

# **CORPORATE OWNERSHIP AND GOVERNANCE REFORMS IN JAPAN: INFLUENCE OF GLOBALIZATION AND U.S. PRACTICE**

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## **Abstract**

This paper is a brief summary and discussion on the recent reforms of Japanese corporations in regards to ownership and board structure. The paper will examine the dissolving of traditional ownership models and legal reform of board structure through reviewing its influence such as recent shareholder activism, hostile takeover, the latest corporate scandal, and further reforms in the regulative environment of Japanese corporate governance in the past few years. Above all, the paper will delve into the conflicts and tensions created by the adoption of US-style shareholder activism or board structures in the corporate world among the Japanese business and legal practices in both country and firm level. The paper provides an analysis from both legal and social perspective, with a view of company as a decision-making group, and focuses on group cohesiveness of Japanese company derived from its ownership and employment structure. The analysis of recent ownership and board reform suggests that while ownership and board structure certainly converge toward Anglo-American style through the reform, the influence of the reforms on corporate governance is still limited or varies by firms, due to the high cohesiveness and conformity of Japanese companies derived from strong ties among their constituencies.

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## INTRODUCTION

The linkage between corporate ownership and governance has been studied for many decades from various angles. While this area of scholarship had largely emphasized the widely-held type of ownership<sup>1</sup> and agency problems that arose out of it,<sup>2</sup> corporate ownership and governance issues continue to differ worldwide even after economies or business practices have largely converged.<sup>3</sup> As corporate activity spread across the world, scholarship has gradually started to focus on institutional and functional differences of each country.<sup>4</sup> Broadly speaking, researches have been conducted through how corporate governance converged and persisted among countries or firms levels. While convergence optimists, such as Henry Hansmann and Reiner Kraakman, claim dominance toward Anglo-American shareholder-centered model,<sup>5</sup> the persistence or divergence is also analyzed and emphasized through the theory of historical path-dependence and complementarity in each corporate governance system.<sup>6</sup>

Corporate governance in Japan has long been regarded as a typical example of the stakeholder-oriented model, in which corporate boards balanced the interests of corporate stakeholders, such as employees, business groups, banks and shareholders. Cross-shareholding, which means that a substantial block of shares are held by corporations and financial institutions, has played an important role in supporting Japanese management behavior.<sup>7</sup> By forming *keiretu*, the Japanese corporate group that holds a small portion of shares, together with a banking system, has contributed to supporting and monitoring Japanese management.<sup>8</sup> Insider-oriented board structure of which most members are promoted through the corporate ladder of same firm under life-time employment also strongly contributes to emphasizing employee's interests in Japanese corporate governance. Under this ownership and board structure, management turnover occurs only inside a company, and public

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<sup>1</sup> See Berle A. Adolf & Gardiner C. Means, *The Modern Corporation and Private Property* (New York, Mac Millan 1932).

<sup>2</sup> See Jensen, Michael & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J.FIN.ECON. 305 (1976).

<sup>3</sup> See La Porta et al., *Corporate Ownership Around the World*, 54 J.FIN. 471 (1999).

<sup>4</sup> See Mark Roe, *Some Differences in Company Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993).

<sup>5</sup> Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439 (2001).

<sup>6</sup> See Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999).

<sup>7</sup> See James C. Abegglen & George Stalk, Jr., *Kaisha, The Japanese Corporation* (New York, Basic Books 1985).

<sup>8</sup> See Ronald Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu; Overlaps between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993).

shareholders only have access to minority interests, rendering them essentially irrelevant in regards to corporate governance.

As we will see in the following sections, this ownership structure experienced significant change after the 1990s through dissolving cross-shareholding and adopting shareholder-oriented, Anglo-American rule at country level. The board structure has also experienced significant change through the reform of corporate ownership and regulation. While these reforms can be considered as a corporate conversion caused by globalization, many Japanese corporations still retain its own governance characteristics. Adopting U.S. style rules has caused conflict and tension in Japanese business and legal world. The influence of the ownership and board reform into corporate governance is still limited or varied by each firm. This paper attempts to address the issue derived from corporate conversion and persistence that occurred very recently in Japan through analysis of related data and important cases in the last few years from a legal and sociological perspective. This paper examines how Japanese company's unique system, once called "company-community," still survives and works after the reform at both country and firm levels, by treating the company as a decision-making group and examining its cohesiveness derived from strong ties between shareholder, employees and management.

## I. DISSOLUTION OF CROSS-SHAREHOLDING AND BOARD REFORM

### A. Dissolution of Cross-Shareholding

In the post-war period, cross-shareholding has long played an important role in Japanese corporate governance through encouraging stable shareholding and allowing management to boost the growth of corporate profits rather than maximizing dividend. Among others, ownership by banks and other financial institutions enhanced the function of the bank to monitor the company.

