Rumble in the Boardroom ?
The Change of Japanese Corporate Governance Schemes

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I. INTRODUCTION

Corporate governance has become widely discussed in Japan since the 1990s and a variety of books and papers have been published since these organisations, study groups, scholars and business people have all discussed the ways by which owners of companies could protect their interest in the firm and influence the management to act in their interest.

The question of who the owners of a company are is complicated in Japan. In contrast to the Anglo-Saxon system where shareholders are the owners, in Japan (and in Germany as well) a corporation has to provide work for the employees and has to operate within a network of several stakeholders.[1] In addition to that, there are other peculiarities in the Japanese industrial organization.[2] Some result from ownership structures: as shown in FIGURE 1, for a long time the ratio of stocks owned by individuals

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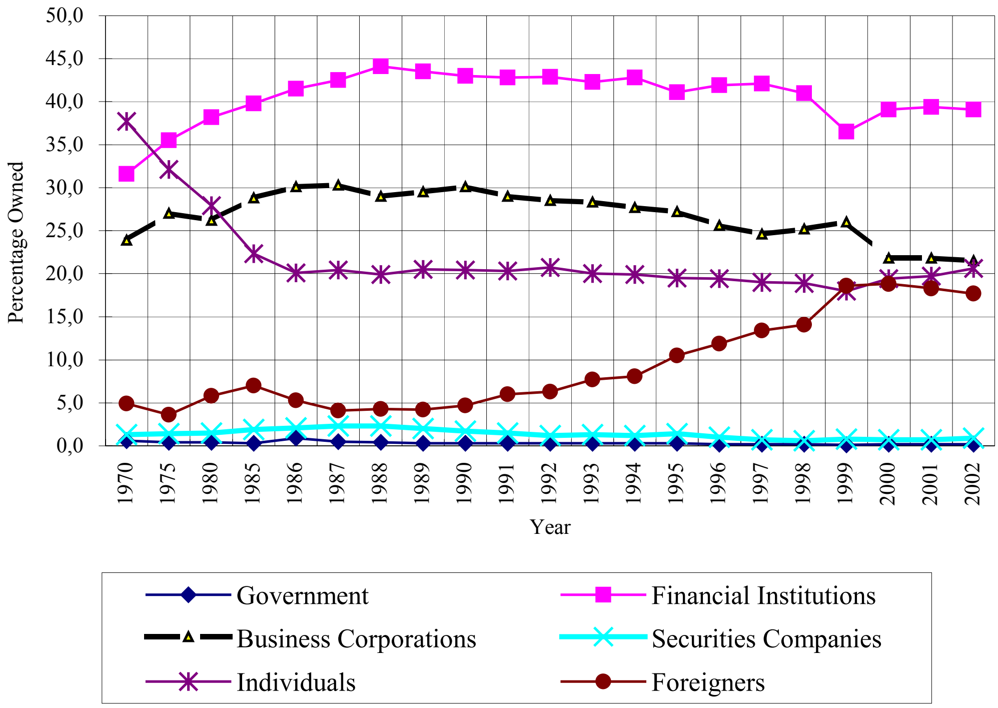
1 M. YOSHIMORI, Whose Company Is It? The Concept of the Corporation in Japan and the West, in: Long Range Planning 28 (1995) 33-44. The German-Japanese comparison is the explicit topic of T. TAKAHASHI (ed.), Corporate Governance - *Nihon to doitsu no kigyô system* [Corporate Governance - the Japanese and German Enterprise System] (Tokyo 1995).

2 T. IGARASHI, Where are we going? The Process of Change in Japanese Corporate Governance, in: ZJapanR 6 (2001) 70.

was about 20 per cent, surpassed only by that held by corporations and financial institutions. These institutional shareholders combined did not only own more than half of the shares, but these shares were mostly locked in stable cross-shareholdings. As a result, almost no external monitoring took place, and these linked corporations were able to distance themselves to a certain degree from the market, paying more attention to growth than to return rates. Stable cross-shareholding made market entry in general, and hostile take-overs in particular, extremely difficult – which can be seen in FIGURE 1 with the low (but increasing) ratio of foreign shareholders. In the case of horizontal enterprise groups, the external monitoring of the firms took place at the regular meetings of the presidents *(shachô-kai).* Banks, although allowed to own just 5 per cent of the shares until recently, were in a dual role as both creditor and shareholder of the same corporation. Firms tended to define a Main Bank with especially close relations. The Main Bank was seen as delegated monitor for other shareholders, and was required to rescue a firm from a crisis. Although these practices function in a growing economy, they become increasingly difficult to maintain in a crisis.

FIGURE 1: Distribution Percent of Market Value Owned by Type of Shareholders



Source: TOKYO STOCK EXCHANGE, 2002 Share Ownership Survey

All the peculiarities mentioned above are changing to a certain degree. But there is one point that is crucial: there already is a part of the economy where corporate governance relations are predicated by control through ownership as in the Anglosaxon model: the vertically integrated firms.[3] Owners of such firms have a substantial amount at stake, have an interest in the firm's situation. They therefore monitor situations closely and take action if things are going wrong. For instance, changes in the board structure in these firms are attributed to bad return rates[4] or weak growth rates of sales or employees.[5]

Board structure is a central point in the corporate governance schemes since it mirrors the balance of power of stakeholders and shareholders and reflects the legal framework of a country. Therefore, this article deals with changes in the board structures of Japanese industrial corporations. Special attention is given to the several shareholder groups.[6]

The main questions investigated are:

1) How are changes in the industrial organization of the Japanese economy reflected by changed ownership structure influence the corporate governance schemes, and in particular the composition of the board of directors?

2) Is there any correlation between the changes and corporate results?

