors and the Market for Corporate Quasi-Control, *Journal of Corporate Law Studies* 19(1) (2019) 1–41, <https://doi.org/10.1080/14735970.2018.1463672>.

However, in practice, it is sometimes still difficult to discuss for the board directors with directors from hedge funds to align their eyes sights on the scope of the timeline because such directors from hedge funds also bear the responsibility for their specific profitability against their clients. Some institutional investors criticise that the short-termism of hedge funds often appears in their intention and behaviours and point out the riskiness of a serious conflict on their board representation. See Y. KURAMOTO/K. KOBU/H. SANPEI/M. SAWAGUCHI, *Kikan tōshi-ka ni kiku (ge)* (機関投資家に関する [下] ) [Hearing from institutional investors (2)], *商事法務 Shōji Hōmu* 2282 (2021) 57.

of the board's actual function and gender diversity. The actual functioning of the board backs good corporate governance rather than its formality, yet Japanese listed companies are still in the transition, which has been explicitly demonstrated by the Toshiba scandal. Since 2015, Toshiba, with a well-developed corporate governance structure, caused a series of incidents such as accounting irregularities at its significant subsidiary, allegations of pressurizing foreign shareholders before an annual general meeting, and clashes between shareholders and the management.<sup>25</sup> Its advanced corporate governance structure could not function due to the lack of the right people and processes.<sup>26</sup> The process issue has been identified as a crucial problem; many Japanese companies fail to develop an objective succession plan, allowing a president and CEO to arbitrarily pick his successor, as also accrued in Toshiba.<sup>27</sup> The nomination issue is of great importance in the Japanese corporate governance. The degree of nomination committees' authority and autonomy is still low, even if the company has a well-developed corporate structure such as Toshiba. It relates to the effectiveness of independent directors, the main player in the nomination process. In this regard, further evaluation of how independent directors can be improved their effectiveness is necessary.<sup>28</sup> Another significant issue that hinders Japanese companies from enhancing board effectiveness is the lack of board diversity. Japanese companies are far behind other countries in terms of progress, as the percentage of female directors in Nikkei 225 is 12.5%, internationally the second lowest following UAE.<sup>29</sup> More severely, the percentage of female executive directors that Nikkei 225 companies have was merely 1.7%, while non-executive directors comprise 24.5%.<sup>30</sup> Although it is not true that the government has yet to take any measures at all,<sup>31</sup> the initiatives are less aggressive than any other strategies. Whilst the government devel-

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25 B. ARONSON, Lessons from the Toshiba Scandal. A Corporate Governance Perspective, *ZJapanR/J.Japan.L.* 54 (2022) 91, 92.

26 ARONSON, *supra* note 25, 107–108.

27 ARONSON, *supra* note 25, 107–108.

28 G. GOTO, Recent Boardroom Reforms in Japan and the Roles of Outside/Independent Directors, in: Oda (ed.), *Comparative Corporate Governance: The Case of Japan*, *ZJapanR/J.Japan.L. Special Issue 12* (2018), available at SSRN: <https://ssrn.com/abstract=3272634>.

29 ALTRATA, *Global Gender Diversity 2022*, 28 July 2022, <https://altrata.com/reports/global-gender-diversity-2022>, accessed 4 June 2023.

30 ALTRATA, *supra* note 29.

31 METI has initiated the system of certification for Nadeshiko Brands with the Tōkyō Stock Exchange since 2012, aiming to introduce certificated enterprises as attractive shares to investors who focus on improving medium- and long-term corporate value to expect further investment in certificated companies and accelerate the of women's empowerment in such enterprises.

oped the voluntary target for the female rate on the board directors of companies listed on the First Section of the Tōkyō Stock Exchange to be 12% by 2022, it has yet to be accomplished, although the First Section no longer exists as described in the next section.

*b) Corporate groups, decentralized governance, and market rules*

The second aspect of implementation is the enhancement of group governance. Practical Guidelines for Group Governance Systems were issued by METI in 2019 to achieve appropriate corporate governance in *keiretsu*.<sup>32</sup> In Japan, listed parent-subsidiary company pairs have been criticized for conflicts of interest between the parent company and shareholders who hold shares solely in the subsidiary company but not in the parent. These subsidiary shareholders can be negatively affected if the subsidiary, which is controlled by the parent company, deals directly with that parent company, transfers a business unit or a business function to it, or becomes a wholly-owned subsidiary of it, while ignoring the interests of shareholders who do not have shares in the parent company. In these situations, the parent company may prioritize its own profit rather than the profitability and further growth of the subsidiary.<sup>33</sup> There are still more Japanese listed subsidiaries than is the case in the US or European countries, although the number has decreased from a peak of 417 in 2006, down to 248 at the end of 2020.<sup>34</sup> Despite these potential problems, the merits of parent companies listing their subsidiaries include ensuring their independent means of finance, “double monitoring” from parent companies and various shareholders, and materializing the business value of subsidiaries in the capital market which

32 METI, *Gurūpu gabanansu shitemu ni kansuru jitsumu shishin* (グループ・ガバナンス・システムに関する実務指針) [The Practical Guidelines for Group Governance Systems], 28 June 2019, [https://www.meti.go.jp/press/2019/06/20190628003/20190628003\\_01.pdf](https://www.meti.go.jp/press/2019/06/20190628003/20190628003_01.pdf).

33 In the US, it is pointed out that when both parent and subsidiary are public, the potential conflicts on exercising fiduciary duties in a controlled company structure are more pronounced. See J. W. RUBIN, When Parent and Subsidiary Are Public, *New York Law Journal*, 20 November 2006, [https://www.hoganlovells.com/~media/hogan-lovells/pdf/publication/nylj-article\\_pdf.pdf](https://www.hoganlovells.com/~media/hogan-lovells/pdf/publication/nylj-article_pdf.pdf).

34 K. NISHIYAMA, *Oyako jōjō no jōkyō (2020-nendo-matsu) – 4-nen-buri ni 2-keta no jungun ni* – (親子上場の状況(2020年度末) —4年ぶりに2桁の純減に—) [The status of the parent-subsidiary listing (the end of fiscal 2020) – The first double-digit decline in four years], 2021, Nomura Institute of Capital Markets Research, [http://www.nicmr.com/nicmr/report/repo/2021\\_stn/2021sum14.pdf](http://www.nicmr.com/nicmr/report/repo/2021_stn/2021sum14.pdf). The percentage of listed parent-subsidiary company pairs in Japan was 6.1% at the end of 2018, which is a significantly higher degree than the US with 0.5%, the UK with 0%, France with 2.2% and Germany with 2.1%. See METI, *supra* note 32.

had been hidden behind conglomerates' multifaceted business.<sup>35</sup> Because of such benefits, Japanese parent companies have continued to list their subsidiaries. Nevertheless, when considering entities under Japan's Companies Act, corporate governance is discussed for each legal entity, both parent and subsidiary separately, and this has meant that group governance has remained a "blank area".<sup>36</sup> However, in the last several years, group governance issues have started to receive attention from regulators and this has resulted in the issuance of the Practical Guidelines for Group Governance Systems, the revision of the Corporate Governance Code, and market restructuring of the Tōkyō Stock Exchange.

The Practical Guidelines for Group Governance Systems provide Japanese group companies (*keiretsu*) with an approach to restructuring the corporate governance of group companies and their subsidiaries. The motive for this was inadequate group governance within *keiretsu* due to the potential conflicts of interest mentioned above, along with absence of group strategy, lower levels of profitability in large, diversified companies and lack of corporate governance in listed subsidiaries. The Guideline has five chapters that cover the design of the group structure, the business portfolio, the internal control system, the nomination and remuneration of subsidiary executives, and the corporate governance of listed subsidiaries. It does not require a "comply or explain" approach, as is the case in the Corporate Governance Code, but it sets out best practice and advice that complement the Code. After the establishment of this Guideline, Japan's Corporate Governance Code was revised in 2021 in a way that attempts to deal with parent-subsidiary companies. While the Code previously did not have any specific provisions that mention group governance, the newly added principle requires an additional number of independent directors or the creation of a special committee to protect minor shareholders in companies that have a controlling shareholder.<sup>37</sup> In addition, the maintenance of a group-

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35 Y. KURAHASHI, *Shihai kabunushi no sonzai o meguru gabanansu mondai (jō) – kabunushi-kan no rieki sōhan mondai e no jitsumu tai'ō* 支配株主の存在をめぐるガバナンス問題(上) 株主間の利益相反問題への実務対応 [Corporate governance issues related to the existence of controlling shareholders (1) – The practical response toward the conflict issues between shareholders], 商事法務 Shōji Hōmu 2212 (2019) 4.

36 METI, *supra* note 32.

37 Supplementary Principle 4-8-3 of Japan's CG Code. The principle prescribes that "companies that have a controlling shareholder should either appoint at least one-third of their directors (the majority of directors if listed on the Prime Market) as independent directors who are independent of the controlling shareholder or establish a special committee composed of independent persons including independent director(s) to deliberate and review material transactions or actions that conflict with the interests of the controlling shareholder and minority shareholders".

wide risk management system is newly required by the revised Supplementary Principle 4-3-4.

Meanwhile, parent-subsidary listing has been expected to decrease as a result of the restructure of Tōkyō Stock Exchange that was carried out in conjunction with the revision of the Corporate Governance Code. In this restructuring, the current four markets (1<sup>st</sup> Section, 2<sup>nd</sup> Section, Mothers, and JASDAQ (Standard and Growth)) have been reorganized into three markets: Prime, Standard, and Growth, as described in Chart 1.

*Chart 1: On 4 April 2022, the Stock Market was Restructured into Three New Market Segments*



*Note:* This image shows how the market segments were changed on 4 April 2022 by the Tōkyō Stock Exchange. Copyright Japan Exchange Group, Inc.<sup>38</sup>

This reorganization entails the entire revision of listing conditions, possibly resulting in a significantly high hurdle for parent-subsidary companies to maintain the subsidiary as a publicly listed company. Newly created listing conditions require a company to have a certain proportion of tradable shares (see table below) which means that subsidiaries of a parent company with only a low percentage of transferable shares will lose their listing. The

<sup>38</sup> Tōkyō Stock Exchange, which consists of four markets (1<sup>st</sup> Section, 2<sup>nd</sup> Section, Mothers and JASDAQ (Standard and Growth)), restructures the market structure to three markets (Prime, Standard and Growth) to improve the convenience for investors and incentives for listed companies to sustainability increase corporate value. See JAPAN EXCHANGE GROUP, *supra* note 1.

revision of the listing conditions allows for a period of transition, but there is clearly pressure for subsidiaries to abandon listing in the future. This new listing rule may make cross-shareholding harder.