After the 1990s, as the Japanese economy experienced a long-term economic recession, the cross-shareholding structure underwent dramatic changes due to the long term stagnation of stock price and banking crisis.<sup>9</sup> This dissolution occurred through the diffusion of bank holding shares and increase of foreign investors. Figure 1 presents the ratio of cross-owned shares divided by the total share value and total number of shares in the market.<sup>10</sup>

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<sup>9</sup> See Hideaki Miyajima & Fumiaki Kuroki, *The Unwinding of Cross-Shareholding in Japan: Causes, Effects, and Implications*, Corporate Governance in Japan: Institutional Change and Organizational Diversity, 80-124 (Masahiko Aoki, Gregory Jackson & Hideaki Miyajima eds., Oxford University Press 2007).

<sup>10</sup> Data in this Figure are from Daiwa-institute of research, Kabushiki Mochiai-Kozo no Suikei(株式持合い構造の推計) [The Estimation of Cross Shareholding Structure] (Nov. 25, 2010), available at <http://www.dir.co.jp/souken/research/report/esg/cg/10112501cross-share.pdf>.

Figure 2 presents a distribution percent of market value owned by different types of shareholders.<sup>11</sup> Although the diffusion of cross-shareholding varied by firms,<sup>12</sup> these data indicate that cross-owned shares once held by banks or large business corporations have been largely diffused to institutional or foreign investors after the 1990s.

Figure 1: Ratio of Cross-Owned Shares

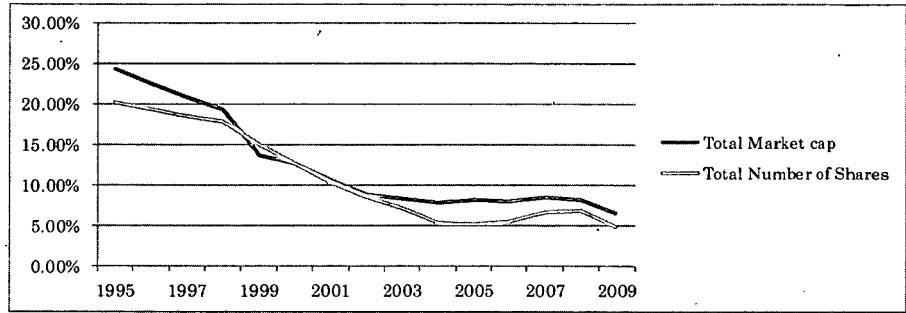
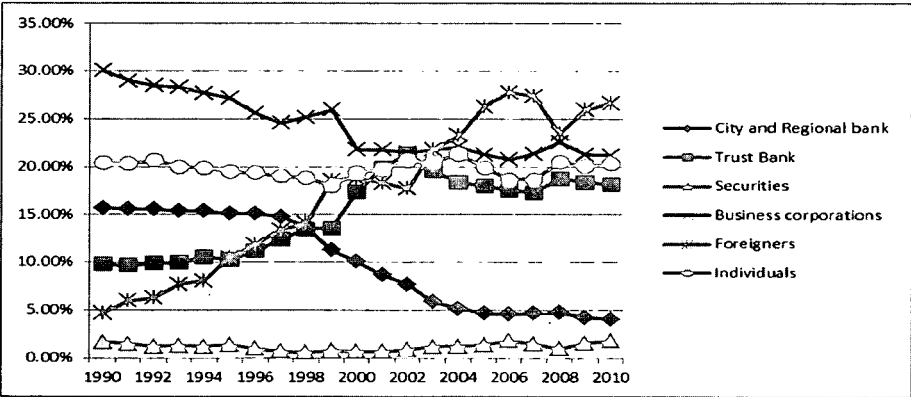


Figure 2: Distribution Percent of Market Value Owned by Type of Shareholder



B. Board Structure

Legally, a Japanese board is in charge of an appointing and monitoring management as well as deciding some important operations and their execution.<sup>13</sup> In many cases, however, a board of Japanese company has not

<sup>11</sup> Data in this Figure are from Tokyo Stock Exchange, 2011 Share ownership Survey (Aug.31,2012), available at <http://www.tse.or.jp/english/market/data/shareownership/index.html>.

<sup>12</sup> See Miyajima, *supra* note 9.