The paper is structured as follows: in the next paragraph, data and methodology are explained, followed by the empirical investigation of the board structures of our sample. Special attention is paid to the links that result from several groups of shareholders: other corporations in Japan, financial institutions, and foreign corporations. Finally, conclusions are drawn and opportunities for further research are discussed.

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3 U. SCHAEDE, Understanding Corporate Governance in Japan: Do Classical Concepts Apply?, in: Industrial and Corporate Change 3 (1994) 278.

4 J.-K. KANG / A. SHIVDASANI, Firm performance, corporate governance, and top executive turnover in Japan, in: Journal of Financial Economics 38 (1995) 29-58.

5 Y. ABE, Chief Executive Turnover and Firm Performance in Japan, in: Journal of the Japanese and International Economies 11 (1997) 2-26.

6 There are, of course, other stakeholders also represented in the board – for instance employees or ex-bureaucrats. It would go beyond the scope of this paper to elaborate on those changes, too.

II. DATA AND METHODOLOGY

1. Data

This paper is based on both financial data and biographical information. Financial data are derived from standardized annual reports, written according to the Commercial Code (*yûka shôken hôkoku-sho*), using the *Tôyô Keizai Databank* and the *"Kaisha Database"*.[7] All companies are listed in the first section of the Tokyo Stock Exchange and were the biggest in terms of sales in 1992 when the database was built up.

Biographical information was obtained separately from the same Japanese annual reports. These all contain a section with biographical profiles of the directors, in which information is provided on their university degrees, career to date, including employment in other companies or government institutions, areas of responsibility and hierarchical level achieved. This degree of exposure – which would be unthinkable in German companies – facilitates the detailed analysis necessary to ascertain links with other entities. The analysis is thus based on publicly available material. It is not intended, and indeed it would hardly be possible, to show all the ties between directors, for example those based on personal friendships, memberships of golf clubs and, in some regrettable cases, bribes.

For this paper, data from the automotive, electronic and electrical engineering and the machine tool industries were selected, because of their high export-orientation. The pharmaceutical sector (only minimally successful in export and still highly regulated) was investigated to provide a control variable. Seventy firms were studied in total and the time span of the study was 1986 to 2001.

To obtain several opinions and test against misinterpretations, relevant people from the industries, mass media and research institutions were interviewed in a survey. Discussions regarding individual issues were held with Japanese managers in person wherever possible.

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7 This database was developed at the Science Center for Social Research in Berlin using Japanese business reports written in accordance with the Commercial Code (= *yûka shôken hôkoku-sho*) and is now maintained at the Center for Japanese Studies of the Beisheim Graduate School of Management. It contains data from the unconsolidated accounts of the 111 largest companies since 1970 in the following five industrial sectors: chemicals, machine tool, electrical engineering, pharmaceuticals and transportation/automotive. Reports from companies in the automotive sector cover the years 1985-1998. Data cover balance sheet, profit and loss statements, investments, and others – about 650 variables per firm and year.

2. *Methodology*

This paper mainly focuses on empirical data such as financial statements and coded information from annual reports, which were accessed using econometric measures, mostly in form of simple statistics.

It was said in the introduction that vertical relations do matter in Japanese industrial organization. To check for them, the seventy firms in our sample were classified as either horizontal (H), horizontal core (HC), independent (I), independent core (IC) or vertically integrated firms (V). The following definitions, originally derived in a joint team at the Science Centre Berlin[8], were used:

- *Horizontal (H) :* A firm is seen as horizontally integrated when it is a member of a presidents' council (*shachô-kai*). The member firms are further interconnected by mutual stable shareholding and director dispatch (for example: *Tanabe Seiyaku*, or *Mitsubishi Electric*).
- *Vertical (V) :* A corporation is seen as vertically integrated if (a) another company owns more than 20 per cent of the shares, or (b) if the major shareholder owns more than 10 per cent and is the major customer at the same time (for example: *Daihatsu, Toshiba Tungaloy*).
- *Independent (I) :* A company is referred to as independent when it does not belong to a presidents' council, nor is it owned by other firm (for example: *Sony, Omron*).
- *Core firm (C) :* When a company is at the top of one of the twenty largest industry groups (as they appear in Tôyô Keizai) it is regarded as a core firm. Since all firms in our sample are listed at the Tokyo Stock Exchange, most of them have a number of subsidiaries. But in order to find the specific nature of core firms, size had to be taken into account, and the differentiation was made according to the Tôyô Keizai definition. As already mentioned, the group of core companies is divided into two subgroups: a) firms that are member of a horizontal *keiretsu* (referred to as "HC", like *NEC* or *Toshiba*), and b) firms that are independent (referred to as "IC", for instance *Sony* or *Matsushita*). FIGURE 2 was drawn to visualize the definitions and the inter-firm relations this article deals with.

In the next step, firms with the same group membership status were formed into sub-samples, and the five sub-samples obtained were compared with each other by simple statistical measures (such as correlation analysis)

Sub-grouping was also carried out on each industrial sector. All the firms that belonged to the same industry were put together into four sub-samples, and these were then compared by the same statistical methods. Examples of certain corporations are given in more detail to highlight specific points.