	Prime Market	Standard Market	Growth Market
Tradable shares	Not less than 20,000 units	Not less than 2,000 units	Not less than 1,000 units
Market cap of tradable shares	Not less than 10 billion JPY	Not less than 1 billion JPY	Not less than 500 million JPY
The percentage of tradable shares	Not less than 35%	Not less than 25%	Not less than 25%

## 2. *Creating an Ideal Environment for Constructive Engagement with Shareholders*

The increase in outside oversight has reduced the centralized power of executive boards and the restructure of corporate group governance has given subsidiaries independence to focus on their needs. This allows more constructive engagement with shareholders, especially minority shareholders, and general meetings are becoming more effective in Japan, particularly with the introduction of digital attendance and voting. Japan's Companies Act has also revised its sections on shareholder proposals, further enhancing shareholder engagement.

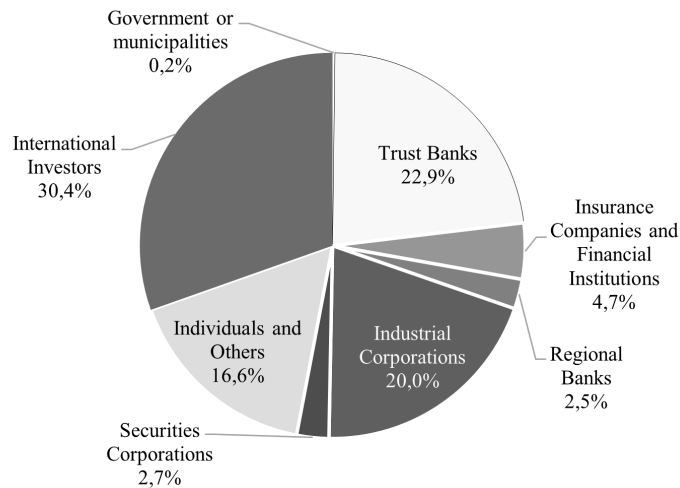
### *a) The current situation of shareholder engagement*

#### *aa) Current shareholder structure and the voting system in Japan*

The largest shareholders in Japanese companies are international investors with 30.4% of shares, followed by trust banks with 22.9%, and industrial corporations with 20.0% (Chart 2). Trust banks are the predominant institutional investors in Japan, handling not only banking services but also fiduciary services such as asset management on behalf of beneficiaries, and stock transfer agency services, which manage shareholder registry on behalf of listed companies.<sup>39</sup>

<sup>39</sup> Japan's Securities Listing Regulations [有価証券上場規程] prescribe that the companies going public must entrust stock administrations to stock transfer agencies such as trust banks (Provision 205 (8)).

Chart 2: Shareholding in Japan's Stock Exchanges in 2021 by Investment Sector



Note: Data collated from “The Results of the Stock Distribution Survey in 2021” provided by the Tōkyō Stock Exchange et al.<sup>40</sup>

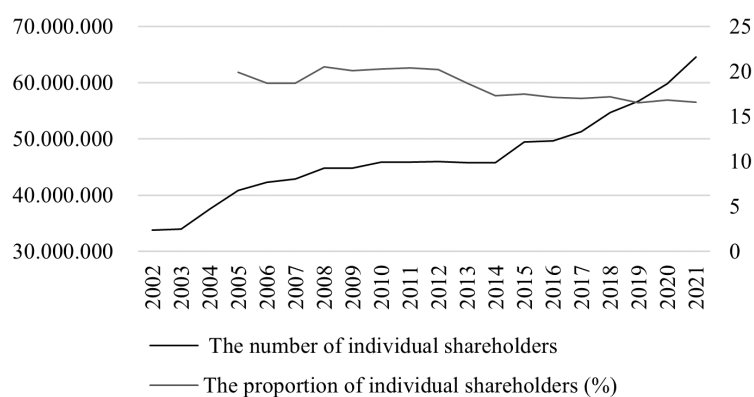
The number of individual investors has risen steadily in Japan between 2002 and 2021 as described in Chart 3,<sup>41</sup> and they are the main attendees at Japanese annual general meetings (AGMs). Linked with this, has been the habit of distributing company souvenirs such as their products, confectionery, and prepaid cards at AGMs and some individual shareholders attended merely to receive souvenirs. This problematic situation was brought to a halt in 2019 by the coronavirus (COVID-19) pandemic. Over 60% of companies provided souvenirs to attendees before the pandemic but this decreased to a mere 8.1% in 2022.<sup>42</sup> Even after the pandemic, such trend remains.

40 TŌKYŌ STOCK EXCHANGE et al., *2021-nendo kabunushi bunpu jōkyō chōsa kekka no gaiyō* (2021 年度株主分布状況調査結果の概要) [The Results of the Stock Distribution Survey 2021], 7 July 2022, <https://www.jpx.co.jp/markets/statistics-equities/examination/nlsgeu000005nt0v-att/report2020.pdf>, accessed 28 March 2022.

41 The number of individual shareholders was approximately 34 million in 2002, which had increased to nearly 65 million in 2021. See TŌKYŌ STOCK EXCHANGE et al., *supra* note 40.

42 *Kabunushi sōkai hakusho 2019-nen-ban* (株主総会白書 2019 年版) [The general meeting white paper 2019], 商事法務 Shōji Hōmu 2216 (2019) 52, and *Kabunushi sōkai hakusho 2022-nen-ban* (株主総会白書 2022 年版) [The general meeting white paper 2022], 商事法務 Shōji Hōmu 2312 (2022) 61.

Chart 3: The Transition of Individual Shareholders



Note: This graph was compiled by the authors based on data from “The Results of the Stock Distribution Survey in 2021” (Tōkyō Stock Exchange et al.)<sup>43</sup>

Voting today is mainly by mail or electronically,<sup>44</sup> while proxy voting is uncommon in Japan. Japan’s revised Corporate Governance Code required companies listed on the Prime Market to introduce an Electronic Voting Platform<sup>45</sup> and this has meant that the number of companies that adopt electronic voting has steadily grown, reaching 81.0% in a survey targeting all kinds of markets in 2022.<sup>46</sup> This upward trend was boosted when com-

43 Illustrated by the author based on the Research by TŌKYŌ STOCK EXCHANGE et al., *supra* note 40; TŌKYŌ STOCK EXCHANGE et al., *2015-nendo kabunushi bunpu jōkyō chōsa kekka no gaiyō* (2015年度株主分布状況調査結果の概要) [The Results of the Stock Distribution Survey 2015], 28 September 2016, <https://www.jpx.co.jp/markets/statistics-equities/examination/nlsgeu000001q8j8-att/report2015.pdf> and TŌKYŌ STOCK EXCHANGE et al., *Heisei 22-nendo kabunushi bunpu jōkyō chōsa kekka no gaiyō* (平成22年度株主分布状況調査結果の概要) [The Results of the Stock Distribution Survey 2021], 7 October 2021, <https://www.jpx.co.jp/markets/statistics-equities/examination/tvdivq000000ec9b-att/report2021.pdf>.

44 Japan’s Companies Act mandatorily requires the companies with no less than 1,000 shareholders to arrange the voting in writing (Article 298 (2)). The percentage of the companies with the voting in writing is 98.9% in a survey targeted for all kind of markets. See *Kabunushi sōkai hakusho 2022-nen-ban*, *supra* note 42, 92.

45 The Electronic Voting Platform is the infrastructure which connects involved parties of shareholder general meetings with the network system for the development of an environment where institutional and foreign investors can exercise voting rights properly, provided by Investor Communications Japan, Inc. See the website of ICJ <https://www.icj.co.jp/en/>, accessed 4 June 2023.

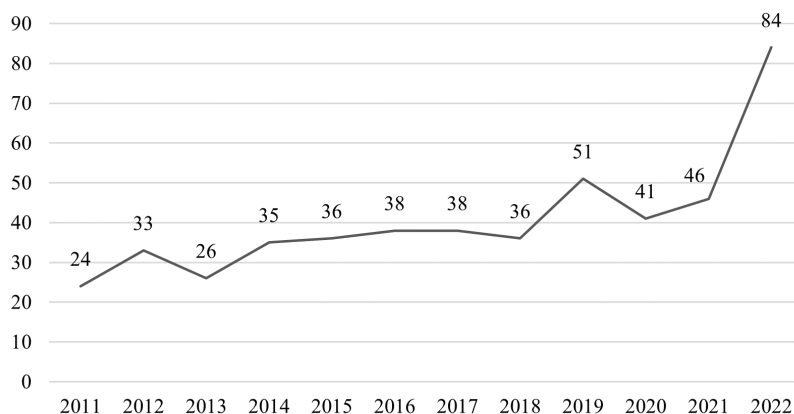
46 *Kabunushi sōkai hakusho 2022-nen-ban*, *supra* note 42, 94.

panies recommended that their shareholders did not attend AGMs during the COVID-19 epidemic.

*bb) Contemporary history on shareholder proposals in Japan*

Since 1981, an amendment to Japan's Companies Act has allowed shareholders with a 1% shareholding ratio to put proposals to general meetings, and many shareholders have done so. However, in the early 2010s, this right began to be abused by, for example, activists opposed to nuclear power plants who swamped meetings with multiple proposals, or by individuals making frivolous proposals.<sup>47</sup> Chart 4 shows that the number of companies that received shareholder proposals increased from 24 in 2011 to 84 in 2022.

*Chart 4: The Number of Companies which Received Shareholder Proposals*



This graph is based on data from “The general meeting white paper” from 2011 to 2022.<sup>48</sup>

<sup>47</sup> Nomura Holdings received 18 proposals in 2012, including a proposal for a change in the address term for directors to “Crystal Officer” and for the renovation of the toilets in the offices to Japanese style. HOYA received 20 proposals in 2011, which brought about litigation on their acceptance.