<sup>13</sup> See Kaishaho(会社法) [Company Act] Art. 362, Para. 2, 4.

emphasized the role of monitoring and deciding important decisions. Instead, boards signify or justify the operation by executives through somewhat ceremonial board meeting, since most board members are strongly tied to management, as both of them are mostly from a firm's employees and have common interests or experiences in the firm. Monitoring has been regarded as the role of a statutory auditor *kansayaku* (監査役), who also has the right to attend board meetings and obtain all relevant information.<sup>14</sup> However, unlike German supervisory board, Japanese statutory auditors do not have the power to appoint or dismiss directors nominated by the board.<sup>15</sup>

During the post-war period, Japanese employment practices were dominated by lifetime employment and revolved around the seniority system. Employment continued until a fixed and mandatory retirement age, and pay and rank grew with years of service rather than of top performance at the same firm. Indeed, lifetime employment emerged only in the immediate post-war period and Japanese labor law itself does not define lifetime employment.<sup>16</sup> Nonetheless, lifetime employment had a great impact on Japanese employee-centered corporate governance and still remains a social norm in Japanese society.<sup>17</sup> Vacancies of boards tend to be filled through the internal promotion of existing managerial staff within the same firm, while the board is regarded as the last step of a long career with the firm that started with graduation from university.<sup>18</sup> The majority of directors are often from senior employment and viewed as representatives of the employees of a section which they once belonged to. This makes the board structures of Japanese companies strongly homogeneous and insider-oriented.

This board structure was under criticism for its lack of monitoring ability. The criticism arose after the 1990s, when Japanese firms were becoming corrupt, as evidenced by some corporate scandals.<sup>19</sup> The Japanese corporate

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<sup>14</sup> See Kaishaho(会社法)[Company Act] Art. 381, Para. 2; Art. 383, Para. 1. For more information about statutory auditor in Japan: see Hideki Kanda, Situation in Japan: Company Law Reform in OECD Countries, A Comparative Outlook of Current Trends at Appendix A (2000), available at <http://www.oecd.org/daf/corporateaffairs/corporategovernanceprinciples/1931692.pdf>.

<sup>15</sup> See Theodor Baums & Birkenkaemper, Anja, Corporate Governance in Germany – System and Current Developments, 9 (1998), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=158038](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=158038)

<sup>16</sup> See Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2122–23 (2001).

<sup>17</sup> See Takashi Araki, *Corporate Governance Reforms, Labor Law Developments, and the Future of Japan's Practice-Development Stakeholder Model*, 2 Japan Labor L. REV 26–57 (2005).

<sup>18</sup> See Ronald Dore, *Stock Market Capitalism: Welfare Capitalism, Japan and Germany versus Anglo-Saxons* (Oxford University Press 2000).

<sup>19</sup> See Ronald Dore, *Insider Management and Board Reform: For Whose Benefit? Corporate Governance in Japan: Institutional Change and Organizational Diversity*, 372 (Masahiko Aoki, Gregory Jackson, Hideaki Miyajima eds. Oxford University Press 2007).

law and governance reform movement has accelerated since 1997 when Japan experienced failures of major bank and financial institutions, such as Hokkaido Takushoku Bank or Yamaichi Securities and some corporate law reform.<sup>20</sup> The most important legal reform in regards to boards occurred in 2002. Japanese corporate law created an option to form committees of the board of directors, which enable corporations to establish a U.S.-style governance style, where more than half of the directors must be outside directors.<sup>21</sup> In 2009, the Tokyo Stock Exchange (TSE) revised its Securities Listing Regulations and required a listed company, for the purposes of protecting general shareholders, to secure at least one independent director/auditor, meaning an outside director/auditor who is unlikely to have a conflict of interest with the general shareholders.<sup>22</sup> Due to these reforms, the number of companies listed in TSE first section which have introduced outside directors system has increased from 487 in 2004 to 908 in 2012, which is equal to the half of all companies.<sup>23</sup>

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<sup>20</sup> For more information, see Gilson and Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J.COMP.L. 343-377 (2005); see also, Zenichi Shishido, *The Turnaround of 1997: Changes in Japanese Corporate Law and Governance*, Corporate Governance in Japan: Institutional Change and Organizational Diversity 310-329 (Masahiko Aoki, Gregory Jackson & Hideaki Miyajima eds., Oxford University Press 2007).

<sup>21</sup> Kaishaho(会社法)[Company Act] Art. 400, Para. 3

<sup>22</sup> Tokyo Stock Exchange Securities Listing Regulations, Rule 436-2.

<sup>23</sup> Jo-Jo Kigyo no Corporate Governance Chosa (上場企業のコーポレートガバナンス調査) [Report of listed company's corporate governance] (July 2012) 4 chart, available at [http://www.jacd.jp/news/odid/120801\\_0ireport.pdf](http://www.jacd.jp/news/odid/120801_0ireport.pdf).