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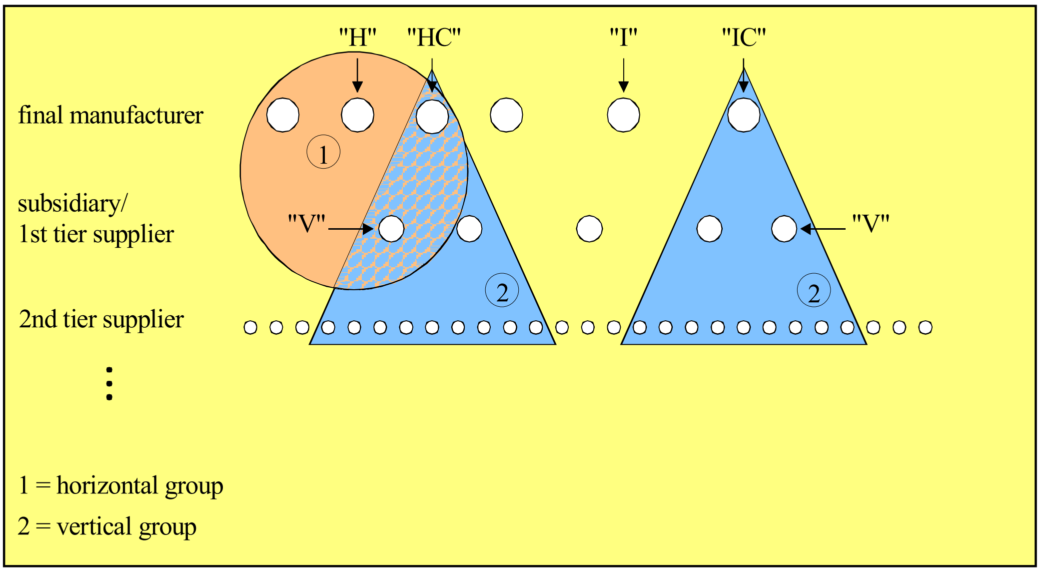
8 A. MOERKE / U. GÖRTZEN / R. ZOBEL, Grundlegende methodische Überlegungen zur mikroökonomischen Forschung mit japanischen Unternehmensdaten (2000) 12-14.

FIGURE 2: Inter-firm Networks in Japan



Source: Own picture on the basis of: M. GERLACH, Alliance Capitalism (1992) 68.

III. EMPIRICAL INVESTIGATION

1. *The overall Picture*

In the first step, we will have a look at the overall development of the sample. Previous research has pointed out that Japanese legislation is changing significantly and that a decrease of board size became common at the beginning of the 21st century.[9] Directors were often transferred to the post of "corporate executive officers" (*shikkô yakuin*)[10], but little changed in their operational tasks. Our samples confirmed that boards were becoming smaller, especially after 1995.[11] To what extent directors were shifted to a *shikkô yakuin* post cannot, unfortunately, be derived from the data.

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9 M. Hayakawa, Die Reform des Gesellschaftsrechts vom Mai 2002 und Corporate Governance in Japan, in: Zeitschrift für Japanisches Recht 7 (2002) 39.

10 C.L. AHMADJIAN, Changing Japanese Corporate Governance, in: U. Schaede / W. Grimes (eds.), Japan's Managed Globalization (Armonk 2003) 226.

11 To test for significant differences, t-tests were applied. According to the results (alpha less .05) it is fair to say that the average number of directors in 2001 is significantly different from 1998 and 1995.

TABLE 1: Average Number of Directors

Year	Mean	Standard deviation	Coefficient of variation
1986	23.03	9.18	0.40
1989	24.06	9.56	0.40
1992	26.00	10.21	0.39
1995	26.54	9.85	0.37
1998	24.84	10.19	0.41
2001	19.43	9.12	0.47

Source: Annual reports, own calculations

Coming back to the argument that one has to differentiate horizontal and vertical relationships when talking about corporate governance in Japan, the development of those numbers was investigated for the sub-samples of horizontal and independent (H and I) firms as well as for core firms and vertically integrated firms (HC, IC, and V). It turns out that the development for all sub-samples was very much the same, but that there are still significant differences in size. Core firms (like *Toyota* or *Matsushita*) tend to have larger boards than the other firms, including vertically integrated firms. When comparing *keiretsu* and independent firms, it turns out that Boards of the "big six" *keiretsu* groups are almost always bigger than their independent counterparts (that is, HC > IC as well as H > I[12]).

However, more important than group membership is the industry a company belongs to. According to FIGURE 3, the boards in the automotive industry are much larger than in other industries. This shows conclusively that the appointment as a director of the board does not necessarily mean participation in leadership. There is (or there was, until now) no clear connection between the board size and the effectiveness of a firm because firms with large boards often carry out the necessary discussions and decision-making in a smaller circle (called *jômu-kai* or *keiei i'in-kai*).[13]

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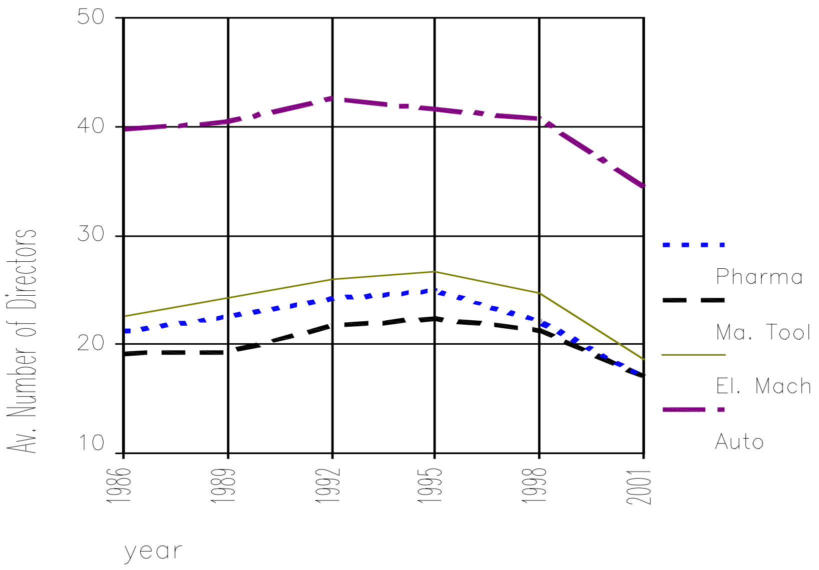
12 In (other) words: Toyota being bigger than *Honda*, or *Sankyo* being bigger than *Chugai*.