<sup>48</sup> *Kabunushi sōkai hakusho 2011-nen-ban* (株主総会白書 2011 年版) [The general meeting white paper 2011], 商事法務 Shōji Hōmu 1949 (2011) 51; *Kabunushi sōkai hakusho 2012-nen-ban* (株主総会白書 2012 年版) [The general meeting white paper 2012], 商事法務 Shōji Hōmu 1983 (2012) 56; *Kabunushi sōkai hakusho 2013-nen-ban* (株主総会白書 2013 年版) [The general meeting white paper 2013], 商事法務 Shōji Hōmu 2016 (2013) 57; *Kabunushi sōkai hakusho 2014-nen-ban* (株主総会白書 2014 年版) [The general meeting white paper 2014], 商事法務 Shōji Hōmu 2051 (2014) 60; *Kabunushi sōkai hakusho 2015-nen-ban* (株主総会白書 2015 年版) [The

Nowadays, although 42.4% of shareholder proposals are still submitted by nuclear power plant activists to electric power companies,<sup>49</sup> other abuse cases are rare. Instead, institutional investors have focused on finance and corporate governance issues of Japanese listed companies. The background to this transition is partly court decisions which declared that shareholder proposals could be considered an abuse of rights and thus illegal,<sup>50</sup> but there has also been a change in the people who submit shareholder proposals. In the early days, abuse proposals were submitted by large individual shareholders who disagreed with company management,<sup>51</sup> but recently, proposers are more likely to be international institutional investors and activists whose proposals include cross-shareholdings, directors' remuneration, and environmental issues.<sup>52</sup> The main characteristic of this trend is that the number of votes in favour of proposals have become significant, and in particular, pro-

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general meeting white paper 2015], 商事法務 Shōji Hōmu 2085 (2015) 53; *Kabunushi sōkai hakusho 2016-nen-ban* (株主総会白書 2016 年版) [The general meeting white paper 2016], 商事法務 Shōji Hōmu 2118 (2016) 56; *Kabunushi sōkai hakusho 2017-nen-ban* (株主総会白書 2017 年版) [The general meeting white paper 2017], 商事法務 Shōji Hōmu 2151 (2017) 60; *Kabunushi sōkai hakusho 2018-nen-ban* (株主総会白書 2018 年版) [The general meeting white paper 2018], 商事法務 Shōji Hōmu 2184 (2018) 59; *Kabunushi sōkai hakusho 2019-nen-ban* (株主総会白書 2019 年版) [The general meeting white paper 2019], 商事法務 Shōji Hōmu 2216 (2019) 63; *Kabunushi sōkai hakusho 2020-nen-ban* (株主総会白書 2020 年版) [The general meeting white paper 2020], 商事法務 Shōji Hōmu 2256 (2021) 77; *Kabunushi sōkai hakusho 2021-nen-ban* (株主総会白書 2021 年版) [The general meeting white paper 2021], 商事法務 Shōji Hōmu 2280 (2021) 71; *Kabunushi sōkai hakusho 2022-nen-ban* (株主総会白書 2022 年版) [The general meeting white paper 2022], 商事法務 Shōji Hōmu 2312 (2022) 72.

- 49 H. MIZUSHIMA, *Hon'nen rokugatsu sōkai ni okeru kabunushi teian no naiyō to kore ni taisuru kabunushi no sanpi handan – tōshō ichibu jōjō kigyō o taishō ni* (本年六月総会における株主提案の内容とこれに対する株主の賛否判断—東証一部上場企業を対象に) [The Contents of Shareholder Proposals on AGM in June this year and Shareholder Voting Decision for or against them – targeting the companies listed in the 1<sup>st</sup> section in Tōkyō Stock Exchange], 商事法務 Shōji Hōmu 2278 (2021) 34.
- 50 Tōkyō High Court, Decision, 31 May 2012, 資料版商事法務 Shiryō-ban Shōji Hōmu 340 (2012) 30, and Tōkyō High Court, Judgement, 19 May 2015, 金融・商事判例 Kin'yū Shōji Hanrei 1473 (2015) 26.
- 51 H. MATSUI, *Kabunushi tei'an-ken no dōkō* (株主提案権の動向) [Trends in Shareholder Proposal Rights], ジュリスト Jurisuto 1452 (2013) 41. Regarding this point, *Kabunushi sōkai hakusho 2011-nen-ban* (株主総会白書 2011 年版) [The general meeting white paper 2011], 商事法務 Shōji Hōmu 1949 (2011) mentions that the number of shareholder proposals placed by institutional investors like foreign investment fund was few in general meetings in June 2011; see *ibid.*, at 51.

posals to amend the articles of incorporation and to force the sale of shares of cross-shareholdings, although unsuccessful, have received more than 20% of votes. In future, because of issues relating to cross-shareholding, the proportion of affirmative votes may well rise in future AGMs, and this has prompted companies to review their cross-shareholdings.

In individual engagement with shareholders, corporate governance has become a significant topic, mainly with major shareholders and Japanese institutional investors,<sup>53</sup> and Japan's Companies Act has therefore been revised to tackle abusive shareholder proposals and to introduce a limit of 10 to the number of proposals that can be made. This was enforced in 2021 (Art. 305 VI). This limitation is still less strict than is the case in the US which permits the submission of only one proposal<sup>54</sup> but all in all, engagement with shareholders has increased over the last decade.

*cc) Contemporary history of shareholder activism in Japan*

Japanese shareholders started to become active in the mid-2000s as they demanded an improvement to shareholder returns.<sup>55</sup> Activity rapidly shrank with the global financial crisis until the second phase of shareholder activism was initiated in 2013 when Third Point targeted Sony. This phase emphasized activism by institutional investors and funds and was promoted by the introduction of Japan's Stewardship Code in 2014 and the Corporate Governance Code in 2015.<sup>56</sup> Since then, the number of Japanese companies targeted by activists has significantly increased to the extent that Japan has overtaken the UK, Canada, and Australia to become in 2020 the country with second most active targeting after the USA (Chart 5).<sup>57</sup>

52 Mizuho Financial Group received the proposal to amend the strategy to align with the Paris Agreement in 2020, which got 34% of affirmative votes.

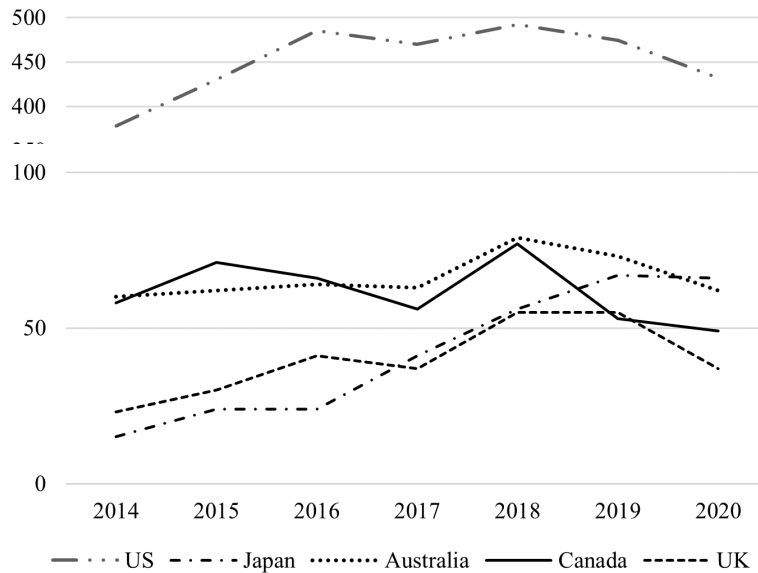
53 T. YAMADA, *Jōjō kigyō to kabunushi/tōshi-ka to no taiwa no jittai to kisei e no hōteki shiza* (上場企業と株主・投資家との対話の実態と規制への法的視座) [The reality of engagement between listed companies and shareholders and the legal perspective for the regulation], 商事法務 Shōji Hōmu 2268–2270 (2021).

54 Rule 14a-8(c) of SEC. Amended Rule 14a-8(c) establishes that a person may not submit multiple proposals for the same shareholder meeting, whether the person submits a proposal as a shareholder or as a representative of a shareholder.

55 Funds such as Murakami Fund, Steel Partners (US) and The Children's Investment (UK) received social attention in the middle of 2000s. See A. MATSUSHITA, *Akutibisto kabunushi taiō no saishin no standādo (jō) – henka suru kabunushi akutibizumu no dōkō o fumaete* – (アクティビスト株主対応の最新のスタンダード [上] – 変化する株主アクティビズムの動向を踏まえて –) [The Newest Standard of Activist Shareholder Policy (1) – In light of the trend of changeable shareholder activism –], 商事法務 Shōji Hōmu 2274 (2021) 15, 19.

56 MATSUSHITA, *supra* note 55, 19.

Chart 5: The Number of Companies Publicly Subjected to Activist Demands, by Company HQ and Time Period



Note: This graph is from A. MATSUSHITA, *The Newest Standard of Activist Shareholder Policy (1) –In light of the trend of changeable shareholder activism–*, and is based on data from “Shareholder activism in January 2021” provided by INSIGHTIA.<sup>58</sup>

Meanwhile, the percentage of loyal shareholders<sup>59</sup> has been falling<sup>60</sup> which may have accelerated shareholder activism, but the approach taken by these activists has been more positive towards engagement with management and has made more rational proposals that are appreciated by the institutional investors who influence voting activity.<sup>61</sup> However, between 2015 and 2021, the number of hostile takeover cases has increased; six cases have arisen and three companies were successfully acquired in 2021, one by a domestic fund

57 INSIGHTIA, *Shareholder Activism In January 2021* (January 2021) [https://www.activistsight.com/research/Insightia\\_ShareholderActivism2020.pdf](https://www.activistsight.com/research/Insightia_ShareholderActivism2020.pdf).

58 A. MATSUSHITA, *supra* note 55, 20; INSIGHTIA, *supra* note 57.

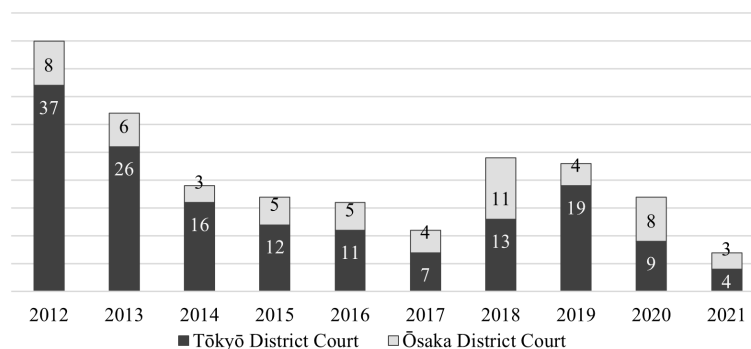
59 “The percentage of loyal shareholders” is taken as the ratio of the voting rights held by the shareholders who can be expected to assent to the company’s proposals in the resolution of the general meeting to the total number of voting rights. See *Kabunushi sōkai hakusho 2021-nen-ban* (株主総会白書 2021年版) [The general meeting white paper 2021], 商事法務 Shōji Hōmu 2280 (2021) 98.

60 *Kabunushi sōkai hakusho 2021-nen-ban*, *supra* note 59, 98–99.

61 MATSUSHITA, *supra* note 55, 20.

and one by a foreign fund.<sup>62</sup> Apart from making shareholder proposals, activists have also requested dialogue with management, proposed general meetings, demanded that shareholders' meetings be called, and joined boards of directors. As for litigation, the fact that a shareholder holding no less than One Share Unit<sup>63</sup> can file litigation to enforce directors' duties on behalf of the company,<sup>64</sup> makes it easy to start an action in Japan. Yet, the trend of derivative actions is downwards, as shown in Chart 6. Rather than litigation, approaches outside the court and preventive activities such as monitoring through engagement with board members are more common.