**Table 1: Number of Outside Directors and Company with Committees**

Foreign shareholders ratio	Total number of Companies	Average Number of Outside Directors <sup>24</sup>	Company with Committees	Ratio of Company with Committees
Under 10%	1443	0.68	14	1.0%
10%~20%	437	0.90	12	2.7%
20%~30%	207	1.15	12	5.5%
30% or more	156	1.54	13	7.7%
Total	2243	0.83	51	2.2%

The board structure has also been affected by high foreign ownership. Table 1 presents the number of outside directors and companies with committees listed in the Tokyo Stock Exchange.<sup>25</sup> As shown in the table, companies that have a high ratio of foreign shareholders also have a higher percentage of outside directors and companies with committees. The correlation between foreign ownership and outside directors, as well as the effects of introducing outside directors on corporate governance, has been pointed out in many literatures.<sup>26</sup> Miwa finds that the ratio of foreign shareholders between 2004 and 2007 has a positive relation with the ratio of outside directors and also a high independence of outside directors during that term.<sup>27</sup> Saito finds the correlation between the introduction of at least one outside director and president turnover, which is more sensitive to firm performance, and the accuracy of earnings forecast.<sup>28</sup> High foreign ownership

<sup>24</sup> Companies with committees are excluded.

<sup>25</sup> Data in this table are from TSE-Listed Companies White Paper on Corporate Governance 2011, available at <http://www.tse.or.jp/english/listing/cg/index.html>.

<sup>26</sup> See, Christina Ahmadjian, *Foreign Investors and Corporate Governance in Japan*, Corporate Governance in Japan: Institutional Change and Organizational Diversity, 125–150 (Masahiko Aoki, Gregory Jackson & Hideaki Miyajima eds., Oxford University Press 2007).

<sup>27</sup> Shinya Miwa, *Nihon Kigyo ni okeru Torishimariyakukai no Kozo to Gaikokujin kabunushi no Kabushiki Shoyu* (日本企業における取締役会の構造と外国人株主の株式所有) [The Board Structure and Ownership of Foreign Shareholders in Japanese Companies] 152 Kokushikan Daigaku Seikei-Ronso (國士館大學政經論叢).

[Kokushikan University Politics and Economic Thesis] 105–127 (2010), available at [libw01.kokushikan.ac.jp/data/.../0586\\_9749\\_152\\_05.pdf](http://libw01.kokushikan.ac.jp/data/.../0586_9749_152_05.pdf). “High independency” means (1) no relationship with banks, controlling company and affiliate company; (2) no experience of corporate CEO of other listed companies and (3) no mutually dispatched directors from other companies.

<sup>28</sup> Takuji Saito, *Boards with and without Outside Directors: An Empirical Comparison*, Working Paper, Kyoto Sangyo University (2010), available at <http://bdti.mastertree.jp/gallery/viewGallery/galleryId/38f5ad81c2a5c98c92d1072e0120dbc70afd85598e068d7cf8208dff59a537dd/v/preview>.



also affected the lifetime employment. Abe and Hoshi finds that companies with high foreign ownership adopt human resource practices that deviated from long time employment system.<sup>29</sup> Thus, the board structure of Japanese corporation, at least to some extent, gradually starts to assimilate towards the U.S due to the increasing foreign shareholder and regulatory reform. The next section will examine the details of influences brought by these reforms.

## II. INFLUENCE OF REFORM

### A. Ownership Reform

Unlike cross-owned shareholders, institutional investors and foreign investors do not usually share long-term business relationships with the company, as their primary motivation for holding shares is to gain a return from their equity investment. In the U.S., the rise of institutional investors has been associated with upsurges in shareholder activism, such as managerial turnover or takeovers.<sup>30</sup> Thus, from convergence perspective, it can easily be anticipated that dissolution of cross-shareholding would cause shareholder activism and more hostile takeovers in Japan.

Some data and cases indicate the emergence of shareholder activism and hostile takeovers as a result of ownership dispersion. First, shareholder voting is vitalized. Under the cross-shareholding structure and stable economic growth in the bubble era, managers' proposals were almost never voted down in annual shareholder meetings, as under such circumstances, either implicitly or clearly, corporate groups tended to cooperate with each other through exercising their voting rights and voting for management proposals. In addition, corporate extortionists or racketeers so-called *Sokaiya* (総会屋) interfered with the activation of individual shareholders at annual shareholder meetings<sup>31</sup> and turned shareholder meetings into more of a ceremony than anything else.<sup>32</sup>

However, as cross-shareholding dissolved and some reforms of corporate acts against *Sokaiya* were implemented,<sup>33</sup> shareholder meetings have become

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<sup>29</sup> Masahiro Abe & Takeo Hoshi, *Corporate finance and Human Resource Management*, RIETI Discussion Paper Series (May 2004) available at [http://www.rieti.go.jp/en/publications/act\\_dp2004.html](http://www.rieti.go.jp/en/publications/act_dp2004.html).