13 H. ODA, Corporate Law Reform in Japan 2001/2002 - Deregulation of Company Law?, in: Zeitschrift für Japanisches Recht 7 (2002) 23, and M. HIRATA, Die japanische torishimariyaku-kai. Eine rechtliche und betriebswirtschaftliche Analyse, in: Zeitschrift für Betriebswirtschaft (Ergänzungsheft 3/96) 9.

FIGURE 3: **Average Number of Directors, per Industry**



Source: Annual reports, own calculations

In the automotive industry, for example, the boards are large because traditionally they contain some directors whose appointment only represents the last stage of the person's career, ending after a relatively short time but providing the person with an extra pension. This is an expensive practice in an extremely cost-sensitive and economically challenged sector. Reduction in the oversized boards is therefore a good opportunity to increase flexibility and decrease costs – which a lot of firms have recognised and practised.

2. Personal Links with other Firms

The specific organisation of Japanese inter–firm networks with mutual cross-shareholding also exerts influence on the composition of board structures. By holding each other's shares, a cross–shareholding, corporations reduce the number of free-floating shares and therefore lessen the risk of hostile take-overs and the introduction of directors from a non-group company. Furthermore, a cross-shareholding reduces the incentive to monitor and to exert influence. In other words: “dog does not eat dog”. Effective action against such firms is only possible when minor share holders combine – as can happen, for instance, in case of horizontal *keiretsu* firms, when the member firms of the “presidents’ council” combine in support of a common cause. In this case they have enough power to exert influence and to send personnel to the board of directors in a certain firm.

But the changes that Japanese inter-firm relations have been undergoing during recent years do not exclude the *keiretsu* groups – as could already be shown above. So, cross-shareholding inside and between the “big six” has unwound to a considerable degree. The following[14] TABLE exemplifies three facts: a) the declining rate of cross-shareholding for *keiretsu* as well as for non-*keiretsu* firms, b) the existence of a remarkable gap between *keiretsu* and other firms, but also c) the narrowing of that gap.

TABLE 2: Unwinding Cross-Shareholding

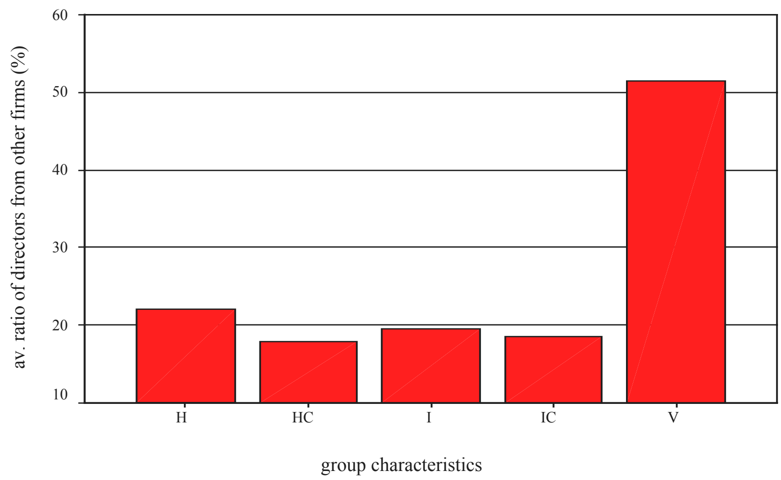
Year	Cross-Shareholding in Per Cent		Difference between Groups and Others
	Corporate Groups	Others	
1987	28.0	12.5	15.5
1999	20.0	7.0	13.0
Difference 99-87	-8.0	-5.5	

Source: NLI RESEARCH INSTITUTE, NLI Research, (2000 Nr. 145) 14.

However, up to now this has not really changed the typical practice of Japanese firms, and insiders continue to predominate their boards. Even the latest numbers in our sample show that the ratio of directors who come from other firms is relatively low and, except for vertically integrated firms, even in 2001 only about one fifth of the directors have worked in another firm.

14 The table refers to the overall economy and is based on NLI data. Therefore, our classification is not used here.

FIGURE 4: **Ratio of Directors from other Firms**



Source: Annual Reports, own calculations

It should be noted, however, that the ratios above are deliberately not called the “ratio of independent directors” since most of the so-called "directors from other firms" have worked in a company from the same group or in an otherwise related company. Unfortunately, at the moment the data do not allow us to split directors into “real” and “quasi” outsiders.

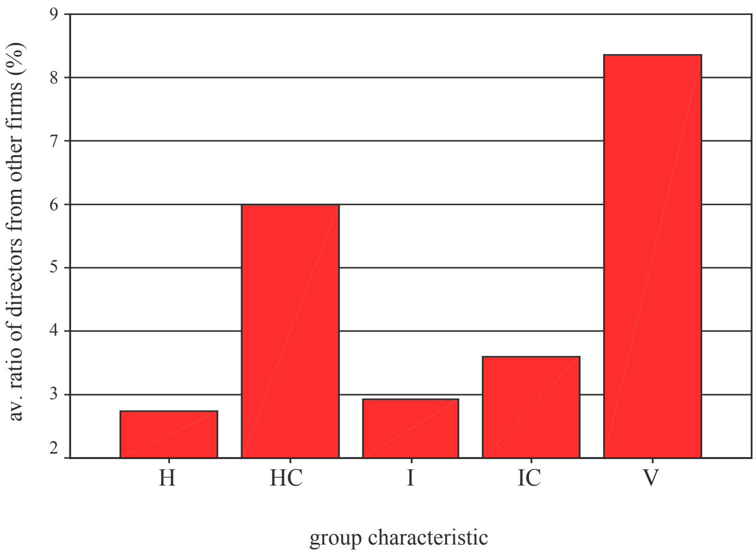
The ratio for vertically integrated firms is quite high due to three reasons. The first is ownership. The owning firm dispatches personnel to the owned firm to secure its influence on the management and its investment.[15] This is very similar to other western model of corporate governance and not peculiar to Japan. The second reason has to do with the Japanese practice of corporate spin-offs or sponsored spin-offs. In contrast to Germany, Japanese firms often support spin-offs and offer recourses[16] like technology or personnel. When a whole department is spun-off, the top-management of the newly founded company mostly consists of people from the mother-company. The third reason

