Japanese Corporate Governance: Behind Legal Norms

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Japanese Corporate Governance: Behind Legal Norms

Caslav Pejovic*

All people are the same. It is only their habits that are different.

Confucius

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INTRODUCTION

Corporate governance may be analyzed from different perspectives, one of them being its legal aspect. However, instead of examining legal rules regarding corporate governance, this paper will analyze the relationship between non-legal norms and corporate governance focusing on the influence that non-legal norms have on the way corporate governance functions in Japan.

Japanese corporate governance has often been the subject of attention of foreign scholars, particularly in debates on the comparative aspects of corporate governance. The main focus is usually on the rules regulating corporate governance and legal reforms affecting those rules. The main bank system, cross-shareholding and long-term employment are usually mentioned as typical features of the Japanese model of corporate governance.

The current literature on Japanese corporate governance often relies on contrasting arguments. Some scholars suggest that it is fundamentally different from Western patterns and its character is determined by the unique Japanese culture. The opposing view disputes this explanation by focusing on economic, legal and political factors, and arguing that these factors are the primary force driving Japanese corporate governance. This bipolar approach is also present in discussions related to other areas

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of Japanese law and practice, such as various theories concerning the low litigation rate in Japan.³

The objective of this paper is to highlight the background of corporate governance in Japan by taking all dominant factors into consideration in light of arguments relied upon by competing theories. This paper will analyze economic, political and legal factors that have contributed to the development of the Japanese model of corporate governance. Particular attention will be given to exploring the world of corporate governance that exists behind the legal norms, focusing primarily on the influence that Japanese social norms have on corporate governance. Such an analysis of the impact of the non-legal norms on corporate governance may provide new insights into the way culture interacts with legal norms in Japan and may contribute to a better understanding of the way in which Japan is currently adapting the system of corporate governance to its evolving business environment.

A broader objective of this paper relates to a general lack of a comprehensive analysis of the effect of non-legal norms on corporate governance in the wider corporate governance literature. This paper suggests that the cultural lens should not be forgotten when attempting to understand how disparate systems of corporate governance work in practice. In this sense, the overall goal of this paper is not just to contribute to Japanese corporate governance literature but to the understanding of corporate governance as a whole.

This paper will first address the basic structure and principle of Japanese corporate governance by giving an overview of both the legal regulation and non-legal norms used in Japanese corporate governance. Then, it will analyze the influences of both the non-legal and legal norms on corporate governance in the light of arguments relied upon by competing economic and cultural theories. The last portion will explore the prospects for changes in the corporate governance in Japan as a consequence of economic decline in recent years, both with respect to the legal regulations and practices based on non-legal norms. Finally, the paper will conclude by evaluating the possible directions of the evolution of Japanese corporate governance in the future.

LEGAL REGULATION OF JAPANESE CORPORATE GOVERNANCE—
UNSUCCESSFUL ADOPTION OF THE AMERICAN MODEL

After Japan opened its doors to the outside world in the mid-nineteenth century, it embarked on a process of modernization, but with a clear strategy to preserve its own values while importing Western technology under the slogan "Japanese spirit, Western skills" (wakon yosai). This approach was buttressed by the Japanese educational system which continued to cultivate traditional values.

Relating to the Japanese legal system, there are two sets of rules in Japan that have co-existed for over a hundred years: (1) legal norms transplanted from the Western legal system, and (2) traditional informal norms. The Japanese legal system is based on legal transplants originally imported from Germany.4 In the post-war period, particularly in the area of corporate law, Japanese law made a distinct move towards the American model.5 The genesis of the Americanization of Japanese corporate law came during the occupation period, when American law heavily influenced major revisions to Japan’s black letter corporate law—which were aimed at implementing a US-style shareholder primacy model. American influence was also dominant after the economic “bubble burst” in the 1990’s.6 In Japan’s post-bubble era, discussions surrounding a new approach to corporate governance often gravitated towards the need to adopt “global standards” in corporate-governance reforms. The idea of adopting “global standards” was typically understood as a thinly veiled disguise for adopting American standards.7

Adoption of the American model into Japanese business culture was unsuccessful. While in the post-war period Japan adopted corporate governance structures and rules based on American corporate law, in practice, they deviated substantially from the American model.8 Dependence on banks for financing, cross-shareholding, as well as the

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4. There are several reasons for the choice of German law, related to suitability for Japan. See HIROSHI ODA, JAPANESE LAW 27-29 (Butterworths, 1992).
6. Id. at 101.
long-term employment system, all developed in the post-war period when Japan was supposedly following the American model. Each of these essential features of the Japanese corporate governance model is in clear contrast to the American model. One of the paradoxes of the Japanese model is that during the period when the model was presumably under the influence of American-style black letter corporate law, it actually diverged from the American model. Some commentators described this divergence as a puzzle.9 This text will attempt to find answers to this puzzle.

NON-LEGAL NORMS10 AND CORPORATE GOVERNANCE

All states have a set of rules embodied in codes, statutes or court cases that represent the formal legal order. Besides this formal set of rules, there is a separate set of non-legal norms that also play a role in the governance of society. According to Lawrence Friedman,11 a legal system includes three basic components: (a) structural component, which means “the institutions themselves” such as courts; (b) substantive component, such as ‘laws themselves’ applied by the courts (both substantive and procedural); and (c) cultural component, which refers to “the values and attitudes that bind system together, and which determines the place of the legal system in the culture of the society as a whole.” Legal culture embodied in non-legal norms is most difficult to define, as it is not so visible and accessible compared to other two components.

Legal systems are embedded in particular cultures that have their own value systems. Non-legal norms are usually based on traditional ways of doing things in a society and rely on moral values, such as trust and reputation. In societies where values, language, meaning, traditions and customs are shared, non-legal norms based on personal relationships play a more prominent role. These norms may also play important role in determining the actual implementation of the formal legal rules. They may be of key importance for understanding the law in action, since they determine when, why, where and how people use law and legal institutions. As those norms are stronger and more important in a

10. In the context of this text, the term “legal norms” is understood as legal rules and standards articulated through formal institutional processes by legislatures, courts and administrative agencies as opposed to the “non-legal norms” understood as rules that evolved through a social custom or tradition without being recognized as legal rules by formal institutions.
society, so will the implementation of formal legal rules be weaker and less effective.

Despite the various debates on comparative corporate governance, there have been remarkably few analyses of the role of non-legal norms in corporate law and practice. Many scholars writing about the legal aspect of Japanese corporate governance are aware of the cultural aspect but for various reasons have limited their analysis to the legal aspect only, or have only vaguely touched upon non-legal norms. The question that has not been sufficiently explored by the literature is: in what way do non-legal norms influence the corporate governance system of individual countries?

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

An analysis of the Japanese legal regulations of corporate governance, which would be separated from the social realities, is bound to fail in its attempt to fully understand the Japanese corporate governance system. It may only reveal the rules, but not their life in the real world of practice concerning how they are applied, and how they function and shape the Japanese corporate world.

The role of non-legal norms in corporate governance has recently attracted the attention of some legal scholars. Curtis Milhaupt's paper *The Evolution of Nonlegal Rules in Japanese Corporate Governance* is one of those few attempts focusing on the non-legal rules in Japanese

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corporate governance. Milhaupt focuses on non-legal norms—in the sense that they are features of Japanese corporate governance that are not based on law but play a very important role in corporate governance. This paper will look at the issues arising from the link between Japanese culture and Japanese corporate governance, but from a different perspective than Milhaupt, and will provide, in some cases, different conclusions. More specifically, this paper will attempt to explain the background of those non-legal norms, as well as provide a more detailed elaboration on the way they affect functioning of corporate governance in practice.

CHARACTERISTICS OF THE JAPANESE MODEL

Japan has adopted Western legal institutions since the Meji period, but these institutions have not operated in the same manner as in the West. The legal form was adopted from the West, but the way of doing things maintained a distinctive Japanese flavor. Despite its “shareholder model” form, Japanese corporate governance is, in essence, much closer to the “stakeholder model” with particular attention being given to the protection of employees. The idea that companies should be managed dominantly in the interest of shareholders is in contradiction with the prevailing understanding of corporate governance in Japan. While capital is certainly important, the Japanese system gives greater importance to the labor and efforts of employees, since they play a crucial role in the development of a company. In fact, the company and its well-being are the central focus of the Japanese system, and the company comes before both shareholders and employees. So, maybe it is more accurate to say that Japanese system is focused more on the company, rather than on the employees.