Chart 6: The Number of New Cases of Shareholders' Derivative Actions



Note: This chart has been compiled from data from Tōkyō and Ōsaka district courts provided by TAKAHASHI, TAKEMURA and NISHIMURA in 商事法務 Shōji Hōmu.<sup>65</sup>

62 M. MOGI/K. TANINO/K. NISHIKAWA, *Tekitaiteki baishū bōei-saku no dō'nyū jōkyō to sono dōkō –2021-nen 6-gatsu sōkai o fumaete–* (敵対的買収防衛策の導入状況とその動向—2021年6月総会を踏まえて—) [The Status and Trend of Hostile Takeover Defences – In Light of the Shareholder Meetings in June 2021], 商事法務 Shōji Hōmu 2276 (2021) 14, 19–20.

63 Under Japan's Companies Act and Securities Listing Regulations (有価証券上場規程), the shareholder rights such as voting rights are granted to each holder of a unit of shares, not one shares in listed companies. One unit is regulated to consist of 100 shares by Japan Exchange Group. A shareholder with one share unit (100 shares) is eligible to cast one vote at a shareholder meeting as well as file a derivative lawsuit.

64 The Article 847 (1) of Japan's Companies Act prescribes the shareholder's right to demand the company to file an action to enforce the liability directors. When the company does not file an Action to Enforce Liability within 60 days from the day of the demand, the shareholder is eligible to file an Action to Enforce Liability on behalf of the company (Art. 847 (3)).

*dd) The current situation of shareholder engagement in Japan*

Recently, with the increased significance to listed companies of voting by institutional investors, various ideas to encourage constructive engagement with them have been introduced. One major innovation has been to hold briefings for investors, an idea introduced by approximately 60% of listed companies in 2021. Other initiatives in nearly 40% of companies involve individual visits to institutional investors and research to identify their beneficial shareholders.<sup>66</sup> The topics that domestic institutional investors are particularly concerned about mainly concern business strategies and models, financial or business portfolio strategy, management philosophy, and evaluation of board effectiveness.<sup>67</sup> One recent high-profile topic is the diversity of skills of the board since the revision to Japan's Corporate Governance Code has required all applicable companies to disclose their skills matrix.<sup>68</sup> But the issue that has been most discussed and emphasized is how corporate governance can be structured in order to achieve both long- and middle-term corporate value and the contribution to a sustainable society.<sup>69</sup> An increasing number of companies have used evaluation of board effectiveness to improve their corporate governance.<sup>70</sup>

65 Described from data published in 商事法務 *Shōji Hōmu* 2144, 2273 and 2274; see H. TAKAHASHI, *Tōkyō chisai ni okeru shōji jiken no gaikyō (jō)* (東京地裁における商事件の概況 [上]) [The Outline of Commercial Litigations in Tōkyō District Court (1)], 商事法務 *Shōji Hōmu* 2273 (2021) 4, 7, and T. TAKEMURA, *Ōsaka chisai ni okeru shōji jiken no gaikyō* (大阪地裁における商事件の概況) [The Outline of Commercial Litigations in Ōsaka District Court], 商事法務 *Shōji Hōmu* 2274 (2021) 4, 7; K. NISHIMURA, *Ōsaka chisai ni okeru shōji jiken no gaikyō* (大阪地裁における商事件の概況) [The Outline of Commercial Litigations in Ōsaka District Court], 商事法務 *Shōji Hōmu* 2144 (2017) 4, 7.

66 *Kabunushi sōkai hakusho 2021-nen-ban*, *supra* note 59, 177–178.

67 K. ITŌ/M. MOGI/S. HASEGAWA/K. YAMADA/D. FUJITA, *Sasutenabiriri keiei jitsugen ni muketa kōporēto gabanansu kaikaku (ge) – gabanansu sābei 2020 kara miru genjō to bunseki* – (サステナビリティ経営実現に向けたコーポレートガバナンス改革 [下] – ガバナンスサーベイ 2020 からみる現状と課題 –) [The Corporate Governance Reforms towards the Achievement of Sustainable Management (2) – The current situation and issues seen in Governance Survey 2020 –], 商事法務 *Shōji Hōmu* 2264 (2021) 42, 50.

68 Revised Supplementary Principle 4-11-1 of Japan's Corporate Governance Code suggests that “the board should establish policies and procedures for nominating directors and disclose them along with the combination of skills, etc. that each director possesses in an appropriate form according to the business environment and business characteristics, etc., such as what is known as a ‘skills matrix’.”

69 ITŌ/MOGI/HASEGAWA/YAMADA/FUJITA, *supra* note 67, 50.

70 Y. IWATA/Y. MAKI, *Torishimari yakkai hyōka no genjō to kongo no kadai* (取締役会評価の現状と今後の課題) [The reality of Board Evaluations and its Future Issues],

In the context of shareholder engagement in Japan, proxy advisors such as Institutional Shareholder Services (ISS) and Glass Lewis are influential and companies pay attention to their policies. The disclosed voting policies of domestic institutional investors also influence companies' discussions about corporate governance to the extent that they are becoming rule-makers in Japanese corporate governance.<sup>71</sup> One distinguishing trait of these voting policies is the significant number of reasons for dissent from proposals on the appointment of top executives. ISS gives a number of examples of such reasons for objection: underperformance in capital efficiency; allocation of more than 20% of its net assets to cross-shareholdings; failure of the board to include at least two or at least one third of outside directors. All these are regarded by institutional shareholders as the responsibility of top executives to carry out.<sup>72</sup>

*b) Digitization of the AGM*

The advancement of technology has a major impact on capital markets, and should play an increasing role in corporate governance. The reforms carried out in Japan have paved the way for a new form of governance assisted by technology in the digital future.

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商事法務 Shōji Hōmu 2262 (2021) 38, 39. The companies that implemented the board effectiveness evaluation reached 91.78% in TSE Prime Market (1,837 companies). On the other hand, as externally facilitated board evaluation has not been required in Japan's Corporate Governance Code like the UK Corporate Governance Code, the rate of the companies with the external evaluation (including consideration of the external evaluation) is still low at 17.4%. However, the companies proactive to utilise the board evaluation to improve the effectiveness are the increasing trend, and the disclosure of the evaluation results has been enriched. See TŌKYŌ STOCK EXCHANGE, *Kōporēto gabanansu kōdo e no taiō jōkyō (2021-nen 7-gatsu 14-nichi jiten)* (コーポレートガバナンスガバナンス・コードへの対応状況 (2022年7月14日時点)) [Correspondence of Corporate Governance Code (at 14 July 2022)], 3 August 2022, <https://www.jpx.co.jp/news/1020/nlsgeu000006jro6-att/nlsgeu000006jrqr.pdf> and TŌKYŌ STOCK EXCHANGE, INC., TSE-Listed Companies White Paper on Corporate Governance 2021, March 2021, <https://www.jpx.co.jp/equities/listing/cg/tvdivq0000008jb0-att/nlsgeu000005qnsz.pdf>.

71 Y. KURAMOTO/K. KOBU/H. SANPEI/M. SAWAGUCHI, *Kikan tōshi-ka ni kiku (jō)* (機関投資家に聞く [上]) [Hearing from institutional investors (1)], 商事法務 Shōji Hōmu 2281 (2021) 23.

72 ISS, Japan Proxy Voting Guidelines Benchmark Policy Recommendations (13 December 2021) <https://www.issgovernance.com/file/policy/active/asiapacific/Japan-Voting-Guidelines.pdf>. The reason for the trait is pointed out as Japanese specific corporate governance structure where the management and monitoring are not separated. See KURAMOTO/KOBU/SANPEI/SAWAGUCHI, *supra* note 71, 23.

One such reform is digitization of general meetings and this is now promoted in Japan. Previously, according to Japan's Companies Act, a physical venue and a paper-based Notice of the Annual General Meeting were essential for general meetings to be held. Currently, however, many Japanese listed companies have adopted a combination of traditional and digital approaches by sending out notice letters and simultaneously uploading their content online and by holding a physical AGM which is also accessible virtually. The recent COVID-19 situation has accelerated the need for digitization and three aspects of digitization are in action: convocation notices, voting, and general meetings.

From September 2022, the Japan's revised Companies Act has disallowed paper-based reference documents and business reports and requires disclosure on the Internet. Traditionally in Japan, the package of notices for a general meeting to shareholders, consisting of the notices, the reference documents, business reports and financial statements, has been required to be dispatched in paper form no later than two weeks prior to the day of the shareholders' meeting.<sup>73</sup> In recent years, Japanese listed companies have practically disclosed all the contents of the package of notices on the Internet partly to economize and partly because institutional investors require disclosure of information in that form as early as possible. Under the new regulation, introduced based on this practical flow, companies must upload the necessary information on their website at least three weeks before the date of a shareholder meeting, and must also send a letter of notification to access the information as well as a voting form to shareholders no less than two weeks before the AGM.<sup>74</sup>

The voting system is also in the process of changing from paper-based voting letters to an internet voting system, as required by Japan's CG Code. In Japan, all listed shareholders' ownership rights are managed in a computerized way by Japan Securities Depository Center, Inc. (JSDC). The Book-Entry Transfer System for Stocks maintained by JSDC makes it easy for shareholders to transfer their shares in terms of cost and time. Transfer data are periodically shared with trust banks in order to update the shareholder lists that they manage on behalf of listed companies. Unlike the UK's indirect system of voting, voting in Japan is performed by each shareholder directly to the listed company, a system that facilitates voting by foreign shareholders. In addition, "smartphone-voting" has become popular in Japan through the pandemic influence, which involves browsing the resolutions and voting on the display of smartphones and by scanning a QR code on the voting forms. In 2022, the great advance of smartphone voting meant that

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73 Artt. 299 (1) (2), 301 (1) and 437 Companies Act.

74 Artt. 325-3 and 325-4 Companies Act.

82.6% of companies with an internet voting system used it.<sup>75</sup> Given that situation, the proportion of shares held by individual shareholders who exercised their voting right has experienced a steady increase from around 38.1% from July 2017 to June 2018 to 43.0% from July 2021 to June 2022.<sup>76</sup> The share percentage voted by individuals is relatively higher than other countries such as US with 31% and UK with 22%.<sup>77</sup> In this way, a digitized voting system fosters and increases the proportion of votes cast at general meetings by both international and individual shareholders.