<sup>30</sup> See, Gerald F. Davis & Tracy A. Thompson, *A social Movement Perspective on Corporate Control*, 39 ADMIN. SCI. Q. 141-173 (1994).

<sup>31</sup> For more information about *Sokaiya*(総会屋), see Mark D. West, *Information, Institutions, and Extortion in Japan and the United States: Making Sense of Sokaiya Racketeers*, 93 NW. U. L. REV. 767 (1999).

<sup>32</sup> See CNN Money. March 1997, available at [http://money.cnn.com/1997/03/11/companies/japan\\_gangsta\\_pkg/](http://money.cnn.com/1997/03/11/companies/japan_gangsta_pkg/).

<sup>33</sup> Kaishaho [Company Act] Art. 120 (prohibiting a stock company to give property benefits to any person regarding the exercise of shareholders' rights).

more activated and vitalized. In 1998, more than 80 percent of shareholder meetings ended without any questions from shareholders.<sup>34</sup> However, this percentage declined to 30 percent by 2011.<sup>35</sup> This trend of active shareholder meetings have been accelerated and strengthened by an emergence of foreign institutional investors. The ratio of companies in which recognized institutional investors dissented from management proposals in annual shareholder meetings was 20% until 2000s. This number has increased to around 60% in 2005 and thereafter.<sup>36</sup>

As the number of opponents increased, managers' proposals were voted down or required to be withdrawn before shareholder meetings in some cases. This was especially true for companies of which the ratio of foreign investors' voting rights ratio was high. For example, in 2005 at an annual shareholder meeting, three company managers' proposals were voted down; the ratios of foreigners' voting rights of these companies were 41.5, 22.1, and 44.0 percent, respectively.<sup>37</sup>

The shareholder proposal is another implication of emerging shareholder activism. Even though shareholder proposals were admitted in the 1982 amendment of the commercial act, except for some core activists against a nuclear power plant, submissions of shareholder proposals were not common in Japan. However, the number of companies that received shareholder proposals for annual shareholder meetings has increased from 17 in 1997 to 36 in 2010.<sup>38</sup>

Some of these shareholder proposals were approved in shareholder meetings. For example, in 2008, a renowned hair-related business company, Aderans, accepted a shareholder proposal that required the replacement of the CEO and the election of three outside directors by Steel Partners, a foreign hedge fund and a controlling shareholder of Aderans, after fierce proxy fights. This resulted in the loss of its management proposal of the reappointment of incumbent directors due to opposition by Steel Partners and many other institutional investors.<sup>39</sup> At that time, foreign shareholder ratio of Aderans reached 51.1%. This ownership structure is clearly distinct from traditional

<sup>34</sup> Kabunushi Sokai Hakusho (株主総会白書) [White Paper of Shareholder Meetings], 1510 SHOJI HOMU (商事法務) (1998).

<sup>35</sup> Kabunushi Sokai Hakusho (株主総会白書) [White Paper of Shareholder Meetings], 1949 SHOJI HOMU (商事法務) (2011).

<sup>36</sup> Data are from Kabunushi Sokai Hakusho (株主総会白書) [White Paper of Shareholder Meetings], 1475, 1510, 1544, 1579, 1613, 1647, 1715, 1749, 1784, 1817, 1850, 1883, 1916, 1949 SHOJI HOMU (商事法務) (1997–2011).

<sup>37</sup> Tokyo Electron Ltd., 41.5%; Yokogawa Electronic Corporation, 22.1%; FANUC Ltd., 44.0%.

<sup>38</sup> Kabunushi Sokai Hakusho (株主総会白書) [White Paper of Shareholder Meetings], *supra* note 36.

<sup>39</sup> For more information, see *Bloomberg Steel Partners Wins Aderans Board Vote, Blocking Bid (Correct)* (May 28, 2009), available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a2mT3zJULeoA&refer=japan>

cross-shareholding. From 2007 to 2011, 19 out of 162 proposals were from investment funds,<sup>40</sup> and most of them were foreign investment funds, such as Steel Partners. Also, in some cases, shareholder proposals were withdrawn subject to the submission of management proposals, which confirms some reform of management.<sup>41</sup> This emergence of shareholder proposals from investment funds, as a tool for negotiating with firms, is somewhat similar to situation in the 1990s in the United States.<sup>42</sup>