15 See J.R. LINCOLN / M.L. GERLACH / C.L. AHMADJIAN, Keiretsu Networks and Corporate Performance in Japan, in: American Sociological Review 61 (1996) 67-88. and J.R. LINCOLN / M.L. GERLACH / P. TAKAHASHI, Keiretsu Networks in the Japanese Economy: A Dyad Analysis of Intercorporate Ties, in: Ibid. 57 (1992) 561-585. as well as U. SCHAEDE, Understanding Corporate Governance in Japan: Do Classical Concepts Apply?, in: Industrial and Corporate Change 3 (1994) 285-323.

16 C. STORZ / S. FRICK, Sponsored Spin-Offs in Japan - Anregungen für die deutsche Mittelstandspolitik?, in: H. Gössmann / A. Mrugalla (eds.), Tagungsdokumentation 11. Deutschsprachiger Japanologentag in Trier, 1999 (Münster; Hamburg; Berlin 2000) 555-573.

can be found in employment practices in some vertical groups. It is said, for instance, that in the *Matsushita Group* the mother firm *Matsushita Electric* employs personnel for the whole group and rotates those people within the group. If one erases those outliers from the sample, the picture shown in FIGURE 5 changes remarkably. Although the split into "real" and "quasi" outsiders is not done for the directors yet, the ratios shown below are thought to be closer to the ratio of "real outsiders" in the board of directors.

FIGURE 5: Directors from other firms (Sample without outliers)



Source: Annual reports, own calculations

It can now be easily understood how necessary the reforms of the Commercial Code in Japan in 2001 and 2002 have been with respect to board structures. Of course, our data cannot tell us about the effects of those changes. This must be left to further research.

3. Personal Links with Financial Institutions

As was said in the beginning, financial institutions in Japan have an important role in the corporate governance because they wear two hats: as shareholders and as creditors. The main bank[17], as the delegated monitor and responsible institution in case of a

17 M. AOKI / H. PATRICK / P. SHEARD, The Japanese Main Bank System: an Introductory Overview, in: M. Aoki / H. Patrick (eds.), The Japanese Main Bank System (Oxford; New York 1994) 3.

crisis is an often-cited role.[18] This scheme worked well until the 1970s and perhaps the beginning of the 1980s, but then the bigger firms shifted from being bank-financed to become more equity-financed (a process called *ginkô banare*[19] *(*going away from/ creating a distance to the banks). It should also be mentioned that there was a shift in the stockholding portfolio of those banks that were acting as main bank and hence monitor: while the group of long-term banks, city banks and regional banks owned 14.9 per cent of total market value of all shares in 1986, this ratio was reduced to 7.7 per cent in 2002.[20] From this point of view one would expect fewer bankers on the board of directors.

But a close look at the credit ratios (the ratio of short-term and long-term credits to total capital) reveals that at least some of the firms in our sample have been increasing their loans again in the 1990s. Interestingly enough, group membership was not an important factor, although the literature points very much to the fact that members of a *keiretsu* group would have better access to money.[21] In the case of our sample, and perhaps more generally, industry effects are more important. This is also shown in TABLE 3. While in the machine tool and pharmaceutical industries the ratio of loans to total capital goes up, in the electrical machinery and automotive industries it goes down. The background to this can be seen in the restructuring processes. While electrical and automotive industries in Japan are mature, machine tool industries and even more so the pharmaceutical industries, contain a considerable number of family-run businesses. These were not necessarily small, but too small to compete effectively on an international level. It was shown in previous research that it was especially in those two sectors that family members no longer ran the business. The classical "split of management and ownership" took place, which also includes a new type of bank-firm relationship and representation of directors with a financial background on the board.[22]

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18 For instance, A. FUKUDA / S.I. HIROTA, Main Bank Relationship and Capital Structure in Japan, in: Journal of the Japanese and International Economies 10 (1996) 250-261. 250; M. KATŌ, *Meinbank kankei ni okeru yakuin haken no keizai bunseki* [Economic Analysis of Director Dispatch in a Main Bank Relationship], in: Keizai to Keizaigaku (1995) 69-92., and K. KOJIMA, Japanese Financial Relationships in Transition, in: Kobe Economic & Business Review 42 (1997) 61.

19 S. YABUSHITA, *Kin'yû shisutemu to jôhô no riron* ["Japan's Financial System: Markets, Banks and Their Stability"] (Tokyo 1995).

20 TOKYO STOCK EXCHANGE, 2002 Shareownership Survey, Table 3 (*www.tse.or.jp,* last access on July 4th, 2003).

21 T. HOSHI / A. KASHYAP / D. SCHARFSTEIN, Corporate Structure, Liquidity, and Investment: Evidence from Japanese Industrial Groups, in: The Quarterly Journal of Economics (1991) 49; D.E. WEINSTEIN / Y. YAFEH, Japan's Corporate Groups: Collusive or Competitive? An Empirical Investigation of keiretsu Behaviour, in: Journal of Industrial Economics 43 (1995) 366.