The digitization of general meetings was being thought about even before the COVID-19 pandemic and, as mentioned above, Japan's Companies Act required a designated physical venue for general meetings. So, holding general meetings in a hybrid way that combined the physical and the virtual had been the only way for digitized general meetings to go ahead in Japan. To assist the management of shareholder meetings, in February 2020, METI issued "Guidance for Hybrid Virtual General Meetings" to facilitate shareholder engagement.<sup>78</sup> Propelled by the necessity of preventing COVID-19 infection, in June 2021, over 300 listed companies held "Hybrid Virtual" general meetings, three times the number in 2020.<sup>79</sup> According to research by the Sumitomo Mitsui Trust Bank, hybrid virtual general meetings saw a higher attendance rate than did physical-only general meetings in June 2021.<sup>80</sup>

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75 ZEN-KABUKON [全株懇], *2022-nendo zen-kabukon chōsa hōkoku-sho* (2022年度全株懇調査報告書) [The Research Report 2022] (October 2022) 9, [https://www.kabukon.tōkyō/data/data/research/research\\_2022.pdf](https://www.kabukon.tōkyō/data/data/research/research_2022.pdf), accessed 6 June 2023. The report shows that the proportion of the companies which have adopted the Internet voting system constitute 81.4% of the respondent companies in 2022, increasing from 72.1% in 2021.

76 TRUST COMPANIES ASSOCIATION OF JAPAN [信託協会], *NEWS RELEASE – Jōjō kaisha no kabunushi sōkai ni okeru kojū kabunushi-tō no giketsu-ken kōshi jōkyō ni tsuite – (上場企業の株主総会における個人株主等の議決権行使状況について)* [Voting rights of individual shareholders and others at general meetings of shareholders of listed companies] (2022) <https://www.shintaku-kyokai.or.jp/archives/013/202211/NR20221101.pdf>, accessed 6 June 2023.

77 EQ, *Shareholder voice 2022. Responding To Uncertain Times*, 11, <https://equiniti.com/media/13391/eq-shareholder-voice-report-2022.pdf>, accessed 6 June 2023.

78 METI, *Haiburiddo-gata bācharu kabunushi sōkai no jisshi gaido* (ハイブリッド型バーチャル株主総会の実施ガイド) [The guidance for Hybrid Virtual General Meetings], 26 February 2020, <https://www.meti.go.jp/press/2019/02/20200226001/20200226001-2.pdf>.

79 Y. YOSHIDA/T. KURAMOCHI/K. NISHIKAWA, *Bācharu kabunushi sōkai jisshi dōkō to ryū-ten* (バーチャル株主総会実施動向と留意点) [The Trend of Virtual General Meetings and Considerations], 商事法務 Shōji Hōmu 2279 (2021) 25, 26.

80 YOSHIDA/KURAMOCHI/NISHIKAWA, *supra* note 79.

In addition, the Industrial Competitiveness Enhancement Act<sup>81</sup> was amended in 2021 to enable companies to hold virtual-only shareholder meetings. Under this amendment, a listed company that has obtained the approval of both the Ministries of Economy, Trade, and Industry and of Justice can hold a “Shareholders Meeting without a Designated Location” by establishing an appropriate article in its constitution.<sup>82</sup> In this way, the digitization of shareholders meetings is now proceeding apace in Japan. Up to now, operational defects have not occurred in hybrid virtual general meetings in Japan, but despite careful consideration and preparation by system companies and relevant parties, it is impossible to completely eliminate the operational risks inherent in virtual general meetings (YOSHIDA et al., 2021). Examples of potential problems might include impersonation of shareholders, interference with the operation by the abusive exercise of inquiry rights, and cyber-attack on the meeting. The increasing use of virtual general meetings to enhance efficient engagement with shareholders is something that must be expected.

### 3. Promoting Medium- to Long-term Investment

ESG is becoming a feature of corporate governance and a way to avoid corporate short termism, and there is hope that increased shareholder engagement can bring about it and that technological advancement can facilitate value-focused investor engagement. In addition to investor engagement, stakeholder engagement is also being considered as an essential element in realizing long-term corporate value. As a result, information disclosure, especially of non-financial information, and further engagement with shareholders has been increasingly required for medium- to long-term investment in Japan. To achieve sustainable investment, the Japanese government has focused on two aspects of shareholder engagement: information disclosure and effective engagement with investors.

In 2019 and in 2023 the Japanese government amended the Cabinet Office Order on Disclosure of Corporate Affairs<sup>83</sup> to expand the range of dis-

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81 The Industrial Competitiveness Enhancement Act (産業競争力強化法 *Sangyō kyōsō-ryoku kyōka-hō*, Law No. 98/2013) prescribes how to introduce the shareholder meeting without the designation of a physical venue in chapter 4.

82 METI Outline of rules concerning a “Shareholders Meeting without a Designated Location” (2021), [https://www.meti.go.jp/policy/economy/keiei\\_innovation/keizai\\_housei/virtual-only-shareholders-meeting\\_explanatory-material-en.pdf](https://www.meti.go.jp/policy/economy/keiei_innovation/keizai_housei/virtual-only-shareholders-meeting_explanatory-material-en.pdf), accessed 10 October 2021.

83 The Cabinet Office Ordinance on Disclosure of Corporate Affairs [企業内容等の開示に関する内閣府令] requires mainly companies listed in Japan to disclose the corporate information by prescribing the contents to disclose.

closure. The information to be disclosed has included management policies and business strategies along with management perception of the risks, remuneration programmes, and the method adopted to verify the rationale behind cross-shareholdings since 2019. In addition, new requirements for the workforce (the percentage of women in managerial positions, the rate of child-care leave by fathers and the gender pay gap), for the sustainability approach and initiatives (Governance, Strategy, Risk Management and Metrics and Targets), and for corporate governance (the frequency and agenda of the board, nomination committee and remuneration committee, and the attendance of committee members, as mentioned above) should be implemented from 2023. Propelled by such a trend, many Japanese companies are willing to expand their corporate disclosure by providing descriptive and easily understood content to stakeholders and shareholders, by posting additional information on business reports to be sent in advance of general meetings, and by publishing an Integrated Report.

Secondly, effective engagement with investors that is geared toward increasing corporate value is promoted by the “Guidelines for Investor and Company Engagement,”<sup>84</sup> which was newly established as a complement to the Corporate Governance Code and revised in 2021. This guideline focuses on issues such as business judgement, investment strategy, enhancement of board function, and corporate governance. The expectation is that listed companies will prioritize issues through constructive engagement with investors in order to improve corporate value. In this way, the Japanese government now encourages effective engagement between listed companies and investors by requiring broad disclosure and identifying essential issues for discussion.

Because of such initiatives for sustainable investment, the Tōkyō Stock Exchange provides ESG-related products for investors such as indices that take into account environmental, social and governance factors.<sup>85</sup> It also offers issuers an explanatory booklet about ESG<sup>86</sup> produced in coordination with the Sustainable Stock Exchanges initiative organized by the United Nations Conference on Trade and Development, the United Nations Global Compact, the United Nations Environment Program Finance Initiative and

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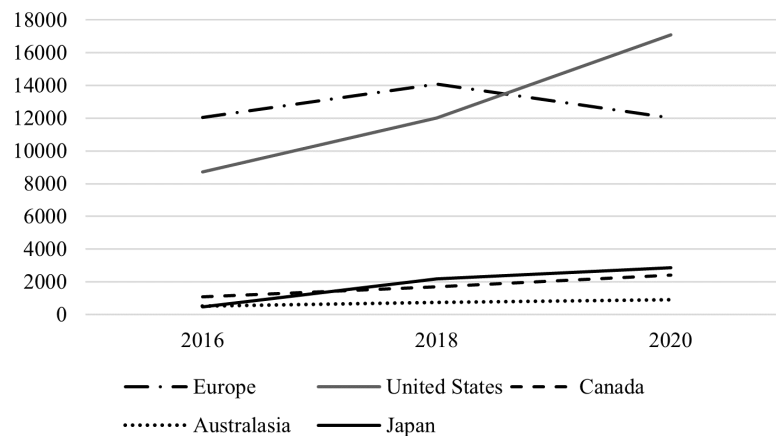
84 FSA, Guidelines for Investor and Company Engagement, 11 June 2021, <https://www.fsa.go.jp/en/news/2021/20210406/03.pdf>.

85 See JAPAN EXCHANGE GROUP, ESG-related Products, 2 April 2022, <https://www.jpx.co.jp/english/corporate/sustainability/esg-investment/esg-relatedproducts/index.html>, accessed 7 April 2022.

86 JAPAN EXCHANGE GROUP (日本取引所グループ) and QUICK, JPX-QUICK ESG *kadai kaisetsu-shū 2022* (JPX-QUICK ESG 課題解説集 2022) [JPX-QUICK Explanatory Booklet of ESG Issues 2022] (30 March 2022) <https://www.jpx.co.jp/corporate/news/news-releases/0090/nlsgeu0000069bma-att/anthology.pdf>.

UN-supported Principles for Responsible Investment.<sup>87</sup> The sustainable investment approach that considers environmental, social, and governance factors in portfolio selection and management, has rapidly increased in Japan from US\$ 474 billion in 2016 to US\$ 2,874 billion in 2020, overtaking both Canada and Australasia.

Chart 7: Global Sustainable Investment Assets



Note: Growth of sustainable investing assets in Japan<sup>88</sup> compared with the global amount. (Based on data from the ‘Global Sustainable Investment Review 2020’ provided by Global Sustainable Investment Alliance)

Furthermore, sustainable investment assets have increased rapidly both internationally, and in Japan between 2016 and 2020, as this graph shows. Increasing concern about sustainability has also been evident from the behaviour of both international and Japanese institutional investors when, for example, they vote against the election of directors if a company neglects sustainability in its actions.<sup>89</sup> GPIF, the largest international pension fund that is endorsed by the Ministry of Health, Labour and Welfare of Japan, has recently adopted an ESG index for shares issued by Japanese companies.<sup>90</sup>

87 Japan Exchange Group, ESG Investment, <https://www.jpx.co.jp/english/corporate/sustainability/esg-investment/index.html>.

88 GLOBAL SUSTAINABLE INVESTMENT ALLIANCE, Global Sustainable Investment Review 2020 (2021), <http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf>.

89 M. SAWAGUCHI et al., *Jogen kaisha/kikan tōshi-ka no giketsu-ken kōshi kijun no dōkō (ge)* (助言会社・機関投資家の議決権行使基準の動向 [下]) [Trends on Voting Standards of Proxy Advisors and Institutional Investors (2)], 商事法務 Shōji Hōmu 2285 (2022) 41, 43–44.

### III. PATHWAY TO A MORE SUSTAINABLE JAPAN

Sustainable management in listed companies is essential for the sustainable growth of not only the company but also the nation's economy, so the Japanese government has attempted to leverage the enhancement of corporate governance to achieve more sustainable growth for companies as well as the country itself.<sup>91</sup> This section introduces initiatives that promote corporate sustainability, such as the transition to a purpose-based corporation, enhancement of sustainability and its disclosure, and digitization.