However, the impact of these shareholder activities on corporate governance at the country level is still significantly limited. Despite the fact that the Japanese Company Act gave shareholder proposals relaxed requirements,<sup>43</sup> the number of companies that received shareholder proposals still remains low (around twenty to thirty), out of more than 2500 listed companies in Japan. Also, in Japan shareholder proposals that receive a majority of support are still extremely rare. In the U.S., 56 of 347 total voted proposals of S&P 500 companies had received majority support in 2011.<sup>44</sup> On the other hand, during 2007 to 2011, nine of 162 proposals were passed in Japan, and most of these proposals were submitted by shareholders who already had become the controlling shareholder. While 52.3 percent of shareholder proposals within U.S. Russell 3000 companies are related to corporate governance, and 37.2 percent of them received majority support in 2011,<sup>45</sup> about half of the submitted proposals in Japan demand higher dividends, which are not permitted in the U.S, as it falls under the power of management.<sup>46</sup> So far, proposals pertain to corporate governance submitted by domestic institutional investors are very few. The Institutional Investor Service (ISS) providing proxy voting and corporate governance services to a significant percentage of foreign investors, which established the new voting guideline provisions that require at least one outside director for top

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<sup>40</sup> SHOJI HOMU (商事法務), *supra* note 36.

<sup>41</sup> See e.g., *Tosha ni taisuru Kabunushi Teian no Torisage ni tsuite* (当社に対する株主提案の取り下げについて) Pentax (May 30, 2007), available at <http://www.pentax.co.jp/japan/news/announce/20070530-01.pdf>

<sup>42</sup> See Stuart L. Gillan, Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: the Role of Institutional Investors*, 57 J. FIN. ECON 275–305 (2000).

<sup>43</sup> Kaishaho (会社法) [Company Act] Art. 303, Para. 2 (For Company with Board of Directors, six months or more and not less than one hundredth (1/100) of the votes of all shareholders or not less than 300 votes of all shareholders.).

<sup>44</sup> See Matteo Tonello & Melissa Aguilar, *Shareholder Proposals: Trends from Recent Proxy Seasons (2007–2011)* at 51 chart 18 (2012), available at: <http://ssrn.com/abstract=1998378>.

<sup>45</sup> *Id.* at 54, chart 21.

<sup>46</sup> Unlike the U.S., the contents of shareholder proposals are free from any screening tests in Japan. See Rule 14a-8 of General Rules and Regulations under the Securities Exchange Act of 1934, 17 C.F.R. §240.

management.<sup>47</sup> On the other hand, the attitude toward domestic institutional investors on corporate governance seems either weak or divided among investors.<sup>48</sup> Also, the actual time spent in annual shareholder meetings is still less than one hour.<sup>49</sup>

Hostile takeover is another expected consequence of dissolution of cross shareholding. Until 2000, it has long been pointed out that there is almost no market control over Japanese corporations. However, the rise of hostile takeover was considered as a corollary of this foreign investor since foreign shareholder is supposed to be more prone to efficient use of their investment.<sup>50</sup>

The series of hostile takeover was launched in 2000 with an attempt of unsolicited tender offer by M&A Consulting firm, founded by famous activist Yoshiaki Murakami, for Shoei Corporation. Hostile takeover in Japan reached a pinnacle in 2005, when Livedoor launched a startling hostile takeover for Nippon Broadcasting System (NBS) without prior public announcement of tender offer by using TSE's after hour system.<sup>51</sup> Soon after this, NBS announced the issue of warrants to its parent company, Fuji Television Inc., in order to dilute Livedoor's shares less than 20% without the approval of shareholders. However, the Tokyo District Court ruled this sensational case by granting an injunction in the following weeks. Tokyo High Court affirmed the District's Court's decision.<sup>52</sup>

Following these waves, legislation of takeover has been developed. Among them, "Guidelines Regarding Takeover Defense for the Purpose of the Protection and Enhancement of Corporate Value and Shareholder's Common interest"<sup>53</sup> by Corporate Value Study Group created by Ministry of Economics

<sup>47</sup> This new provision of the policy will be fully implemented at all Japanese companies beginning in 2013, See ISS's 2012 Japan Proxy Voting Summary Guidelines, 6 available at [www.issgovernance.com/files/2012ISSJapanGuidelineSummary.pdf](http://www.issgovernance.com/files/2012ISSJapanGuidelineSummary.pdf).

<sup>48</sup> See Daisuke Ikeuchi (池内大介), *Syagaitorisimariyaku no Dokuritsusei to Giketuken Koshi Kekka tono Kankei-Bunseki ni kansuru Ichikousatsu* (社外取締役の独立性と議決権行使結果との関係分析に関する一考察) [A Discussion of a Relationship between Independency of Outside Directors and Results of Exercise of Voting Rights], available at, [http://www.aoyamabs.jp/campuslife/files/essay2011\\_d\\_ikeuchi.pdf](http://www.aoyamabs.jp/campuslife/files/essay2011_d_ikeuchi.pdf). See also Ahmadjian, *supra* note 26, at 131.