The most typical features of the Japanese model of corporate governance include: the main bank system, cross-shareholding, long-term employment, and the close relationship between the business elite and the government. There are competing theories that attempt to


16. There is a general consensus in the literature that the main bank, keiretsu and lifetime employment are the three central features of Japan’s post-war system of corporate governance. However, two of the most prominent Japanese corporate governance scholars, Yoshiro Miwa and Mark Ramseyer, have recently published numerous articles and a book which suggest that all of the central features of Japanese corporate governance are “academic myths” (i.e., they do not exist). For an example, see Yoshiro Miwa & J. Mark Ramseyer, The Fable of Keiretsu (U. Chi. Press, 2006); Yoshiro Miwa & J. Mark Ramseyer, The Myth of the Main Bank: Japan and Comparative Corporate Governance, 27 Law & Soc. Inquiry 401 (2002). For a critique of Miwa and Ramseyer’s contrarian research—which also supports the general view
explain the character of these features by relying on different rationales, such as economic, legal and political factors on one side, and culture on another. We shall use *keiretsu*, or cross-shareholding, and long-term employment as case studies to compare the arguments of these theories.

**Concept of Cross-Shareholding**

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

*Keiretsu* literally means “economic line-ups” and includes something more than what is just covered by the concept of cross-shareholding. *Keiretsu* is a structural arrangement of Japanese firms characterized by close business relationships intertwined with long-term commitments among members. There are various types of *keiretsu*, but the main type is the *keiretsu* corporate group (sometimes called “*gurupu*”), with the main bank at the center. Normally, the shares held under these ongoing stable shareholding arrangements constitute the controlling portion of the firm’s shares. There is a mutual understanding between the companies that these shares are not to be traded, but to be kept as a safety mechanism. Member companies within a *keiretsu* offer each other preferential treatment in commercial and financial transactions. They may exchange information through the main bank and, in times of crisis, they are expected to help each other.

Concept of *keiretsu* is of crucial importance for understanding the Japanese model. The fact that most of Japanese large companies are

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17. *Keiretsu* is the term usually used in the English literature to denote cross-shareholding. In Japanese, cross-shareholding is usually called “*mochiai*” or “*kabushiki mochiai*,” while the term “*keiretsu*” refers to the network of companies.

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


20. In Japan, a distinction is made between investment shareholding and mutual shareholding. The first one involves trading on the stock market, while the second means that shares are not traded but are used to cement the relationship and prevent takeovers.
owned by other companies and banks, which are also owned not by classic types of shareholders, but by other companies in the same keiretsu raises the question: who really owns these companies and banks? In a sense, private ownership as an essential ingredient of capitalism is lacking in the Japanese model.

**Concept of Long-Term Employment**

Long-term employment is another typical feature of the Japanese model. Under this system, which is not regulated by any particular law but is based on informal norms and practice, an employee is recruited directly from school or university and is expected to remain in the company's employ for the length of his or her career. In return, he or she can expect not to be fired or discharged, except under some extraordinary circumstances.\(^21\) The basis of this agreement is the commitment of employers to provide secure employment to their employees in return for loyalty and "lifetime" service. The employer can rely on loyal employees and their dedication to work hard in exchange for the investment in their training. As a part of this system, the promotion of employees within the hierarchy of the company and the wages paid are based on the principle of seniority.\(^22\)

The mandatory retirement (teinen) system is an essential element of long-term employment. Historically, in the post-war period, the retirement age has been 55 years old. However, recent amendments to Japan's labor law mandate that it now must be 60 or higher.\(^23\) Presently most companies fix the age of retirement between 60 and 65.\(^24\) This system typically applies to workers in major Japanese companies but is far less present in small companies.

Long-term employment does not mean a formal obligation of the company not to dismiss its employees, nor does it mean that the company does not dismiss employees as this happens in practice.

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23. Act Concerning Stabilization of Employment of Older Persons, Law No. 103 of 2004], art. 8. This Act entered into force on April 1, 2006.

Rather, long-term employment should be understood in the sense that the company will not resort to layoffs unless it is in deep economic crisis and layoffs are the only possible way to keep the company afloat and prevent bankruptcy.\textsuperscript{25} Even in times of crisis, such as the oil shock crises, or more recently in the time of "lost decade," companies used other mechanisms aimed at avoiding layoffs, such as the reduction of overtime and assigning employees to affiliated companies.

Long-term employment, in the sense of spending the whole career in the same company, is not really unique to Japan since such patterns exist in many other countries, as well. However, relying merely on the numbers and statistics to prove that the Japanese model is not different from other long-term employment patterns misses the point. The essence of the Japanese model of long-term employment is not in the numbers, but in its character. There are several elements of the long-term employment system that are typical for Japan, such as the way of recruiting graduates,\textsuperscript{26} seniority-based wages, internal transfers based on a rotation system and on-the-job training, which result in firm-specific skills, making it extremely difficult for employees to move to other firms. These features make Japanese long-term employment qualitatively different from the corresponding patterns in most other countries.

**ECONOMIC THEORIES\textsuperscript{27}**

*Keiretsu as Protection Mechanism*

Economic theories emphasize economic rationales, as well as legal and political factors, as being the key factors in establishing *keiretsu*. They point out the fact that individual shareholding decreased while the shareholding of financial institutions and corporations increased after the 1950s and particularly in the 1960s and 1970s. In the post-war period, individual shareholding fell from 69.1% in 1949 to 23.9% in 1986, while the ratio of shareholding by financial institutions increased from 9.9% in 1949 to 41.7% in 1986, and the ratio of shareholding by corporations

\textsuperscript{25} Leon Wolf, *The Death of Lifelong Employment in Japan?* in CORPORATE GOVERNANCE IN THE 21ST CENTURY JAPAN'S GRADUAL TRANSFORMATION, supra note 1, at 53, 77.

\textsuperscript{26} Practice of simultaneous recruiting of new graduates (*shinsotsu-ikkatsu-saiyō*) and the way of applying for jobs by the students (*shūshoku katsudō*) seem to be unique to Japan and S. Korea.

\textsuperscript{27} "Economic theories" is not really an appropriate term, since in this text the theories covered by this term also include theories that emphasize legal and political factors. This term is chosen as a matter of convenience to distinguish all other theories from the theories that emphasize cultural factors.
increased from 5.6% in 1949 to 24.5% in 1986. This trend was a result of the easing of restrictions on ownership of shares by financial institutions and corporations due to the revision of the Anti-Monopoly Act of 1947. After the initial period in the 1950's, when the Anti-Monopoly Act of 1947 prohibited stockholding by companies, things radically changed in the 1960s. Japan became a member of the OECD in 1964, and one of the conditions for membership was the deregulation of its financial market. As the government relaxed the entry of foreign capital into the country, there was a growing concern about possible takeovers of Japanese companies by foreign companies.

As a response to the liberalization of the country's markets, large Japanese corporations created a defense mechanism by establishing a stable shareholding system with the participation of "friendly companies." Following these changes, the Commercial Code was revised to allow the issuance of new shares to companies, leading to the concentration of shareholdings in the hands of banks and corporations and the creation of keiretsu, which contributed to the relatively stable and concentrated ownership structure of Japanese companies. Logically, this resulted in a substantial reduction of individual shareholdings as the shares became concentrated in a small group of financial organizations and corporations. Thus, the keiretsu was made possible by government action which was behind the regulations allowing shareholdings by companies.

Long-Term Employment—Development of the Doctrine of Abusive Dismissal

Economic theories dispute the cultural roots of long-term employment by pointing out the fact that it did not exist as a firmly established system in the time between the two World Wars. The origins of the long-term employment concept date from the early part of the twentieth century, when it gradually developed as a business strategy to avoid the high fluctuation of workers that created difficulties for companies, particularly in key industries such as iron and steel. To

solve that problem, companies started to offer incentives designed to encourage experienced workers to stay, such as increased wages based on seniority and hefty retirement allowances for long-term workers. An ideological justification for the long-term employment relationship developed afterwards, tying it to Confucian notions of reciprocal obligations. At the start, however, long-term employment was, in fact, a new strategy based on rational economic choice by employers. The system was first institutionalized only in the 1950s and became popular in the 1970s. The modern long-term employment system was allegedly designed as a result of a compromise entered into between management and unions aimed at overcoming existing labor problems, being a mutually beneficial bargain rather than as a solution imposed by social norms.

Long-term employment in its present form developed as a result of economic benefits. It contributed to a greater productivity that benefited both the shareholders and management through higher profits, as well as labor through greater employment security. It has also been argued that since long-term employment affects only a portion of employees and is not universal, it cannot be based on culture, because culture assumes a set of norms and practices that are universal.