#### 1. *A More Purpose-based Corporation*

Today, corporate purpose is regarded as mission-purpose, which, according to D. KERSHAW and E. SCHUSTER is “the reason for a corporation's existence; why it matters for society that it exists.”<sup>92</sup> It is internationally acknowledged that “purpose-based” management should be prioritized over “efficiency- or profits-based” management for the sustainable growth of companies.<sup>93</sup> For example, in the UK, Principle B of the CG Code 2018 states that it is “the first mover in its regulatory recognition of mission-purpose.”<sup>94</sup> This requires the establishment of a corporate purpose along with its values, and strategy.<sup>95</sup> In the same way, corporate purpose is defined as the reason for the existence of a company in Japan and since 2015 the Japanese government has tried to promote more purpose-based corporations through its CG and Stewardship Code as well as relevant Guidelines.<sup>96 97</sup>

90 FTSE Blossom Japan Sector Relative Index, see GPIF, New Adoption of ESG Index ‘New adoption of FTSE Blossom Japan Sector Relative Index’, 30 March 2022, [https://www.gpif.go.jp/en/investment/20220330\\_esg\\_adopt\\_en.pdf](https://www.gpif.go.jp/en/investment/20220330_esg_adopt_en.pdf).

91 PRIME MINISTER'S OFFICE [首相官邸], ‘Nihon saikō senryaku’ kaitei 2014 – mirai e no chōsen (「日本再興戦略」改訂 2014 — 未来への挑戦) [Revised ‘Japan Revitalization Strategy’ 2014 – The Challenge toward the Future], 24 June 2014, <https://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/honbun2JP.pdf>.

92 D. KERSHAW/E. SCHUSTER, The Purposive Transformation of Corporate Law, *The American Journal of Comparative Law* 69 (2021) 478–538, <https://doi.org/10.1093/ajcl/avac004>.

93 C. MAYER, The Governance of Corporate Purpose [2021] ECGI Working Paper Series in Law, Working Paper No. 609/2021 [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3928613](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3928613).

94 KERSHAW/SCHUSTER, *supra* note 92.

95 This principle is explained in detail in MAYER, *supra* note 93.

96 METI, Guidance for Integrated Corporate Disclosure and Company–Investor Dialogue for Collaborative Value Creation (‘Guidance for Collaborative Value Creation’), 29 May 2017, 2, [https://www.meti.go.jp/english/policy/economy/corporate\\_accounting/pdf/guidance.pdf](https://www.meti.go.jp/english/policy/economy/corporate_accounting/pdf/guidance.pdf). This Guidance critically bespeaks that Japanese com-

Principle 2-1 of Japan's CG Code requires the establishment of business principles for each corporation, set out in a way that is consistent with the creation of corporate value in the middle- to long-term. Principle 3-1 has required their disclosure since 2015.<sup>98</sup> Given these principles, an increasing number of boards have considered allocating more meeting time to discuss middle- and long-term business strategies. However, most enterprises in Japan still do not allocate adequate time to long-term strategy and 58% spend only between 0% and 10% of board discussion time on long-term strategy.<sup>99</sup> Medium-term strategy is more regularly discussed with 52% of companies spending 10% of board time on it and 41% allocating between 10% and 40%.<sup>100</sup> Discussion on long-term strategy is still underdeveloped among Japanese boards. On the other hand, the announcement of corporate purpose to shareholders has been addressed to some extent. The proportion of companies that set out their corporate purpose in Notices of shareholders' Annual General Meetings increased from 8.2% in 2015 to 26.6% in 2021.<sup>101</sup> Despite this, it is still questionable whether the corporate purposes, as written in AGM Notices, are based on actual board discussion of long-term strategy, and more extensive discussion of long-term strategy and of corporate purpose aligned with such a strategy is much needed.

In order to trigger consideration and disclosure of corporate purpose and strategy, METI released its Guidance for Integrated Corporate Disclosure and Company-Investor Dialogues for Collaborative Value Creation.<sup>102</sup> Given that Japanese companies had tended to pursue short-term profit rather than longer-term corporate purpose and value, this guidance gives

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panies had pursued only short-term financial performances rather than corporate purpose and value.

97 METI [経済産業省経済産業政策局], *Jimu-kyoku setsumei shiryō* (事務局説明資料) [Secretariat Briefing Materials], June 2021, [https://www.meti.go.jp/shingikai/eco\\_nomy/sustainable\\_sx/pdf/002\\_03\\_00.pdf](https://www.meti.go.jp/shingikai/eco_nomy/sustainable_sx/pdf/002_03_00.pdf). This report explains "purpose" of the corporation as "*sonzai igi* [存在意義]" which means the reason or the significance of the existence.

98 Principle 2-1 says that "Guided by their position concerning social responsibility, companies should undertake their businesses in order to create value for all stakeholders while increasing corporate value over the mid- to long-term. To this end, companies should draft and maintain business principles that will become the basis for such activities."

99 PRICEWATERHOUSECOOPERS AARATA LLC, *supra* note 16.

100 PRICEWATERHOUSECOOPERS AARATA LLC, *supra* note 16, 10.

101 *Kabunushi sōkai hakusho 2015-nen-ban* (株主総会白書 2015年版) [The general meeting white paper 2015], 商事法務 Shōji Hōmu 2085 (2015) 62; *Kabunushi sōkai hakusho 2021-nen-ban* (株主総会白書 2021年版) [The general meeting white paper 2021], 商事法務 Shōji Hōmu 2280 (2021) 82.

102 METI, *supra* note 96, 2.

corporate executives advice on how to communicate their purposes, business models, strategies, and governance to investors and, at the same time, how to help investors make investment decisions and decide on stewardship activities. The Guideline covers six areas: value, business model, sustainability and growth, strategy, performance and important key performance indicators, and corporate governance. Each section includes an explanation of the priority issues and sets out critical points to be considered as well as information that should be conveyed to investors. The Guidance is expected to function as a “universal language” to enhance corporate disclosure and engagement between executives and investors<sup>103</sup> and shows how Principles 2-1 and 3-1 of Japan’s CG Code can be put into effect.

Management of the business portfolio to promote growth of corporate value has started to be discussed now that the Japanese government has set the direction for discussion.<sup>104</sup> Capital cost is focused on as the most important factor in the appropriate allocation of corporate capital to each business segment. Traditionally, this has not been properly considered by Japanese boards, because shareholders and institutional investors have required Japanese companies to review business portfolios by considering capital cost.

Approximately 80% of the companies with over 100 billion JPY market capitalization comprehend their cost of capital. However, the percentage of companies that utilize capital cost to downsize and withdraw business segments was still a mere 14%.<sup>105</sup> In the board practice, the reality of agendas of Japanese board meetings hardly includes a comprehensive strategy based on thought about the business portfolio and is still inclined toward the decisions on the execution of individual businesses and the reports on the execution of individual businesses. The percentage of boards that periodically discuss the business portfolio is 45% lower than that of those without periodic discussions.<sup>106</sup>

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103 METI, *supra* note 96, 4.

104 METI, *Jigyō saihen jitsumu shishin ‘jigyō pōtoforio to soshiki no henkaku ni mukete’ (Jigyō saihen gaidorain)* (事業再編実務指針～事業ポートフォリオと組織の変革に向けて～(事業再編ガイドライン)) [Practical Guidelines for Business Transformations – Toward Changes to Business Portfolios and Organizations – (Business Transformation Guideline)], 2020, <https://www.meti.go.jp/press/2020/07/20200731003/20200731003-1.pdf>.

METI explains the outline of the guidelines in English in the Executive Summary. See METI, “Practical Guidelines for Business Transformations –Toward Changes to Business Portfolios and Organizations – (Business Transformation Guideline) Executive Summary”, 2020, [https://www.meti.go.jp/english/press/2020/pdf/0731\\_004b.pdf](https://www.meti.go.jp/english/press/2020/pdf/0731_004b.pdf).

105 ITŌ/MOGI/HASEGAWA/YAMADA/FUJITA, *supra* note 67, 50.

106 PRICE WATERHOUSE COOPERS AARATA LLC, *supra* note 16.

Thus, in Japan, the issue of transformation from short-term to purpose-based decision making has been addressed simultaneously by various approaches such as the CG code, Guidance, and Guidelines, as well as by stimulating purpose-based decision making by boards, disclosure to and engagement with shareholders, and portfolio management that is aligned with the corporate purpose. The combination of the minimum requirements set out in the CG Code and more specific and detailed guides relating to various situations provides Japanese listed companies with many options for implementation. Although the figures from the surveys quoted here indicate that there is still some way to go, and Japan's CG Code revised in 2021 is criticized because it spawns the risk of encouraging purely formal compliance due to the too harsh requirements,<sup>107</sup> transformation is gradually proceeding as the proactive attitude of CEOs and directors are now being seen in Japan.<sup>108</sup>

## 2. *Enhancement and Disclosure of Sustainability*

Recently, discussion about sustainability has increased significantly. As a result of the example set by the UK, governance through ESG has steadily strengthened and is now a dominant issue. Although concern for the environment only has a short history in Japan, initiatives are now getting underway, mainly because of the requirement for disclosure from the revised CG Code. For social issues, strategy for human resources is receiving attention in Japan, specifically as a result of the declining birth rate, an aging society, and the diversification of the workforce and its perceptions of value.<sup>109</sup> Added to these factors, the notion of lifetime employment is no longer assumed. The COVID-19 epidemic has brought to head issues in human resources strategy such as business continuity and resilience, including the

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107 J. BUCHANAN, Japan's Corporate Governance Code 2015–2021. Legitimacy and the Transition from Principles to Prescription, *ZJapanR/J.Japan.L.* 53 (2022) 19, 37.

108 For example, Omron Corporation (electronic device industry) explicitly and neatly disclose the issue in the long term- development and their vision in the Annual Securities Report, [https://www.omron.com/jp/ja/ir/irlib/pdfs/yuho/20220624\\_85.pdf](https://www.omron.com/jp/ja/ir/irlib/pdfs/yuho/20220624_85.pdf), accessed 7 June 2023. Ebara Corporation also explains its middle- and long-term strategy, stating its board's engagement with strategic discussion, [https://www.ebara.co.jp/ir/library/annual-report/pdf/\\_icsFiles/afieldfile/2023/01/25/INT22\\_a3\\_JP\\_2.pdf](https://www.ebara.co.jp/ir/library/annual-report/pdf/_icsFiles/afieldfile/2023/01/25/INT22_a3_JP_2.pdf), accessed 7 June 2023.