22 A. MOERKE, Organisationslernen über Netzwerke. Eine empirische Analyse der personellen Verflechtungen von Boards of Directors japanischer Industrieaktiengesellschaften (Wiesbaden 2001) 92.

TABLE 3: Average Credit Ratio in Per Cent[23]

Industry	1986	2001
Pharmaceutical Industry	3.0	6.5
Machine Tool	10.0	13.2
Electrical Industry	12.0	10.2
Automotive	12.2	9.3

Source: Annual reports, own calculations

With this in mind, it comes as no surprise that also the ratio of directors with a financial background is increasing in the machine tool and pharmaceutical sectors.[24]

TABLE 4: Average Ratio of Directors with financial Background to all Directors

Industry	Year 1986	Year 2001
Pharmaceutical	7.14	13.06
Machine Tool	6.75	13.26
Electrical Machines	7.63	7.37
Automotive	6.77	8.31

Source: Annual reports, own calculation

The question is, of course, how these findings are related to the economic (or otherwise) success of a corporation. Following the argument of *Lincoln et al.*[25] who said that financial institutions dispatch personnel to firms in trouble, one would expect a negative relationship between measures of success (such as growth, return rate) and the ratio of directors from financial institutions. The data confirms this expectation to a certain

23 One restriction applies: The coefficient of variation for these values is quite high, so one has to be careful drawing conclusions already from these mean values.

24 However, a statistically significant positive correlation could only be found for the electrical and the automotive industries (419 and .418 at a 1 percent level each).

25 J.R. LINCOLN / M.L. GERLACH / C.L. AHMADJIAN, Keiretsu Networks and Corporate Performance in Japan, in: American Sociological Review 61 (1996) 67-88.

degree. For return rates, the coefficient of correlation is negative, at about -0.28 for the pharmaceutical sector and -0.21 for the machine tool sector, and is statistically significant at the 5 per cent level..

In trying to wrap-up these findings, one has to state that at least until 2001 the rumble in the boardroom did not necessarily come from directors nominated by the financial institutions. Rather than groundbreaking new developments, we see the classical scheme: as soon as financial institutions increase their lending, they send personnel to monitor the firms.

4. Foreigners on the Board

As we have seen in the introduction, foreign shareholding in Japan has been increasing. While at the beginning of our investigation foreigners owned about 5.3 per cent of the stock, now in 2001 this ratio has risen to 21.8 per cent. The background of this development is manifold, of course. But is seems to be clear that with the ongoing economic crisis in Japan, previously well-functioning cross-shareholding turned out to be more of a burden than a successful investment. With falling share prices, capital invested in those shares is diminishing. Then, even if it becomes necessary for the survival of the share-holding company, those shares cannot be sold easily. This fact results in the necessity to find yet other ways to get capital funding. The insurance function in the *keiretsu* groups, which is seen as a scheme that group firms would bail out other members of the group knowing that they would get a return in terms of higher prices, secured transaction and less competition after the troubled firm recovered cannot last when the group goes down the drain. Japanese corporations seemed to have realized that their western counterparts had the money to invest in Japan and the knowledge to deal with corporate restructuring. And if one thinks of such spectacular cases like the *Daimler-Chrysler* investment in *Mitsubishi Motors*, *Renault's* alliance with *Nissan*, the merger of *Roche Japan* and *Chugai*, it would seem quite natural to see changes in corporate governance structures resulting from foreign shareholders.

But pure optimism may be misleading. For mergers and acquisitions, as well as for inbound foreign direct investment, one has to bear in mind that the volume of transactions into Japan is only half of what is leaving the country.[26] So we first have to ask what the aims of investors are when they invest in a Japanese company, and how sizeable the investment is. Already in our sample, sixteen out of the seventy firms had foreigners among their three largest shareholders. But among them, only six have foreign shareholders from the industry, the other ten shareholders are financial institutions! Four out of the six are automotive corporations; the other two are *Sony* and *Komatsu*.

26 MOERKE, M&A in Japan – eine Bestandsaufnahme, in: H. Conrad / R. Kroker (eds.): Deutschland und Japan. Mit Reformen zu neuer Dynamik (Köln forthcoming 2003).

TABLE 5: Firms with Foreign Top Three Shareholders (as of March 31, 2001)[27]

Name	Code	Number of Top 3 Foreign Shareholders		Accumulated Shareholding
		Finance & Manufacture	Manufacture only	
Isuzu Motors Ltd.	7202	1	1	48.4
Nissan Motor Co. Ltd.	7201	2	1	39.3
Mazda Motor Corp.	7261	1	1	33.3
Suzuki Motor Co.	7269	3	2	26.9
Yamanouchi Pharma	4503	2	0	14.0
Chugai Pharma[28]	4519	2	0	13.9
Shionogi & Co., Ltd.	4507	1	0	10.4
Sony Corporation	6758	2	1	9.9
Komatsu Ltd.	6301	2	1	9.8
Kenwood Corporation	6765	1	0	9.2
Chiyoda Corporation	6366	1	0	8.6
Makita Corporation	6586	2	0	7.7
Asahi Diamond Ind.	6140	1	0	6.9
Aida Engineering, Ltd.	6118	1	0	5.1
Hitachi Ltd.	6501	1	0	3.9
NEC Corporation	6701	1	0	3.7