<sup>49</sup> SHOJI HOMU, *supra* note 36.

<sup>50</sup> Luke Nottage, *Japanese Corporate Governance at the Crossroads: Variation in Varieties of Capitalism?*, 27 N.C.J.INT'L L. & COM REG 266-269 (2001).

<sup>51</sup> At that time, after hours system is ruled out the definition of tender offer in a securities regulation, which requires prior announcement and filing the commencement of tender offer.

<sup>52</sup> *Nippon Hoso K.K. v. Livedoor K.K.*, 1173 HANREI TAIMUZU (判例タイムズ) 125 (Tokyo H. Ct., Mar. 23, 2005) (an appeal from an injunction against issuance of warrants).

<sup>53</sup> MINISTRY OF EcON., TRADE & INDUS. & MINISTRY OF JUSTICE, Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of

Trade and Industry (METI) is strongly influenced by the holding of Delaware case law, such as *Unocal Corp. v. Mesa Petroleum Co.*<sup>54</sup> This wave of hostile takeover and promulgation of Guidelines triggered a huge demand for takeover defense. By 2007, 371 companies adopted takeover defense, known as shareholder rights plan.<sup>55</sup> This trend of hostile takeover was regarded as a strong inclination toward Anglo-American corporate governance style and gave striking evidence of convergence theory.<sup>56</sup>

However, hostile takeover in Japan faced strong backlash in 2007, when the takeover defense was first tested by the judiciary in the *Bull-Dog Sauce* case. In May 2007, having 10.3% of the outstanding shares, Steel Partners launched an unsolicited tender offer for all shares of Bull-Dog Sauce. The board of directors of Bull-Dog Sauce opposed the tender offer and proposed a special resolution in order to issue discriminately warrants at a ratio of three per share, which were allocated to all shareholders except Steel Partners, which is entitled to an equivalent amount in cash in exchange for the dilution of its share to less than 3%. In June 2007, resolution of this defense measure was passed with 83% of the outstanding voting in favor of management.

Steel partners filed for injunctive relief with Tokyo District Court prior to the shareholder meeting. Tokyo District Court dismissed the request for injunction, based on the arguments that the shareholders have the authority to decide whether it is necessary to take defensive measures. The Tokyo High Court affirmed, labeled Steel Partners an “abusive acquirer,” with the intention to buy shares for its own short-term profit and without sound management of the company. Finally, the Supreme Court affirmed that shareholders have the authority to determine whether the corporate value would be damaged and the court should respect their decision unless their decision was patently unreasonable.<sup>57</sup> After this case, hostile takeover and introduction of defensive measures significantly cooled down.

The striking facts of this case are that the defensive measure was approved with most shareholders other than Steel Partners at the annual shareholder meeting, and the final tendered share was only 1.89% of total outstanding shares, despite the fact that tender price added 12.82% to 18.56% of premiums on market price and there were no block shareholders who expressly

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Corporate Value and Shareholders' Common Interests May 27 (2005), English translation available at [http://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/shishin\\_hontai.pdf](http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishin_hontai.pdf).

<sup>54</sup> 493 A.2d 946 (Del. 1985).

<sup>55</sup> Amane Fujimoto et al., *Tekitaiteki Baishu Boeisaku no Donyu Jokyo* (敵対的買収防衛策の導入状況) [Status of the Adoption of Defensive Measures Against Hostile Takeovers], 1809 SHOJI HOMU (商事法務) 31, 34 chart 4.

<sup>56</sup> See Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2203 (2005).

<sup>57</sup> *Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bull-Dog Sauce Co., Ltd.*, 1809 SHOJI HOMU 16 (Sup. Ct., Aug. 7, 2007).

supported the management prior to the annual shareholder meeting.<sup>58</sup> The court's decision was analyzed by renowned scholars from various perspectives; however, there is no doubt that the court highly respected this high approval ratio. In light of this, Tanaka pointed out that Bull-Dog Sauce enlarged its cross-shareholding with the other non-financial business company from 2001 and at the time of the annual shareholder meeting in 2007, insider<sup>59</sup> shareholders reached 58%.<sup>60</sup>

## B. Board Reform

From the convergence perspective, board structure assimilation can be regarded as evidence of convergence. However, data, recent cases and discussion of board structure reform require careful thought about the influence of this reform on corporate governance in Japan. As seen in Section 1, while the demands for outside directors have increased by rules and growth of foreign ownership, the number and ratio of outside directors or board with committees in Japanese firms are still very low. This makes striking contrast to the U.S. board, where most firms have boards with many independent directors and a majority of independent directors on board is required by listing rules.<sup>61</sup>