109 T. MORIMOTO, “*Jizokuteki na kigyō kachi no kōjō to jinteki shihon ni kansuru kenkyū-kai hōkoku-sho ‘jinzai-ban Itō repōto’ no kaisetsu* (「持続的な企業価値の向上と人的資本に関する研究会 報告書～人材版伊藤レポート～」の解説) [The Exposition of Report of the Study Group on Improvement of Sustainable Corporate Value and Human Capital ‘The Human Resource Version of Itō Report’], *商事法務 Shōji Hōmu* 2247 (2020) 4, 5.

response to a diversified work style and environment.<sup>110</sup> This Section introduces the initiatives that are being taken to promote a transition toward a more strategic and sustainable way of thinking about human capital in Japan, and toward a more broadly-based and detailed disclosure of sustainability matters.

Lifetime employment originated after World War II through conservative political efforts in Japan. Japanese companies promised their employees lifetime employment which, whatever its benefits, has been criticized for not giving a motive for either companies or their employees to invest in the improvement of general or specific skills.<sup>111</sup> Currently, most internal board directors are still appointed from the pool of the company's most promising employees, whereas employees' plans for their career paths have moved away from lifetime employment and have diversified so that people now think about changing jobs, starting their own businesses, and having side jobs.<sup>112</sup> At the same time, there has been a switch from the conventional form of employment towards job-based employment.<sup>113</sup> In this situation, the creation of value within a company's employees is central to the creation of corporate value, and initiatives are being put in place to achieve corporate sustainability through reconsideration of human capital strategy. In 2020, METI issued a "Report of the Study Group on Improvement of Sustainable Corporate Value and Human Capital" which recommends a direct linkage between management strategy and personnel strategy, active communication between executives and employees, supervision and monitoring related to personnel strategies employed by the board, promotion of intelligence and empirical diversity in the workforce, and facilitation of the reskilling and skill shift of employees and executives.<sup>114</sup> This way of thinking was reflected in the CG Code, as revised in 2021, which requires disclosure of the policies and goals for diversity in core human resources and the policies for human resource development and internal environment development to ensure diversity (Supplementary Principles 2-4-1). In addition, the Code requires the provision of information on investments in human capital in an understandable, specific manner that is consistent with management strategies and issues (Supplementary Principles 3-1-3). Supplementary Principle 4-2-2 requires the board to effectively supervise in-

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110 MORIMOTO, *supra* note 109, 5.

111 R. GILSON/M. ROE, Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance, *Columbia Law Review* 99 (1999) 508.

112 MORIMOTO, *supra* note 109, 5.

113 METI, Report of the Study Group on Improvement of Sustainable Corporate Value and Human Capital, September 2020, [https://www.meti.go.jp/shingikai/economy/kigyo\\_kachi\\_kojo/pdf/20200930\\_1e.pdf](https://www.meti.go.jp/shingikai/economy/kigyo_kachi_kojo/pdf/20200930_1e.pdf).

114 METI, *supra* note 113.

vestment in human capital and intellectual property, in addition to allocating management resources and implementing business portfolio strategies, for the sustainable growth of the company. In this way, the reconsideration of human capital issues is serving as an essential factor promoting corporate sustainability in Japan, fueled by the diversification of the workforce and social change due to the COVID-19 epidemic.

Nowadays, sustainability disclosure is regularly adopted in the US, UK, and EU nations. In particular, the Task Force on Climate-related Financial Disclosure (“TCFD”) has gained wide support from market players, and now financial information regarding the climate risks beyond the demands of the TCFD is required.<sup>115</sup> In this international stream, Japan’s CG Code, as revised in 2021, now requires disclosure about sustainability. This new adaptation is recognized as ‘an impressively swift manner’, in comparison with the introduction of outside directors that took 15 years to mandate the listed companies to appoint them.<sup>116</sup> New Supplementary Principle 2-3-1 demands that Japanese boards “recognize that dealing with sustainability issues, such as taking care of climate change and other global environmental issues, respect of human rights, fair and appropriate treatment of the workforce including caring for their health and working environment, fair and reasonable transactions with suppliers, and crisis management for natural disasters, are important management issues” and that they “consider addressing these matters positively and proactively in terms of increasing corporate value over the mid-to-long-term.” In addition, if a company is listed in the Prime Market, the quality and quantity of disclosure should be based on the TCFD recommendations,<sup>117</sup> collecting and analyzing “the necessary data on the impact of climate change-related risks and earning opportunities on their business activities and profits.” The establishment of basic policy on these sustainability initiatives is required as the board’s responsibility as per Supplementary Principle 4-2-2. Furthermore, the re-

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115 J. ARMOUR/L. ENRIQUES/T. WETZER, Mandatory Corporate Climate Disclosures: Now, But How?, *Columbia Business Law Review* 3 (2021) 1085.

116 S. KOZUKA, Introducing Sustainability into Japanese Corporate Governance. The Shift to “New Capitalism” or a Continued Gradual Transformation? *ZJapanR/J.Japan.L.* 54 (2022) 63, 72.

117 TCFD (Task Force on Climate Related Financial Disclosures) requires climate-related financial disclosures, designed to solicit decision-useful, forward-looking information that can be included in mainstream financial filings. The recommendation consists of four thematic areas that represent core elements of how organizations operate: governance, strategy, risk management, and metrics and targets.

See TCFD, Final Report Recommendations of the Task Force on Climate-related Financial Disclosures, 15 June 2017, <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>.

quirement is now mandatory; the sustainability approach and initiatives have been envisaged to be disclosed in line with the TCFD framework (Governance, Strategy, Risk Management and Metrics and Targets). In this way, Japanese initiatives toward sustainability disclosure are tackled by the “comply or explain method” of the CG Code. As a result, Japan has the largest number of companies that have announced support for the TCFD framework,<sup>118</sup> with over 1300 companies, which constitutes approximately 30% of the whole advocates in the world.

For a company to comply with these sustainability codes, the most important initial action is to put in place a basic sustainability policy which must align with the corporate strategy, especially as it relates to risks and profits.<sup>119</sup> The Guidelines for Investors and Company Engagement suggest that a sustainability committee is set up under the board as a framework to promote initiatives on sustainability.<sup>120</sup> According to the research implemented by Sumitomo Mitsui Trust Bank, the companies which established the sustainability committee on the management side comprise 21%, and the ones with the committee on the monitoring side constitute 18%.<sup>121</sup> As there are a certain number of the companies that consider developing the sustainability committees, the rate is anticipated to hereafter further increase. One Japanese enterprise now holds joint meetings of the sustainability and the risk management committees in order to link the discussion of both topics and to consider the significant risks of issues like climate change and envi-

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118 KOZUKA, *supra* note 116, 88.

119 The alignments of sustainability policy with the strategy can be seen in some Japanese companies' disclosure. Hitachi provides information of the Sustainability Management linked with the mid-term management plan in Ch. 2 in Sustainability Report, [https://sustainability.hitachi.com/wp-content/uploads/2021/12/en\\_sustainability2021-1.pdf](https://sustainability.hitachi.com/wp-content/uploads/2021/12/en_sustainability2021-1.pdf). Sumitomo Corporation combines the solution of social issues with the corporate sustainable growth in the business strategy, <https://www.sumitomo-corp.com/en/jp/about/policy/mid-term>. Fuji Oil Holdings focuses on the corporate risks relevant to ESG materiality for the achievement of sustainable management, [https://www.fujioilholdings.com/en/pdf/ir/library/integrated\\_report/fujioil\\_integrated\\_report2021\\_01\\_03\\_en.pdf](https://www.fujioilholdings.com/en/pdf/ir/library/integrated_report/fujioil_integrated_report2021_01_03_en.pdf).

120 FSA, Guidelines for Investors and Company Engagement (15 February 2021) 1.3 <https://www.fsa.go.jp/en/news/2021/20210406/03.pdf>.

121 SUMITOMO MITSUI TRUST BANK, Corporate Governance Survey 2022, November 2022, <https://engagementsquare.smtb.jp/e/s/corporate-governance-survey-2022>, accessed 8 June 2023.

The ‘Corporate Governance Survey’ is Japan’s Largest Corporate Governance Survey; the participants are 1,787 listed companies, accounting for nearly half (47%) of all listed companies in Japan; the survey period was 15 July–26 August, 2022.

ronment-related business.<sup>122</sup> The proportion of companies that were compliant with the Prime Market companies at the middle of July 2022 was: 95.75% with 2-3-1 (to further consider addressing sustainable matters); 72.95% with 2-4-1 (to disclose the policies and goals for diversity in core human resources and the policies for human resource development and internal environment development to ensure diversity); 62.55% with 3-1-3 (to disclose corporate initiatives on sustainability with the management strategies); and 86.45% with 4-2-2 (to develop a basic policy for the company's sustainability initiatives).<sup>123</sup> Thus, most companies have started to consider sustainability, but fewer have disclosed their sustainability figures. While the majority have formally reached compliance, this is only at a basic level as they have still to comply fully with the last three principles. Substantive initiatives regarding sustainable management have only recently started in Japan and the Japanese government is now promoting discussion about the guidelines for disclosure of non-financial information, especially on sustainability, in order to enhance corporate value.<sup>124</sup> Further substantive initiatives on sustainability disclosure and are expected in Japan.<sup>125</sup>

### 3. Digital Transformation and AI Governance

In Japan, digital transformation is regarded as an issue of sustainability that includes the use of data for operational efficiency and also radical reform of business models to improve productivity leading to corporate reform and new profit opportunities.<sup>126</sup>

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122 N. KAWASAKI et al., *Sasutenabirīti i'in-kai no jitsumu (V) –Tōkyū Fu-dōsan Hōru-dingusu no torikumi-* (サステナビリティ委員会の実務 (V) —東急不動産ホールディングスの取組み—) [The practice of the sustainability committee (5) – Tokyo Fudōsan Holdings Corporation], 商事法務 Shōji Hōmu 2279 (2021) 50, 53–54.

123 TŌKYŌ STOCK EXCHANGE, *supra* note 70.

124 The Study Group on Disclosure Policies for Non-financial Information, Towards a virtuous cycle of sustainability-related information disclosure and enterprise value creation – Interim Report by the Study Group on Disclosure Policies for Non-financial Information, 6 April 2021, [https://www.meti.go.jp/english/press/2021/pdf/1112\\_Interim\\_Report\\_Non-financial\\_Information.pdf](https://www.meti.go.jp/english/press/2021/pdf/1112_Interim_Report_Non-financial_Information.pdf).

125 The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code, Revisions of Japan's Corporate Governance Code and Guidelines for Investor and Company Engagement (6 April 2021) 4, <https://www.fsa.go.jp/en/news/2021/20210406/01.pdf>.

126 K. TAKEI, *DX gabanansu – shakaiteki kachi o jitsugen suru dejitaru toransu-fōmēshon-* (DX ガバナンス—社会的価値を実現するデジタルトランスフォーメーション—) [DX Governance – Digital Transformation to Achieve the Social Value], 商事法務 Shōji Hōmu 2271 (2021) 32.