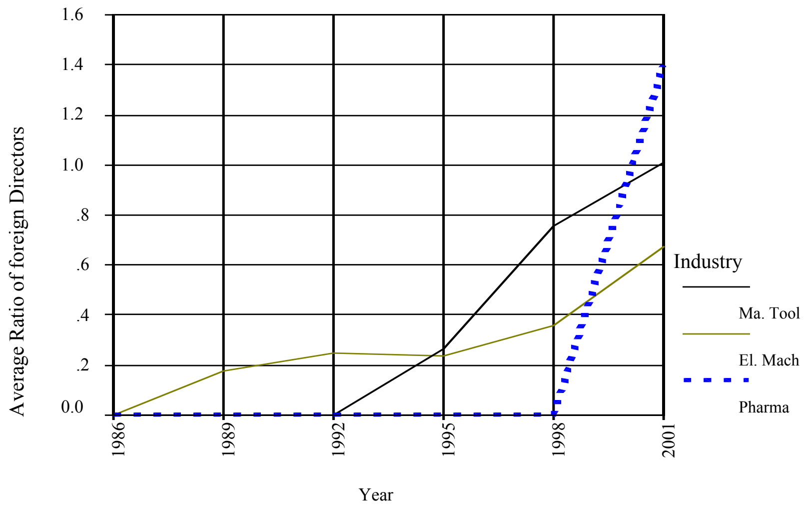
Source: Annual reports, own calculation

So obviously some Japanese corporations are sufficiently interesting for foreigners to cause them to invest their money and wait for returns. In the few firms where foreign shareholders have the necessary shareholding to entitle them to a chair on the board, the main aim of this investment seems to be to restructure the Japanese investment (and to

27 Due to (lacking) data availability, *Mitsubishi Motors* is not yet in the sample.
28 Since the merger with *Roche Japan* was finished in October 2002, *Roche* is not yet listed here.

earn returns afterwards). As is widely known, the automotive industry has become a main target for foreign investors to invest and to act in this way. But, as the following figure shows, there have also been foreigners in the machine tool and electronic industry, and recently in the pharmaceutical industry – with the ratio of foreigners to overall board structure increasing.

FIGURE 6: Ratio of Foreign Directors to Overall Number of Directors (Without Automotive Industry)



Source: Annual reports, own calculations

The connection with corporate success, however, is still difficult to measure. According to interviews and my own research in the field of M&A, Japanese firms tend to avoid foreign major shareholding as long as they can. Only if there is no other alternative, foreign firms are allowed to actively engage and purchase substantial parts of the firm and try their best for a turn-around. Some successful examples could be shown in case studies. *Nissan* is profitable again, and so is *Mitsubishi Motors*. *Sony* has recovered – but this is not necessarily because of foreign shareholders but due to their own restructuring plans. However, a study of the *Bank of Japan* reveals that the return rates of subsidiaries of foreign firms in Japan tend to be higher than those of purely Japanese firms.[29]

29 R. Takahashi / T. OYAMA, Insights into a Recent Increase in Foreign Direct Investment in Japan. Theoretical Explanation and Research Based on Actual Developments, Bank of Japan Research and Statistics Department, Working Paper 00-14 (Tokyo 2000).

IV. CONCLUSION

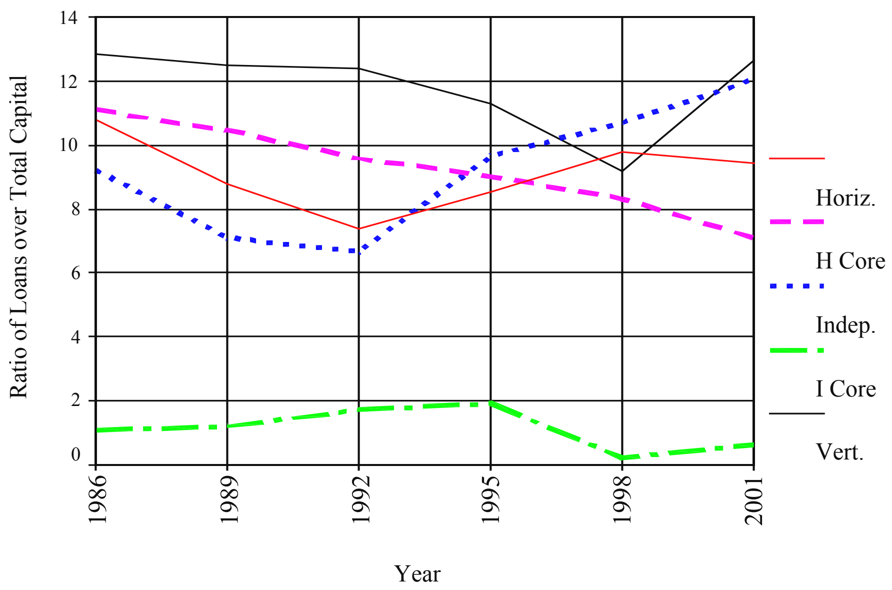
This article addressed changes in the board structure of Japanese industrial corporations. Board structure is seen as a central point in the corporate governance scheme since it mirrors the balance of power of stakeholders and shareholders and reflects the legal framework and industrial organization. For the time investigated, it can be said that changes in the industrial organization in Japan are visible: cross-shareholding is decreasing, banks are changing their stock portfolio and their lending policy, and foreigners tend to play a larger role as shareholders.

Board structures reflect these changes with a certain time lag. First and most obviously, the board size is shrinking. Second, with the exception of vertically integrated firms, boards are still dominated by insiders. Changes in bank-firm relationships are accompanied by a diversification in terms of bank representatives on the board. Enterprises in the pharmaceutical and machine tool industry tend to appoint more people from financial institutions, but they also tend to increase their borrowing, so one would expect bank representatives on the board to monitor the firm; this is not really a new development. Foreign shareholders tend to play a more active role in terms of ownership, but they become active in terms of board membership only in those few cases where they acquire substantial parts of Japanese firms. This can be seen in the automotive industry and, to a certain extent, in the pharmaceutical industry. Changes in corporate governance behavior are seen in those firms already, but at this moment the data would only allow case studies.