Political factors also played a role in the development of long-term employment in Japan. The legal framework that developed during the same period and supported long-term employment was arguably based on a government policy that encouraged the long-term employment practice. The government supported lifetime employment because it contributed to reducing the tensions between employers and employees that in case of escalation could have caused problems to the peace and stability of the State.

In parallel with this development, at about the same time, the Japanese courts developed the doctrine of abusive dismissal. This new legal doctrine was present in a number of cases starting in 1950s, restricting the employer's power to dismiss employees. This development led legal scholars to emphasize the importance of

33. Id. at 159-60.
34. Id. at 153-60.
35. Aoki, supra note 28, at 3-43.
restrictions on termination of employment contracts under Japanese labor law as the factor that contributed to long-term employment.\textsuperscript{38}

CULTURAL THEORIES

Keiretsu as Traditional Way of Doing Things

According to the cultural explanation, stable shareholding is related to the Japanese group mentality.\textsuperscript{39} The cross-shareholding system is deeply rooted in the Japanese group mentality because the Japanese feel more confident in dealing with people belonging to the same group, where trust serves as a bond which is considered to be more important than any legally binding obligation. As a result, Japanese firms have a tendency to “cluster themselves into groupings of affiliated companies that extend a broad spectrum of markets.”\textsuperscript{40}

Cultural theories point out the parallel between the traditional village and the grouping of companies into larger groups of keiretsu with the appropriate subordinate system in which all companies are subordinated to their respective presidents (shacho).\textsuperscript{41} The traditional village represents a paradigm.\textsuperscript{42} In a traditional Japanese village, there was a strong bond connecting all the people, and they maintained long-term mutual relationships. For those people, “it was inconceivable to live outside [their village].”\textsuperscript{43} The sense of depending on each other as members of the community ensures mutual loyalty and provides a sense of security to the members.

Similar considerations exist in the case of keiretsu. If one company has difficulties, it is likely to be assisted by other companies from the same keiretsu (the same as the villagers would help each other in case of calamities); more powerful companies are expected to support smaller ones. The sense of obligation towards the company may be linked with the sense of belonging to a family and the responsibility towards one’s

\begin{itemize}
\item \textsuperscript{38} Miwa & Ramseyer, supra note 16, at 159.
\item \textsuperscript{40} Michael L. Gerlach, Twilight of the Keiretsu? A Critical Assessment, in COMPARATIVE LAW: LAW AND THE LEGAL PROCESS IN JAPAN 379-381 (Kenneth L. Port & Gerald Paul McAlinn eds., Carolina Academic Press, 1996).
\item \textsuperscript{41} Horie, supra note 39, at 1-16.
\item \textsuperscript{43} Ryuichi Iwata, Japanese Style Management: Its Foundations and Prospects 54 (1982).
\end{itemize}
own family. In the same sense, *keiretsu* also represents a kind of family with members that feel close to each other. In this sense, *keiretsu* is not purely an economic concept but a cultural one, as well.

*Long-Term Employment—Company as Family*

In contradiction to economic theories which deny the existence of long-term employment in Japanese tradition, cultural theories rely on the argument that long-term employment, in fact, has its roots in Japanese history. The kinship-based economic unit was established in the Tokugawa period and provided the basis for the long-term employment system, seniority-based status, which became the basis of the modern system of employment in Japan. In the Tokugawa period, Japanese business entities functioned like family businesses even when the employer would hire outsiders to manage them. The employees were expected to show loyalty and dedication to the *ie* so that its name would be preserved—"... the employees were trained from their boyhood to serve the *ie* (meaning 'home'), and were expected to climb up the ladder beginning from *detchi* （丁稚—apprentice), through *tedai* （手代—assistant manager), to *banto* （番頭—manager)." This represented the foundation of long-term employment based on seniority and loyalty to the company.

Japanese corporate culture is often described as a family system, in the sense that the Japanese company is based on the principles of a traditional family. The seeds of this family concept of companies are deeply rooted in Japanese culture, based on obedience, hierarchy and loyalty which all make up important elements of Japanese culture. Originally, the Confucian ethic of the group was typically applied to relationships in a family, which are traditionally lifetime relationships. The group concept was extended to the traditional *ie* and later on to the firm. *Ie* was abolished as a legal unit by revisions of the Civil Code

45. Tokugawa period is a division in Japanese history during which Japan was ruled by shoguns of the Tokugawa family from 1603 to 1868.
made after World War II. Nevertheless, the concept of ie still exists as an informal norm of the social structure in Japan. Japanese employees often refer to their companies as “uchi” (home) to describe the company where they work.

According to cultural theories, the kaisha (company) symbolizes the organization where people are not united by contractual relationships, but it includes an element of association resembling that of a family. Of course, the kaisha provides income that enables the employees to support themselves and their families, but it also involves an emotional linkage which may also exist in the West, but usually not so deeply rooted as in Japan. “The company is the people” is a common saying in Japan. By characterizing itself as a family unit, the company has achieved a greater level of loyalty between management and employees. Each employee has an attachment to the company as “my company” (uchi no kaisha), so that all of the employees, in a sense, represent the company. If someone does something wrong, there will normally be solidarity between the employees who will try to protect him or her, because what was done was done for the company.

The relationship between an employer and an employee is based on the hierarchical order in line with Confucian teachings. In return for the employees’ loyalty and devotion to their duties, the employer is expected to treat them with benevolence. It has been recognized that devotion to the community plays a key role in suppressing individual desires for the common welfare of the group.

Culturalist theories argue that one of the main features of Japanese industrial relations is the identification of employees with the company, related to a group mentality and the need of employees for a sense of

51. CHIE NAKANE, JAPANESE SOCIETY 3 (1973).
52. There has been a substantial number of cover-ups by Japanese companies aimed at protecting their employees. The Mitsubishi cover-up affair was one of the largest corporate scandals in Japanese history. In 2000 it was revealed that one of the Japanese giants, Mitsubishi Motors Corp., had suppressed complaints made by consumers to avoid massive and expensive recalls. Mitsubishi was forced to admit a systematic cover up of defect problems in its vehicles. In 1995 one of Daiwa Bank’s bond traders, Toshihide Iguchi, in New York lost $1.1 billion speculating in the bond market. The company was later indicted for not reporting crimes by Iguchi including unauthorized sales of clients’ securities to cover losses.
belonging to a peer group. Working in a company is considered to be a part of one’s identity, and by moving to another company, a person feels deprived of an important part of his or her identity. It is often said in Japan that an employee chooses a company, not a profession. Entry into the company is viewed as “being born again into another family.”

Personal interrelationships give a feeling of belonging to a group (nakama ishiki) and security to the individual, but they may also result in a feeling of dependence. Community in Japan may be best understood in terms of mutual interdependency and a shared sense of belonging to a community or group. The Japanese people even evaluate each other on the basis of the group they are affiliated with, making them very sensitive about the reputation and prestige of their group.

DUALISM OF LEGAL AND NON-LEGAL NORMS IN JAPAN

The co-existence of non-legal and legal norms emphasizes the confusion and requires that both sets of rules be taken into account simultaneously. In Japan, as well as in some other Asian nations influenced by Confucianism, there is a stronger emphasis on community interests at the expense of individual ones, and more importance is given to moral norms at the expense of legal norms. Regulations of corporate governance represent, to a certain extent, just the façade behind which there exists a world that has its own life and logic far removed from its outside appearance. Consequently, there are two sets of rules in Japan that have co-existed for more than a century, such as the legal system imported from the West and the traditional rules.

ROLE OF LEGAL NORMS

The way in which corporate governance functions in Japan raises the issue of the role of law in Japan, and specifically corporate law. By giving dominant importance to the role of social norms, cultural theories implicitly downplay the importance of law within the society. There is a

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55. NAKANE, supra note 51, at 11.
56. ABEGGLEN & STALK, supra note 21, at 200.
57. Sankei Shimada, the executive director of Nissho Iwai Trading Company who committed suicide following Douglas-Graman affair, wrote the famous note before leaping from the building to his death: “The life of the company is eternal. For that immortality we must sacrifice ourselves.”
58. For example, China, S. Korea, Singapore, and Vietnam.
view that law is largely irrelevant to the social and economic organization in Japan. Some scholars even doubt that legal reforms can be effective due to social and cultural constraints.

In contrast, the majority of scholars attach great importance to the role of law. The increase of derivative suits in Japan has been used as an illustration of the relevance of law within the country. The sudden increase in shareholder derivative suits almost immediately after a reduction in the filing fees in the early 1990s, as noted by Mark West, illustrates the importance of these legal rules.