The Guidelines for Investors and Company Engagement suggest digital transformation (DX) as a topic for dialogue with investors. Japanese METI has promoted Digital Governance as a framework for enhancing corporate value which balances the challenges associated with innovation, such as cybersecurity and resistance to the loss of tradition, against the social responsibility of companies and organizations.<sup>127</sup> In 2020, METI issued a Digital Governance Code that has four sections: Vision and Business Model; Strategy (including human resources and cultures as well as environmental maintenance of the IT system and digital technologies); Performance and important benchmarks; and Governance Systems, whose structure is aligned with Japan's Act on Facilitation of Information Processing. Each section includes the basic concept, certification criteria, the ideal direction of initiatives, and examples of implementation. The Code aims at a radical change to the Japanese traditional business model to enhance the sustainability of corporate values.<sup>128</sup> It was revised in 2022, enhancing development and ensuring human resources specialized in digital and alignment of digital transformation and sustainability and green transformation.<sup>129</sup> After enacting the Digital Governance Code, in 2021 METI launched the DX Certification Program in 2021 and the Japanese government now awards DX certification to companies that have complied with the Digital Governance Code and, as of August 2021<sup>130</sup> and the preferential tax treatment that goes with it.<sup>131</sup> In addition to certification, in 2023 METI awarded two companies the DX Grand Prix, nominated 32 companies as DX companies and selected 19 as DX featured companies.<sup>132</sup>

All this is part of the Japanese government's action to make Japanese companies take digital governance seriously and to enhance their corporate

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127 TAKEI, *supra* note 126.

128 METI, Digital Governance Code, 9 November 2020, [https://www.meti.go.jp/shingikai/mono\\_info\\_service/dgs5/pdf/20201109\\_01.pdf](https://www.meti.go.jp/shingikai/mono_info_service/dgs5/pdf/20201109_01.pdf).

129 METI, *Dejitaru gabanansu kōdo kaitei no pointo* [デジタルガバナンス・コード改訂のポイント] [Key points of the revised Digital Governance Code], September 2022, [https://www.meti.go.jp/policy/it\\_policy/investment/dgc/dgc2-point.pdf](https://www.meti.go.jp/policy/it_policy/investment/dgc/dgc2-point.pdf), accessed 6 June 2023.

130 The certification program targets both public companies and private small and medium sized businesses. Although the certificated companies mostly consist of listed companies, in light of the total number of listed companies in TSE with 3827 (on 17 February 2022), their proportion is still significantly low.

131 METI, The outline of DX Certification Program and the Points of its Application, 6 August 2021, [https://www.meti.go.jp/policy/it\\_policy/investment/dx-nintei/0806\\_dx-certification\\_point.pdf](https://www.meti.go.jp/policy/it_policy/investment/dx-nintei/0806_dx-certification_point.pdf).

132 METI, METI has selected 'DX companies' and 'DX featured Companies'!, 31 May 2023, <https://www.meti.go.jp/press/2023/05/20230531001/20230531001.html> accessed 6 June 2023.

sustainability. Japanese companies now generally believe that digital transformation and its governance is an urgent and significant issue and 48% of Japanese boards consider DX as a priority issue for discussion.<sup>133</sup> However, the DX initiatives in Japanese companies have developed less than the extent that institutional investors anticipate. While more than 50% of institutional investors expect developing systems for securing and training necessary personnel, developing a digital strategy for business model transformation, and developing a management vision based on the use of digital technology, the percentage of Japanese companies with systems for securing and training necessary personnel is just 30%, and the proportions of the companies with the digital strategy for business model transformation and the ones with the management vision based on the use of digital technology are around 20%.<sup>134</sup>

Regarding digital issues, corporate initiatives using artificial intelligence are known to be potentially hazardous and in need of proper governance.<sup>135</sup> This has now been addressed in Japan by the publication in March 2019 of “Social Principles of Human-centric AI”. Japan has also contributed to the formulation of the OECD’s recommendations on artificial intelligence, which included social principles for AI to be implemented in society at large.<sup>136</sup> To support the implementation of these AI principles, in July 2021 METI issued Governance Guidelines for implementing AI Principles. The Guidelines contain action targets to be implemented by AI businesses, hypothetical examples of implementation for the action targets, and practical examples for a gap analysis between AI governance goals and the current state.<sup>137</sup> The Guidelines are not legally binding but are “expected to support a company’s voluntary efforts as widely shared material that is referred to by AI companies who are involved in AI business, typically the development/operation of AI systems, in their business transactions, and through the development of a common understanding among stakeholders on the implementation of AI principles”.<sup>138</sup> These Guidelines are designed

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133 PRICE WATERHOUSE COOPERS AARATA LLC, *supra* note 16, 11.

134 SUMITOMO MITSUI TRUST BANK, *supra* note 121.

135 C. PICCIAU, The (Un)Predictable Impact of Technology on Corporate Governance, *Hastings Business Law Journal* Vol. 17 (2021) Article 5, [https://repository.uchastings.edu/cgi/viewcontent.cgi?article=1215&context=hastings\\_business\\_law\\_journal](https://repository.uchastings.edu/cgi/viewcontent.cgi?article=1215&context=hastings_business_law_journal).

136 Expert Group on How AI Principles Should be Implemented and AI Governance Guidelines WG, Governance Guidelines for Implementation of AI Principles, Ver. 1.0, 9 July 2021, 3, [https://www.meti.go.jp/shingikai/mono\\_info\\_service/ai\\_shakai\\_jisso/pdf/20210709\\_9.pdf](https://www.meti.go.jp/shingikai/mono_info_service/ai_shakai_jisso/pdf/20210709_9.pdf).

137 *Ibid* 3.

138 *Ibid* 4.

to integrate with other relevant guidelines in such a way that a comprehensive set of guidelines is built up.<sup>139</sup> It has also been amended in 2022.<sup>140</sup>

The use of digital transformation as a mechanism for more effective corporate governance seems not yet to have been explicitly discussed. As discussed in Section III, it is now possible to hold digitized general meetings, but the effectiveness of digital communication with shareholders is still a topic for investigation.<sup>141</sup> Apart from shareholder engagement, a board's effectiveness can also be enhanced by digital transformation. Digital distribution of board materials is already common practice across the globe, including in Japan, so high-level and timely availability of materials and relevant documents or references could enhance discussion in the board room, especially for independent directors. If the information includes strategic analysis of the corporate business operation and the results of shareholder engagement by digital and artificial intelligence, board discussion of corporate strategy can become deeper and more substantive. In addition, monitoring risk management, a significant issue for board members, can be enhanced by risk analysis and simulation through the use of digitized data and artificial intelligence. Once a serious risk has been identified in this way, board members could make a quick response by digital means such as virtual board meetings or online communications. This has the potential to give a more resilient and sustainable monitoring system. Digital transformation offers many new ways to strengthen corporate governance and enhance corporate sustainability.

#### IV. CONCLUSION

The reforms to Japan's corporate governance can be summarized as follows: 1) decentralization of the decision-making process to increase shareholder participation; 2) embedding ESG factors to make corporate governance conform to international practice; and 3) deploying technology, along with the means to control it, to achieve corporate governance. Decentralization of the decision-making process has been achieved through restructuring the stock market, by using law and regulation to increase outside share-

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139 *Ibid* 3.

140 Expert Group on How AI Principles Should be Implemented and AI Governance Guidelines WG, Governance Guidelines for Implementation of AI Principles Ver. 1.1, 28 January 2022, [https://www.meti.go.jp/shingikai/mono\\_info\\_service/ai\\_shakai\\_jisso/pdf/20220128\\_2.pdf](https://www.meti.go.jp/shingikai/mono_info_service/ai_shakai_jisso/pdf/20220128_2.pdf), accessed 6 June 2023.

141 D. ZETZSCHE/L. ANKER-SØRENSEN/R. CONSIGLIO/M. YEBOAH-SMITH, Enhancing virtual governance: comparative lessons from COVID-19 company laws, *Journal of Corporate Law Studies* 2021, 115–150, <https://doi.org/10.1080/14735970.2021.1977453>.

holders' engagement, and by deploying technology to facilitate shareholder participation.

To embed ESG in corporate governance, a combination of government guidelines, the Stewardship Code, and the Corporate Governance Code have provided a framework for the engagement of boards, investors, and market operators. Boards disclose information based on the ESG related frameworks, investors make investment decisions based on the information disclosed, institutional investors comply with the Stewardship Code, and market operators provide ESG related products to give an incentive to both boards and investors.

As a nation renowned for its technological skill, Japan has shown how technology can be deployed to reform corporate governance. E-voting, e-disclosure, and e-meetings have increased shareholder participation not just through technology but also with strong support from the necessary law and regulation to facilitate their implementation. At the same time, Japan has recognized that the coming of the digital era can transform corporate operations and that digital governance is an important element of corporate governance (the 'G' in ESG).

Japan's experience, and the initiatives it has taken, provide lessons for policy makers in other nations as they steer corporate governance reform to increase shareholder participation, embed ESG in corporate practices, and drive digital transformation.

#### SUMMARY

*This paper examines the development of corporate governance in Japan over the last fifteen years to understand what has changed and whether the intended results have been achieved. First, it demonstrates how corporate Japan is moving away from the post-war bank-dominated, heavy-industry led, and inter-locked model. This provides a new corporate model for Japan for comparative research into law and economics. In addition, we examine how reform was accomplished, considering the legal tools used as well as the dynamics among the various stakeholders. Secondly, the paper shows how this new corporate model for Japan can catalyze sustainability through encouraging companies to be more purpose-based and through digital governance. Finally, we offer some concluding remarks.*

#### ZUSAMMENFASSUNG

*Der Beitrag untersucht die Entwicklung der Corporate Governance in Japan in den vergangenen fünfzehn Jahren, um zu verstehen, was sich tatsächlich*

*geändert hat und ob die angestrebten Ziele erreicht wurden. Als erstes wird aufgezeigt, wie die japanische Unternehmenswelt dabei ist, sich von dem Model der Nachkriegszeit zu verabschieden, das bankdominiert war, von der Schwerindustrie angeführt wurde, und innerhalb dessen die Unternehmen miteinander verflochten waren. Die Untersuchung entwickelt ein neues japanisches Unternehmensmodel für die vergleichende rechtliche und ökonomische Forschung. Zudem untersucht der Beitrag, auf welche Weise die Reform umgesetzt wurde, wobei den rechtlichen Instrumenten und der Dynamik zwischen den verschiedenen Beteiligten besondere Aufmerksamkeit zuteilwird. Zum zweiten zeigt der Beitrag auf, wie dieses neue Unternehmensmodel für Japan Nachhaltigkeit schaffen kann, indem Unternehmen ermuntert werden, sich stärker zielorientiert auszurichten, und ferner durch eine digitale Governance. Es folgen einige abschließende Anmerkungen.*

*(Die Redaktion)*