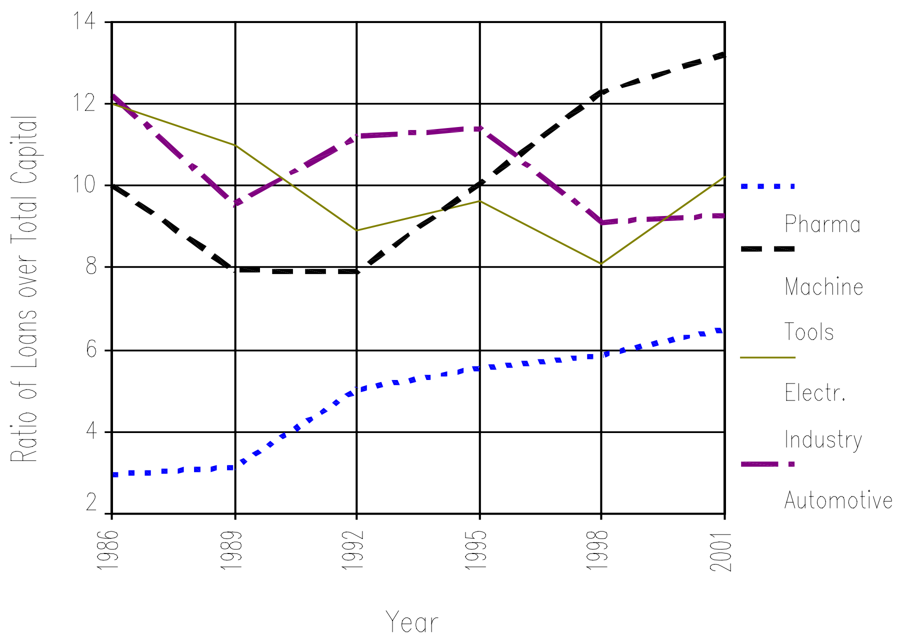
All in all, we can say that board structures were changing slowly until 2001. The changes in the Commercial Code that took effect in 2002 can be expected to further enforce those changes.

APPENDIX

Ratio of Loans over Total Capital: the Enterprise Groups



Ratio of Loans over Total Capital: the Industries



V. ZUSAMMENFASSUNG

Der Beitrag thematisiert Veränderungen in den Strukturen der Führungsorgane japanischer Aktiengesellschaften, dem Verwaltungsrat bzw. board of directors *oder* torishimariyaku-kai. *Ausgangspunkt sind die Veränderungen, die in der japanischen Industriestruktur in den letzten Jahren zu bemerken waren: partielle Auflösung des Überkreuzbesitzes an Aktien, Wechsel von Banken- zu Kapitalmarktfinanzierung, verstärktes Engagement ausländischer Aktionäre am japanischen Aktienmarkt.*

Anhand einer Stichprobe von 70 Unternehmen aus den Branchen Automobilindustrie, Elektrotechnik/Elektronik, Maschinenbau und Pharmazie aus den Jahren 1986 bis 2001 werden Veränderungen in der Struktur der Verwaltungsräte aufgezeigt. Im Mittelpunkt stehen dabei drei Gruppen von Aktionären, die aufgrund ihres Aktienbesitzes Personen in den Verwaltungsrat entsenden können: andere japanische Unternehmen aus Japan, Finanzinstitute sowie ausländische Unternehmen. Die Unternehmen der Stichprobe werden einmal hinsichtlich ihrer Zugehörigkeit zu einer Unternehmensgruppe (keiretsu) *und dann hinsichtlich ihrer Branchenzugehörigkeit verglichen. Dabei zeigt sich, daß Brancheneffekte die Gruppeneffekte in vieler Hinsicht überwiegen.*

Im einzelnen kommt der Beitrag zu den folgenden Ergebnissen: Die Zahl der Mitglieder des Verwaltungsrates hat seit 1995 stetig abgenommen. Wenig geändert hat sich allerdings hinsichtlich der Präsenz von unternehmensexternen torishimariyaku. *Noch immer stammt die Mehrzahl der Mitglieder des Verwaltungsrates aus dem Unternehmen, und „extern" wird noch zu oft mit „unternehmensextern, aber gruppenintern" gleichgesetzt. Die neuen Regelungen des Handelsgesetzes aus dem Jahr 2002 hinsichtlich der Strukturen des Verwaltungsrates dürften hier aber zu einer Entwicklung hin zu mehr „Outsidern" führen. Finanzinstitute stellen besonders in den Branchen Werkzeugmaschinen und Pharma mehr Mitglieder des Verwaltungsrates – dieses sind auch die Industrien, in denen Unternehmen wieder mehr Bankkredite aufnehmen. Die Schlußfolgerung, daß Finanzinstitute damit ein Monitoring der Unternehmen hinsichtlich der Mittelverwendung anstreben, liegt auf der Hand. Die Repräsentanz von ausländischen Unternehmensvertretern ist an einen Aktienbesitz in nennenswerter Höhe gekoppelt, was bisher nur in wenigen Unternehmen der Fall ist. Auch hier lassen sich Brancheneffekte ausmachen: Die Automobilindustrie, die sich in einer deutlichen Krise befand, gehört zu den Bereichen, die sich Ausländern gegenüber geöffnet haben – mit der positiven Wirkung einer geschäftlichen Erholung. Aber diese Entwicklung greift jetzt auch auf andere Branchen, z.B. den Pharmabereich, über.*

Zusammenfassend muß gesagt werden, daß sich Änderungen in den Strukturen der japanischen Verwaltungsräte nur langsam vollziehen. Die neue Gesetzgebung dürfte diesen Prozeß beschleunigen, noch nachdrücklicher würde aber ein Bewußtseinswandel innerhalb der japanischen Unternehmen wirken.