The argument that the number of derivative suits has substantially increased after the lowering of court fees has strong persuasive force. However, this argument should be taken with some reservations. A logical question that may be asked is: would the number of derivative suits be equally high if the court fees were equally low when the law on derivative suits was enacted? The answer might be "no," because the issue of the litigation rate is too complex to be explained by relying only on the amount of court fees. Litigation rates were traditionally low in Japan, and only in recent decades has there been an increase in Japan's litigation rate without changes in the court fees.

This example, which is emphasized as evidence that the law matters, can be seen from the opposite perspective—that the law does not play a very important role and that the rise of derivative suits has received so much scholarly attention because it is a deviation from the norm. In any case, the increase in derivative suits can be at least an illustration of a possible change in traditional attitudes towards law.

The role of law in Japan has not been so visible during a long period despite its existence on the books. Derivative suits remained dormant for several decades after being introduced into Japanese corporate law, despite the fact that many opportunities for such suits existed in response

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61. Philip Lochner, Corporate Japan: Beginning of a New Era, Columbia Conference held on March 23, 2001 (quoted in id. at 198).

62. Between 1950 and 1990 there were fewer than twenty derivative suits. Since the fee for filing derivative suits was reduced by law to the modest amount of 8,000 yen, there has been a huge increase of derivative suits. By the end of 1999, there were 286 derivative suits, ninety-nine of which were filed in 1999 alone.


to various managerial abuses. Similarly, securities laws existed but were not often used in practice, despite widespread insider trading practices and market abuses. Antitrust laws existed but did little to prevent widespread bid-rigging and cartels. The legal infrastructure for hostile takeovers existed, although not well developed, but Japan has remained largely free of hostile takeovers. Recently, however, there have been many court cases concerning hostile takeovers (in terms of proxy fights, inspection of target company's books, selling out dissenting shares at a fair value, etc). These examples of extended stagnation illustrate the fact that legal transplants need certain time to take root in a new environment.

Despite some skepticism, there should be no doubt that the law plays a very important role in modern Japan. All modern societies are law-driven societies whether they use statutes, decrees, ordinances, administrative guidelines, or whatever. Japan is not an exception. If the law did not matter, why would Japanese legislators spend so much time and energy in revising something that was not relevant? It can be argued that the functioning of corporate governance depends more on practices

65. In contrast to a low rate of general crimes, in Japan there has been a long list of corporate crimes. Here are just a few illustrations: Yamaichi Shoken collapsed in 1997 because of off-the-book debts ("tobashi"), a technique for hiding losses. In one of the largest corporate scandals in Japanese history, in 2000 it was revealed that one of the Japanese giants, Mitsubishi Motors Corp., had suppressed complaints made by consumers to avoid massive and expensive recalls. In 1995, one of Daiwa Bank's traders, Toshihide Iguchi, in New York lost $1.1 billion speculating in the bond market. Typically, these corporate crimes were not motivated by greediness of managers but by a desire to protect one's company.

66. Insider Trading Spike Linked to Close Confidants, KYODO NEWS (Sept. 4, 2010), http://search.japantimes.co.jp/cgi-bin/nb20100904a2.html.

67. As of 2008, thirteen lawsuits were still pending over 1990s bid rigging for local government contracts to supply incinerator plants: Builders Settle Damages Suit Over Bid-Rigging, KYODO NEWS (Apr. 4, 2009), http://search.japantimes.co.jp/cgi-bin/nn20090404a6.html.

68. Puchniak claims that there has not been a single successful hostile-takeover bid in the post-war period. Puchniak, The Efficiency of Friendliness, supra note 12, at 195.

69. The greatest attention attracted the famous "Livedoor" case—Nippon Hoso K.K. v. Raibudoa K.K., Appeal from Injunction Against Issuance of Warrants, Tokyo Koto Saibansho [Tokyo High Ct.] Mar. 23, 2005, 1173 HANREI TAIMUZU [HANTA] 125 (Japan). In this case, the court ordered the provisional injunction against the issuance of stock-acquisition rights to a third party, for the reason that the relevant takeover action was not found to be abusive. Another important case was Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bull-Dog Sauce Co., Ltd., 1809 SHOJI HOMU 16 (Sup. Ct., Aug. 7, 2007). In this case, the court recognized that almost all shareholders other than the acquirer had judged that the acquisition of control by the acquirer would be detrimental to the company's interests and thus the shareholder interests, and affirmed the implementation of the takeover-defense measure.

than on legal rules. On the other hand, even if not vigorously enforced in all situations, the law has an important persuasive effect. The law, itself, cannot change things immediately, but its existence is still important for creating a legal framework that will legitimize one kind of behavior and prohibit others.

Non-legal norms weaken and are replaced by legal norms as a society becomes socially, economically and culturally more advanced. That has already happened in Japan, and this process of change will continue.

**ROLE OF NON-LEGAL NORMS**

To understand accurately Japanese corporate governance, it is critical to understand the way in which non-legal norms impact the practice of corporate governance. Reasons rooted in the Japanese culture lie behind the way Japan has integrated foreign legal concepts, including those related to corporate governance, such as the separation between ownership and management, the organization of the firm and the way in which management functions. These concepts cannot be fully understood if observed in isolation from the larger context of Japanese social norms.

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

According to Milhaupt, "corporate norms may be the product of interest group dynamics." This is one possible explanation which has some explanatory weight behind it. However, Milhaupt's explanation is incomplete as it fails to address why such norms arise in Japan, and whether the emergence of norms such as those related to long-term employment would be possible, for example, in the United States. If yes,

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then why is there a lack of such norms in the United States, at least in comparison to their prominence in Japan? If not, then why do such norms exist in Japan and not in the United States? The most persuasive answer to these questions can be found in theories that emphasize the importance of Japan's social norms. The fact that similar patterns of long-term employment have developed in different situations and under different circumstances indicates the existence of some integrating factor that played a role in the structuring of this system in Japan. Such patterns have not developed in most other parts of the world, at least not in the form this system existed and exists in Japan, which explains the difference.

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

Non-legal norms often play a more significant role in Japanese corporate governance than do formal legal rules. Even though the non-legal norms did not play a direct role in the process of creating cross-shareholding and long-term employment, they certainly had an influence in the process of their acceptance and integration in the Japanese economic model. The nature of cross-shareholding and the long-term employment system are perfectly congruent with Japanese social values, even if concepts were adopted on account of other considerations. The concept of long-term employment and the way it operates are familiar to employees based on their experiences and education outside the company. So, they tend to easily adjust to their new environment due to the well known patterns of conduct that they are accustomed to. In a similar way, cross-shareholding corresponds to the traditional patterns of cooperation in Japan. The fact that the cross-shareholding and the long-term employment system solution perfectly suit the Japanese traditional social norms only enhanced their successful implementation and functioning in practice.

Cultural theories discussing the influence of non-legal norms usually emphasize the importance of Confucianism. However, this argument should be taken with some reservation. Some scholars argue that Confucianism in Japan was used by the Japanese elite as a kind of "cultural engineering" for manipulation and social control to promote the

goals of the elite. According to this view, the metaphor of kaisha as a family may have been used to create a sense of family relationship among employees, while the actual reason for this “familistic rhetoric,” used in a wider context of a “family state,” was to enhance managerial power. Use of the concept of ie was aimed at creating an image of culture based on relationships and concealing the real reasons. This kind of argument is more relevant for determining how the culture can be influenced, than how culture actually affects the business environment. Even if these patterns developed as result of a cultural engineering, the cultural explanation still has some weight. The question that can be asked is: why was such cultural engineering not successful or attempted in Western countries, but was successful in South Korea, which shares a similar culture with Japan?

The role of non-legal norms in shaping the Japanese economic model should not be overestimated. Particularly, the theories that emphasize Japanese uniqueness (so-called ‘Nihonjinron’ theories) should be taken with a grain of salt. While the factor of culture is certainly important in explaining different patterns of behavior, it is also critical not to overstate its importance and to avoid stereotypes.

DISCREPANCY BETWEEN LEGAL AND NON-LEGAL NORMS

The formal legal structure governing Japanese corporate governance is similar to the formal legal structure in many other jurisdictions. In Japan, however, there is a substantial gap between legal norms and actual practice. This is a constant in Japan—the formal structure is adopted and then adjusted to the Japanese way of doing things, which continues to function parallel to the formal system.

Examples of this discrepancy between form and practice can be seen in the way of the functioning of general shareholders meetings and the board of directors (“BOD”)—both of which demonstrate some idiosyncratic, culturally based features of Japanese corporate governance. The way the BOD and general shareholders’ meetings function deviates significantly from the formal rules that regulate them. Under the law, the BOD is charged with monitoring corporate activities

76. VAN WOLFEREN, supra note 48, at 16.
79. Zenichi Shishido, supra note 8, at 189; Puchniak, The 2002 Reform, supra note 2, at 52-53.
and is vested with the authority to make important managerial decisions. In practice, however, the BOD has not played this role, particularly with regard to the monitoring function. One of the key features (and problems) of corporate governance in Japan is that the BOD is dominated by the very same executives who are in charge of the day-to-day operations of the company. Obviously, this kind of supervision has a flaw, as it makes no sense if the monitors are those same persons that are to be monitored.

Similarly, despite formally being a supreme organ of the company, shareholders’ meetings have been relegated in practice to merely formal rituals. Very few shareholders actually attend the meetings. Many shareholders’ meetings in Japan typically take less than thirty minutes to present business and financial reports, approve the distribution of profits and elect new directors and auditors. Such general meetings of shareholders often represent just ceremonies of formality and public approval of decisions that have already been made in informal fora.

In order to understand the way of functioning of the company management, it is necessary to understand the process of making decisions and the role of informal ways of decision-making. In Japan, the formal processes are rigid and top-down, involving a kind of ritual formality with importance given to seals, and do not allow much deviation from the established rules. On the other hand, the informal processes are far more flexible and have a very different logic, with great importance given to consensus and collective participation in making a decision. The efforts made to achieve consensus and avoid disputes are incorporated in the way decisions are made. This informal way of making decisions through various forms of meetings and communications is based on personal relations rather than on formal ways of communication. As result, the decisions are often not made at the general meetings of shareholders or the BOD, but at informal places.

Within the keiretsu system there is usually a group of presidents of corporations who make up the so-called “shacho-kai” (Presidents Club), an informal organ which meets regularly. Shacho-kai is an important venue for fostering ties among the companies belonging to the same keiretsu. These meetings have, to a certain extent, a mysterious character since the outsiders do not know what goes on at these meetings, no notes are taken, and no statements are made officially after those meetings. Due to the lack of information, there can be various speculations about the importance of those meetings. Based on available information

81. Examples include: Mitsubishi Kinyo Kai, Sumitomo—Hakusui Kai, Mitsui—Nimoku Kai, Fuji—Fuyo Kai, and Sanwa—Sansui Kai.
obtained from practitioners, a number of corporate groups, such as Mitsui and Mitsubishi still hold "shacho-kai" regularly to exchange information and strengthen their relationships. Apparently, these bodies never function as a decision-making organ of group companies, though there are differences in the way they function in different corporate groups.

Another important informal body that seems to play an important role in the decision making process is *jomukai*. *Jomukai* can be translated as a "meeting of managing directors" and is aimed at supporting the BOD. A few senior directors acting as *jomukai* or a similar informal management committee actually have the ultimate decision-making power in a company. Decisions made by such bodies are usually final, and the confirmation of such decisions at the meetings of the BOD is purely a formality to satisfy formal requirements. Although these meetings are not a part of Japan's formal corporate governance structure, they serve in practice as an important informal body that discusses the general corporate policy and strategy of the corporation.

This contradiction between legal and non-legal norms in practice reduces, to a certain extent, the power of the formal organs of the company as the real power is exercised in informal ways, largely outside of those organs. If the general meetings of shareholders and the BOD are formally in charge of making key decisions for a company, but decisions are, in fact, being made by the informal bodies and only formally approved by the general meetings of shareholders, then these informal bodies actually represent institutions that are in many respects more relevant than the BOD and the general meetings of shareholders.

The contradiction mentioned above should be taken into account when the issue of convergence is discussed. Gilson makes a distinction between a convergence in form and a functional convergence of corporate governance. According to him, each system of corporate governance is able to find functional equivalence without formal convergence. Gilson argues that corporate governance will be subject to functional convergence even without a formal convergence of legal rules. This can be seen from a completely opposite perspective—that there can be a formal convergence without a functional convergence. Japan is a typical example. The choice of an American model does not mean functional convergence, but only a formal one. The legal reforms brought about a formal convergence of rules, while the practices have


83. See id. at 338.
remained quite different. Those practices are determined dominantly by
the non-legal norms in clear contrast to the legal norms thereby
demonstrating a functional divergence.

PRESENT TENDENCIES

In present Japanese corporate governance, some trends can be
identified as a result of a number of factors, such as social changes,
economic recession, and legislative actions. These are visible in all areas
related to corporate governance.

Keiretsu

The decline of cross-shareholding in Japan seems to have stopped,
and its demise will probably not happen anytime soon. The keiretsu
system may not change significantly, though some changes have
occurred within the system. While banks have reduced their
shareholdings in the companies, the keiretsu will probably retain its
“safety level” that makes hostile takeovers difficult. Although banks
may not be able to re-establish their participation in cross-shareholding,
such obstacles do not exist in the case of firms, and they have been active
in re-establishing “stable shareholdings.” According to a Bloomberg
columnist, “the old practice of cross-shareholdings between companies
and takeover defenses made a roaring comeback” as defensive
mechanisms against hostile takeovers, 84 though the level of cross-
shareholding, even after the increase, was still below its bubble peak.

These new trends, however, are mainly a result of the interests of
certain actors, rather than being influenced by the social norms. The
main reason for this revival is the fear of hostile takeovers that increased
after the deregulation of mergers and acquisitions in Japan. The new
Corporation Law of 2005 allowed foreign companies some flexibility in
acquiring Japanese target companies by acquiring the company’s
shares. 85 However, implementation of the new law was delayed for a
year due to opposition from Japanese companies which feared that the
merger-and-acquisition provisions of the new law might allow hostile

84. William Pesek, Japan 2008 May Put Science Fiction to Shame, BLOOMBERG,
aZluNeKsDOQ0&refer=columnist_pesek. On the recent resurgence of cross-
shareholding, see Keisuke Nitta, On the Resurgence of Cross-Shareholding—Data from
the Fiscal 2008 Survey of Corporate Ownership Structure, available at http://www.nli-
According to Nitta, the recent resurgence of cross-shareholding is almost exclusively
result of actions by business firms, while banks remained passive (p. 5-6).
85. 会社法, Law No. 86/2005.
takeovers of Japanese companies by foreign firms. Eventually, these provisions became effective on May 1, 2007, despite the opposition.86

With respect to ownership structure, they have probably been the most visible changes that have occurred. The shareholdings of banks and insurance companies that have been traditionally management-friendly have substantially declined in the last two decades.87 During the same period, foreign shareholdings have substantially increased, though more recently some downward trends were also reported.88

*Long-Term Employment*

After the collapse of the bubble economy in the 1990s, long-term employment has come under pressure as a result of economic recession. Economic decline required Japanese companies to be more flexible in hiring and firing employees than the traditional system allowed. Many companies have decided to lay off a substantial number of employees in the process of restructuring companies while, in the same period, the number of part-time employees has substantially increased.89 In fact, the largest difference in long-term employment in the last ten years has been the increase in part-time employees.90 Since Japan has always had part-time employees in large companies, this is a change in scale and not in form.

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87. Stock ownership by banks declined to 4.9% in 2009, from 15.1% in 1997. In the same period stock ownership by financial institutions declined to 32.4% from 41.9%. However, a slight reverse trend is noticeable in the last few years. See generally Tokyo Stock Exchange, *Fact Book*, p. 64 (2010), available at http://www.tse.or.jp/english/market/data/factbook/b7gie60000003o32-att/fact_book_2010.pdf (last visited Feb. 7, 2010).

88. According to Tokyo Stock Exchange *Fact Book*, supra note 87, foreign shareholding in 2009 was 23.6%, down from 28% in 2007. Nitta, *supra* note 84, provides information indicating that after the Lehman collapse in September 2008, there has been a substantial decline of foreign institutional shareholding (from 14.1% in fiscal 2007 to 11.82% in fiscal 2008).

89. According to the Statistics Bureau of the Ministry for Internal Affairs and Communication figures, there were 33.55 million or 65.7% regular employees in Japan in 2010, while non-regular employees numbered 17.55 million, or 34.3% of the total. See Table 1-1 Employee Excluding Executive of Company or Corporation by Type of Employment, http://www.stat.go.jp/english/data/roudou/zuhyou/ edt011.xls.

90. The key characteristic of part-time employment in Japan is the fact that the employee is not a regular employee, regardless of the number of working hours. Part-time employees are often hired by a fixed term contract, and they are disposable according to the fluctuation of business. The same is true of other fixed-term employees (often called "kikan-jugyoin" or "keiyaku-shain") who may work full time but are definitely non-regular workers.
It has been repeatedly argued that long-term employment is disappearing, or even that it does not exist anymore. Despite such claims, many employees still believe today that they are employed for the rest of their working life at their company unless something goes very wrong. Although employment customs are said to be changing, there is still a pervasive belief that it is only really morally acceptable to resort to layoffs when the company faces bankruptcy. This informal understanding has been supported in a number of court cases. Recently some large listed companies have even gradually switched back to traditional long-term employment. This new tendency might be part of the change of corporate strategies regarding human resources, taking into account failure in the merit system.

Although the economy will probably further suffer as a consequence of the global financial crisis that started in 2008, it is unlikely that the long-term system will be abandoned, though it may be further modified. Employment practices will probably remain one important segment of the Japanese model of corporate governance that has not converged with the American model, and it is not likely to converge in the foreseeable future.

Legal Reform of Corporate Governance

A sweeping reform of Japanese corporate-governance laws was introduced in 2002. There are several important changes that have been introduced in the existing corporate management structure. Most of the debate on reforms has revolved around the clash between the American model, which is geared towards placing primary importance on shareholders and relying on external control, and the traditional Japanese model, which is primarily a stakeholder model based on internal control. Under the new Corporation Law which entered into force in May 2006, taking the Company Law outside the Commercial Code, Japanese corporations are given the option to select from two distinct corporate governance regimes—the Reformed Large Corporation, based on conventional Japanese model, and the New Type Company with committees with an executive officer (“CEO”), based on the American

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91. See Wolff, supra note 25.
94. 会社法, Law No. 86/2005.
The biggest innovation was the establishment of a totally new governance structure known as the “Committee System,” which was viewed by some scholars as a sign of the Americanization of Japanese corporate governance.\(^\text{96}\)

Outside directors have been in the centre of discussion and legal reforms as an attempt aimed at the improvement of monitoring. The Tokyo Stock Exchange (“TSE”) has also regulated participation of independent directors. TSE Securities Listing Regulations (as of March, 2010) by Rule 436-2 provide for obligations of the companies listed at TSE to ensure at least one independent director/auditor (meaning an outside director/auditor prescribed in Article 2(15) and Article 2(16) of the Corporation Law of 2005, respectively) who is unlikely to have conflicts of interest with shareholders.\(^\text{97}\)

Since the TSE Rules leave the choice between directors and auditors, majority companies have opted to appoint auditors, who are not typically independent. The report of the TSE, based on notifications on appointment of independent directors/auditors, published on July 21, 2010, shows that out of the listed companies which submitted ID/A notifications and had already secured ID/A(s), 10.6% submitted notifications containing only independent directors, 70.7% contained only independent auditors, and 18.7% contained both independent directors and auditors. So, the TSE Rules on independent directors/auditors, which declared better protection of shareholders as its goal, seem to be just another façade in the Japanese corporate governance system, as the main goal of having independently minded persons that would protect shareholders is compromised by allowing companies to appoint auditors who are not necessarily independent.

Hostile takeovers were also the subject of legal reforms. In 2005 the Ministry of Economy, Trade and Industry and the Ministry of Justice issued the “Guidelines Regarding Takeover Defense for the Purpose of Protection and Enhancement of Corporate Value and Shareholders’

\(^{95}\) Article 2 of the new Corporation Law provides (Definitions): (10) “Corporation with a Board of Auditors” shall mean a kabushiki kaisha which has established a Board of Auditors or a kabushiki kaisha in which the establishment of a Board of Auditors is required based on the provisions of this Law; (12) “Corporation with Committees” shall mean a kabushiki kaisha which has established a nomination committee, an audit committee and a compensation committee [hereinafter “the committees”].


Common Interests," aimed at creating rules for takeover defenses. The Guidelines give specific examples of defenses, along with conditions governing their use. In principle, defenses are legitimate if they serve the interest of shareholders, and not if their goal is merely to secure the position of incumbent management. The Guidelines were clearly influenced by American law. However, the way the rules on hostile takeovers function is also determined by business and legal infrastructure, which is quite different between the United States and Japan: the relationship between shareholders and management is very different, the status of independent directors who may play a key role in any hostile takeover attempts is also very different, as well as the role of the courts. It remains to be seen how Japanese courts will cope with this challenging issue.

For the moment, the corporate-governance reforms have not led to radical changes in the board, the presence of outside directors has not yet been adopted as a standard, and stock options and hostile takeovers are still a rarity in Japan. Meetings of shareholders, however, have become more serious, indicating a greater readiness to accommodate the interests of shareholders. There is a growing tendency of individual shareholders attending the annual meetings and becoming more active at those meetings, often asking questions. Asset-management companies and trust banks were more active at this year’s annual shareholders’ meetings by voting against the management proposals. At average, 15% of the management proposals were voted against, in comparison with 10% last year. Those proposals included retirement allowances to directors, nomination of management and proposals for issue of warrants aimed as protection device against hostile takeovers. As a result, the duration of the meetings have also become longer, and in June 2010 the average duration of annual meetings was fifty minutes—seventeen minutes longer than in June 1999.

It is still premature to make predictions about the impact of legal reforms of corporate governance in Japan. Time will tell whether the
present legal reforms will end up in failure, just a "formal convergence" without substantially changing the way of doing things, or whether they will bring substantial changes.

FACTORS OF CHANGE

When discussing reasons that lie behind the changes in the Japanese corporate-governance system, several challenging questions may be raised. Why has Japanese corporate governance remained stagnant in the postwar period until the 1980s, and why have legal norms that have been dormant for about forty years suddenly started to be applied? Have the Japanese courts and judges suddenly become aware of the tools they have had in their hands for almost forty years, but have never resorted to using? What is the impact of economic decline on the legal reforms? To answer these questions it is necessary to identify the relevant social, political, economic and legal factors that play a role in these changes.

Social Factors

In recent years, the informal practices of corporate governance based on non-legal norms came under pressure as a result of globalization, which brought about various changes in the Japanese business and social environment. Japan has been gradually transformed, especially in the urban portion of society and among the younger generation, which is naturally more inclined to accept changes and foreign influences. Younger Japanese have ideas about their careers that are different from those of their parents. They are less committed to long-term employment and are more likely to change companies if others offer better conditions. In the process of restructuring, employees and managers have gradually adjusted to the previously painful experiences brought about by mergers. This also indicates the gradual modernization of Japanese society from being family- and group-oriented towards an individual-oriented society that gradually adopts Western standards.

The attitude of the Japanese towards law has also been changing for the past several decades. At the time many legal reforms were being introduced, the readiness to use those legal norms was still lacking. Over

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

time, things have changed as a result of the globalization process at the international level, and the urbanization of Japan at the national level, which resulted in the weakening of social ties in society and a more open attitude to the changes that were coming from the outside world. In particular, after the 1970s, the Japanese became increasingly ready and willing to resort to law as an instrument for dispute resolution. This can be seen from the increase in the number of cases litigated. The relevance of non-legal norms may be decreasing, corresponding to the increased role of the law in Japanese society.

The appearance of some shareholder activists, such as Takafumi Horie (known as “Horiemon”), the founder of Livedor corporation, and Yoshiaki Murakami, an outspoken investment fund manager, is an illustration of the change of attitudes within Japan. Both of them were in the center of a number of highly publicized stories, such as the attempt at a hostile takeover of NBS (Nippon Broadcasting System), which represented a sign of departing from the traditional and accepting the new ways of doing things.

Some non-profit organizations are also active in promoting reforms of corporate governance. One such organization is the Kabunushi (Shareholders) Ombudsman (“KO”) which is comprised of lawyers, accountants, academics and shareholders. It aims to reform Japanese management practices to incorporate the views of all shareholders in Japanese companies. In addition, one part of large business also showed readiness to embrace new ways of doing things. A notable example is Sony, which introduced its Shikkoyakuin (Executive Officer) system in 1997 that served as a model for the New Type Company. More recently, there are signs that Japan’s real estate investment trusts (J-REIT) may also become active players in takeovers.

Political Factors

The Japanese version of capitalism is, to a certain extent, similar to the planned economy, a kind of controlled capitalism with industrial
policy as an important tool for directing development. In theory, the Japanese model has been described as a "developmental state." It is based on partnership between politicians, bureaucrats and businesspersons, which is often termed the "iron triangle," comprising big business, the ruling political party, and the bureaucracy. The Diet is considered an extension of the bureaucracy, and Japan is sometimes referred to as a "government of administration" rather than a government of laws. Some segments of the Japanese government, particularly the Ministry of Finance and the Ministry of Trade and Industry, play active roles in regulating and monitoring the Japanese corporate world. This demonstrates the important role of the political factors in the Japanese economic model.

While in the post-War period, the American corporate governance model was imposed on Japan; in subsequent periods, the Japanese actors designed independently the corporate governance policy. This task was carried out not only by regulating and monitoring activities, but also by exercising influence on the way the regulations are implemented in practice.

As Japan was improving its economic performance, particularly since the 1970s, there was a return to "wakon-yosai" rhetoric in a new form—nihonjinron. These new theories, which were officially endorsed by the Nakasone Government in the 1980s, emphasized Japanese specificity uniqueness as a positive model for a Japanese road towards modernity and its global outreach. While the key elements of the Japanese corporate governance were, in fact, based on a rational choice, they were given a cultural explanation. This kind of cultural nationalism may be explained by a huge economic success of Japan at that time, which boosted the Japanese pride.

After Japan entered into the so-called 'lost decade' (which turned to be lost decades), political rhetoric changed. In the 1990s, kaikaku (reform) became the new keyword. Most comprehensive legal reforms of corporate governance were carried out during the mandate of the Prime Minister Koizumi (2001-2006), who supported the idea of embracing the American model, which was supposed to go in parallel...

110. "Developmental state" is a term used by political-economy scholars to refer to the phenomenon of state-led macroeconomic planning in East Asia in the late twentieth century.
112. See Dale, supra note 78, at 213.
114. See id. at 32.
with deregulating the corporate sector based on the ideology of neoliberalism.

Things have changed again after defeat of the Liberal Democratic Party ("LDP") in the elections held in 2009. The Democratic Party of Japan ("DPJ") won the elections by using new rhetoric based on social justice and deploring the ideas of "market fundamentalism" promoted by the previous Government. The DPJ introduced several reforms which were based on a stronger social-welfare policy.\textsuperscript{115} Some recent developments, such as the Japan Post's offer of permanent employment to 65,000 of its part-time employees, indicate that long-term employment may have a comeback under the new Government.\textsuperscript{116} However, the popularity of the DPJ has started to fall already in 2010, resulting in its rather poor performance in elections held in July 2010. These developments on the Japanese political scene will continue to play an important role in designing legal reforms, including those affecting corporate governance.

\textit{Economic Factors}

There have also been important changes in some economic factors, mainly as result of economic decline. The traditional features of the Japanese corporate model - the keiretsu, the main bank system and long-term employment - all suffered setbacks as a result of the prolonged economic crisis. The shareholdings of stable shareholders significantly declined in the 1990s, while foreign shareholdings increased. Faced with the problem of bad debts, a number of banks had to dispose of substantial parts of their shareholdings. This has affected the monitoring process in companies, so that the monitoring function of shareholders may become stronger as a replacement for the reduced role of the banks as monitors. The crisis has also affected the long-term employment system, so now the Japanese people have learned to live with the new reality where there is no strong guarantee of long-term employment. Economic decline was one of the key factors that pushed legal reforms since 1990s and is likely to continue to do so.


Legal factors

The role of law is becoming more prominent alongside the process of globalization and modernization of Japanese society. Legal reforms relating to Japanese corporate governance have been numerous and often comprehensive, affecting many aspects of corporate governance. Most reforms in Japan have been motivated by the need to change the existing practices. The main factor in the recent reforms was the need for overcoming the economic decline that has continued for over a decade.

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

An important step towards a greater role of law in Japan has been the establishment of the Justice System Reform Council in 2001. The Council recommended substantial reforms to the Japanese legal system, including changes in legal education and increases in the number of lawyers. As result of such reforms, it may be expected that the law will play an increasingly important role in coming years.

LIMITATION FACTORS

In Japan, a common opinion is that there is much reform but not much transformation. The impression is that Japanese legislators have undertaken reforms as a kind of fashion in order to show that they make efforts to restructure the existing system to make it more efficient. The extent and effect of these reforms seems to be designed in a way to adjust the existing model in order to preserve it rather than to subject it to a substantial change. Some legal reforms in Japan had only a symbolic effect, while others brought changes only many years after they were introduced. Cultural barriers often posed obstacles or delayed actual change, particularly when cultural factors were aligned with the interests of the business elite. This can be viewed from a different perspective that cultural arguments were used as rhetoric to mask the actual interests of the business elite that opposed the changes.

Despite comprehensive legal reforms, traditional patterns endure, and the fundamental elements of Japanese corporate governance have not changed.\textsuperscript{117} It is very difficult to implement legal reforms that would transform the stakeholder model into a shareholders model. The social role of corporations is too deeply rooted to be easily changed. Large

\textsuperscript{117} Haley, supra note 3.
corporations continue to be controlled by the managers who effectively prevent shareholders from exercising control over them. On the other hand, the shareholders traditionally do not show much ambition to interfere with the job of managers.

One of the key elements of the Japanese corporate governance reforms is the introduction of outside directors. Outside directors, however, failed to play a substantial role in monitoring. While outside directors are seen as a potentially powerful new element of monitoring, such expectations may prove to be too optimistic. It makes little sense to have outside directors who are not really independent and have no real power to influence the decision-making processes. Some companies may decide to incorporate outside directors precisely because they do not consider them to be a threat to the management power. On the other hand, having outside directors may be useful to attract institutional shareholders from the US or the UK, as they feel more comfortable to invest in the companies that have outside directors.

Japanese companies may find it difficult to integrate outside directors, at least in the initial period. It is unlikely that Japanese companies will adopt a system in which outside directors will play the dominant role. This would be contrary to Japanese corporate culture, which is inherently biased against the presence of outsiders given the tradition of board members having longstanding and close personal relationships with each other. The opposition to outside directors is, in fact, motivated by the interests of the business elite rather than being determined by cultural factors, even though such attitude fits cultural patterns towards outsiders. Why would powerful senior managers adopt a system that would reduce their power by placing some key decisions under the authority of outside directors? The importance of this aspect of Japanese business culture may prove to be a stumbling block for a system of external control based on outside directors.118

The opposition to comprehensive reforms that would impose a stricter control over management was obvious during recent legal reforms. The logical question is then: why were Japanese companies given an option to adopt the New Type Company, rather than it being imposed as a mandatory requirement? The flexibility offered by Japanese reforms can be attributed to powerful industry groups led by Keidanren, which supported greater discretion of the management and opposed the initiative for stricter monitoring of management. During the

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118. This is illustrated by the extremely small percentage of Japanese companies that have adopted the US-style board structure—which requires a minimum of two outside directors, see Puchniak, supra note 12, at 256-57. See also Peter Lawley, Panacea or Placebo? An Empirical Analysis of the Effect of the Japanese Committee System Corporate Governance Law Reform, 9 ASIAN-PAC. L. & POL’Y J. 105, 112 (2007).
process of adoption of the new Corporation Law, Hiroshi Okuda, the Chairman of Toyota, who also served as the Chairman of Keidanren, expressed a view that reforms in Toyota should go in the direction of strengthening internal control, rather than introducing outside control.\textsuperscript{119} Fujio Mitarai, the President of Canon, who replaced Okuda as the Chairman of Keidanren, held identical views, taking the stance that Canon does not need outside directors to achieve more efficient management.\textsuperscript{120}

The importance of this attitude of the major part of the business elite should not be underestimated, and it may pose a serious obstacle to more comprehensive changes within the country. Additionally, the harsh court sentences handed to T. Horie and Y. Murakami in 2007 raised questions about the reasons behind the Japanese court’s attitude, which is usually lenient in the case of corporate crimes.\textsuperscript{121} These sentences might be interpreted as a warning for those who consider challenging the traditional ways of doing things.

Legal reforms have had a limited impact so far and have not substantially changed existing business practices in Japan. Analysis of the legal reforms made in Japan indicates that, despite adopting some elements of the American corporate-governance system, Japan has retained the most important features of its traditional model. The firm continues to be controlled by its top management, while shareholders are still deprived of effective mechanisms of control over the corporation, so not many things have really changed in practice. No legal reform can easily change the traditional ways of doing things, such as nemawashi. Then, how can the Japanese model converge with the American one when the process of making decisions remains quite divergent? These informal ways are deeply rooted in the Japanese way of doing things and cannot be changed overnight through legislation.

One possible explanation of the slow adoption of legal transplants in the case of Japan and some other countries in East Asia is that the Western law is based on concepts that are, to a great extent, alien to the traditional norms of those societies. This issue is beyond the scope of this paper, but a basic explanation might be helpful for better understanding of the issues discussed here. The main features of

\begin{enumerate}
\item \textsuperscript{119} See \textit{TOYOTA, ANNUAL REPORT} (2003) at 32.
\item \textsuperscript{120} In order to realize a more streamlined and efficient management decision-making process, Canon has not adopted an outside director system. See \textit{CANON, ANNUAL REPORT} 6 (2004).
\item \textsuperscript{121} T. Horie was found guilty of falsifying the company’s accounts and misleading investors and was sentenced to a two-year, six-month sentence: http://search.japantimes.co.jp/cgi-bin/mn20070319a1.html. Y. Murakami, was sentenced to two years in prison for insider stock trading: http://search.japantimes.co.jp/cgi-bin/nb20070720a1.html.
\end{enumerate}
Western culture that influenced its legal culture are individualism and rationalism. Individualism means that the personal autonomy and rights of individuals must be protected, often against the larger group, the State and society. This idea is in fundamental contradiction with the idea of collectivism and submission of an individual to the community, which is typical for Confucian philosophy. Under the concept of rationalism, conduct of the people should be governed by the rule of reason, meaning an objective standard of conduct based on reality and usefulness. In the Japanese context, rationalism has a different meaning and is related to “giri”—a kind of obligation that arises from a social interaction with other persons.\(^{122}\) As a consequence of these differences, transplantation of Western law to the Japanese society resulted in a legal system that functioned in Japan in a different way than its Western model.

In societies where social norms are strong, top-down legal reforms must be done very carefully in order to not cause damage to well-functioning markets. In order for real change to occur, there should be a consensus in society that those informal ways are outdated and an agreement on the need to start a new way of doing things. So far, no such consensus and agreement have been achieved in Japan. This has been demonstrated by the contents of the amendments to the Special Act to the Commercial Code (Shoho-tokurei-ho) in 2002, which allowed two models of company to exist in parallel; when a consensus cannot be achieved, a compromise is used.

A note of caution is needed when legal norms and principles, as applied in one country, are transplanted into the legal system of another. People often wrongly assume that “if rules are made to resemble each other something significant by way of rapprochement has been accomplished.”\(^{123}\) In order to have an effective legal transplant, the law has to fit well in the new environment, so that it can be absorbed by the society and implemented into practice. Otherwise, the so-called “transplant effect” may be expected, which means that the law transplanted in this way would not be widely used, at least in the initial period.

**POSSIBLE FUTURE DIRECTIONS**

Japanese attitudes are likely to change as society becomes increasingly commercialized and exposed to the globalization process.

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Although significant changes in values and attitudes are likely to happen slowly, they carry a potential for change that may undermine the traditional ways of doing things in Japan.

The family-like company will probably continue to exist in Japan, but this kind of concept of a company will most likely become weaker as a result of new trends, including the changing social values and attitudes of the Japanese people. Social changes do not, however, necessarily mean that the informal norms and structures will disappear. In reality, they persist, and no substantial changes have occurred so far.

Increased foreign shareholding needs careful consideration - will it lead to more control over management? While this development may contain a potential for change, it is premature to make predictions. A substantial part of foreign shareholdings is, in fact, in the hands of institutional shareholders who do not show much interest for active participation in management. They would have to join hands with local Japanese shareholders in order to be able to have an impact, and this may not be an easy task.

Probably no substantial change in the direction of the American model will happen as long as the main features of the Japanese business culture remain unchanged. It is unlikely that a majority of Japanese companies will adopt the American model company, and even those companies that have adopted it may soon realize that such a model may not be effective when operating within the traditional Japanese business environment. There will be some adjustments to the Japanese model, but those will probably be more "cosmetic" than radical.

Despite the persistence being demonstrated by the traditional and informal ways of doing things in Japan, it would be misleading to believe that the Japanese corporate culture remains static and inflexible. Over the years, there have been gradual changes aimed at meeting the new trends and challenges brought about by the globalization process and the rapidly changing environment. The changes introduced by the new legal reforms are significant, but the companies may need some time to digest those changes and make necessary adjustments.

Japanese corporate governance may need to make further and real adjustments in order to attract more foreign investors. Companies may, eventually, become increasingly exposed to the impact of the market and may not be able to afford to keep excess employees. As a result, instead of long-term, profit-oriented governance, the short-term governance aimed at improving value of shares may become more important to companies.

Japanese corporate governance is changing in a significant and often unpredictable way. Uncertainty is more about the extent and pace of changes, rather than whether the changes are necessary and in what
direction the changes will lead the Japanese corporate model. Based on the assessment of various factors of change analyzed above, it can be expected that in the coming years, the non-legal norms will gradually weaken at the expense of the increased importance that will be given to the formal legal norms.

CONCLUSION

Legal regulation of corporate governance in the post-war period in Japan has been continuously influenced by the American model. In the same period, the way it functioned in practice significantly deviated from the American model. This divergence between the legal norms and their implementation in practice remained largely outside debate on the Japanese corporate governance.

Discussions on both divergence and convergence usually focus on legal rules. But such focus is often misplaced because legal rules are only one segment of a legal system. The law plays a crucial role in designing the Japanese corporate governance system, but the role of law cannot be fully understood without considering the social and institutional aspect of a national legal system, particularly the role of non-legal norms.

Developments in corporate governance in Japan are too complex to be explained by a single factor. This author takes a middle way by recognizing the relevance of cultural, economic, legal and political factors as major determinants that have shaped Japanese corporate governance—Japanese corporate governance can be properly understood only by giving adequate attention to all relevant factors. While economic interests may have been the driving force behind the adoption of some of the key features of Japanese corporate governance, such as cross-shareholding and lifetime employment, they were accepted by all relevant actors and integrated well in the Japanese corporate world because those features were well suited for Japanese ways of doing things. Full understanding of the interaction between social norms on one hand and economic, legal and political factors on the other hand is key for understanding the Japanese model; any approach limited to only certain of these factors could be misleading and incomplete.

An issue that is open to discussion is to what extent the Japanese legal system has converged on the Western models. There is no doubt that progress has been made in that direction. However, this does not

124. The existence of Western models has been questioned, as corporate governance models in the West are also undergoing significant changes. See Dan Puchniak, The Japanization of American Corporate Governance? Evidence of the Never-Ending History of Corporate Law, 9 ASIAN-PAC. L & POL’Y J. 7 (2007).
mean that, today, the law in Japan plays an identical role as in the West. In the case of corporate governance, a number of issues have to be examined in order to make a proper assessment. For example, do the BOD and Meeting of Shareholders perform their functions in the same way as in the West? Do they strictly follow legal norms, or are they still under the influence of informal bodies and practices, such as *jomukai* and *nemawashi*? Have *keiretsu* and the Japanese pattern of long-term employment ceased to be important features of the Japanese corporate governance? Until clear evidence is produced that such informal bodies and practices have ceased to play an important role in the Japanese corporate governance, the argument that the Japanese model operates in the same way as the West’s will remain questionable.

When discussing the relationship between legal and non-legal norms in the context of changes, one of the key questions is how to measure changes in law and practice. The assumption that the legal model is identical with the actual model used in practice might be wrong. There is a contrast between the law-driven Western model and the relationship-driven Japanese model. Instead of focusing on changes in law, it may be more appropriate to consider changes in actual practice and changes in social norms. But this kind of change may also be more difficult to evaluate. Another difficult task would be to evaluate the link between changes in law and changes in practice. So, it is not surprising that there are substantial differences in opinion about the actual effect of legal reforms on Japanese corporate governance.

Another question is whether, behind the facade of Westernization, Japan had undergone any kind of significant transformation and whether it has accepted the idea of law and justice as they are understood in the West. It can be argued that there is friction between the imported Western legal system on one hand and traditional Japanese morals and values on the other, but it may not be as strong as believed by many foreigners. Japan has made a successful merger of Western concepts of law while preserving its own traditional values. After all, Japan is known for its skills to adopt foreign models and adjust them to its needs.

The corporate model before the newest reforms looked like many Western models; but behind that façade, the actual way of functioning of that model was very much based on the Japanese way of doing things. While the globalization process has an impact on Japanese society and the attitudes of Japanese people, some distinctly different Japanese attitudes will continue to exist. Time will show whether behind the new façade there is also a real change, or if it is just a new façade covering the traditional way of doing things.