The most debatable recent case which invokes the reform of Japanese board is the Olympus Scandal in 2011. In this case, Olympus, the world leading corporation of endoscopes, had concealed its losses for more than ten years through an investment firm shifting the losses between the portfolios of other clients, either genuine or fake. This is known as the so-called "Tobashi" scheme, that is, the payment of 68.7 billion yen (US\$687 million) in M&A fees through a series of dubious transactions.<sup>62</sup> This accounting fraud was discovered by the British-born CEO Michael Woodford after he read an article

<sup>58</sup> *Id.* More than 90% of shareholders (other than Steel Partners) voted for the company. Steel Partners raised the tender offer price and extend tender offer period. However, tendered shares remained only 1.89%, See Tousha Kabuken touni taisuru Kokai Kaitsuke no Kekka ni tuite (当社株券等に対する公開買付けの結果について) [Final results of the tender offer for the company's stock.] (August 24, 2007), available at [www.bulldog.co.jp/company/pdf/070824\\_IR1.pdf](http://www.bulldog.co.jp/company/pdf/070824_IR1.pdf).

<sup>59</sup> Wataru Tanaka (田中亘) Baishu Boeisaku in the Shadow of Kabushiki-Mochiai Jirei Kenkyu (買収防衛策イン・ザ・シャドー・オブ株式持合い-事例研究) [Defensive Measure in the Shadow of Cross Shareholding-Case Study], 1885 SHOUJI HOMU 4, 8 chart 1, Insider was defined as the share of financial institution (other than trust), other business entity, officer and employees. Officers owned 0.96%; employees owned 2.87%.

<sup>60</sup> *Id.* Other shareholders are as follows, (1) financial institutions 16.61%; (2) foreign investors 11.48% and (3) individual investors 32.63%.

<sup>61</sup> NYSE Listed company manual 303 A.01.

<sup>62</sup> For more information, See The Third Party Committee, Olympus Corporation, Investigation Report, Dec 6, 2011 available at [http://www.olympus-global.com/en/info/2011/if11206corpe\\_2.pdf](http://www.olympus-global.com/en/info/2011/if11206corpe_2.pdf) [English Version, hereinafter "Third Party Report"].

in the Japanese financial magazine FACTA that exposed Olympus's apparent irregular payments.<sup>63</sup> In 2011, he called the former CEO, Tsuyoshi Kikugawa, to question the corporation's improper accounting of US\$687 million paid to a middle-man as an M&A fee in 2008. Soon after his inquiry, the board of Olympus removed Woodford from the position of CEO due to "differences in management style" with unanimous approval at a 5-minutes board meeting.<sup>64</sup> At that time, foreign shareholders, who owned more than 30 percent of Olympus's shares, were not content with the ambiguous explanation of an M&A fee and required formal investigation. Thereafter, this huge fraud was disclosed by a third party committee that was established by Olympus.

The third party pointed out that Olympus's board lacked monitoring systems because of an extreme sense of vertical division and lack of diversity, which stifled debate and compromised the independence of the board members.<sup>65</sup> Although there had been outside directors on the board, they were nominated by CEO and lacked the proper knowledge and understanding of business and could not actively participate in the discussion at the board meeting.<sup>66</sup>

After the scandal, Olympus announced its determination to nominate new board directors, six of eleven of which would be outside directors.<sup>67</sup> However, despite strong voices from foreign investors to replace all the board members, two candidates for directors were from Olympus's main bank,<sup>68</sup> and the CEO candidate was the company's current executive officer. At a shareholder meeting on April 20, 2012, all of the candidates were elected with a majority support, while the motion from foreign investors, which wished for the re-election of Woodford, was voted down.<sup>69</sup> Olympus's shares were owned by banking institutions (39.20%), securities firms (3.02%) business companies (8.57%), foreign investors (35.32%), and individual investors (12.26%).<sup>70</sup>

<sup>63</sup> See *Id.* at 177–78.

<sup>64</sup> Torishimariyaku Sekinin Chosa linkai no Chosa Hokokusho (取締役責任調査委員会の調査報告書) [Investigate Report of Director's liability's committee] at 109, available at [http://www.olympus.co.jp/jp/corc/ir/data/tes/2012/pdf/nr20120110\\_2.pdf](http://www.olympus.co.jp/jp/corc/ir/data/tes/2012/pdf/nr20120110_2.pdf).

<sup>65</sup> See Chosa Houkokusho (調査報告書) [Investigating Report] Dec 6, 2011 (Japanese Version) at 144–45, available at [http://www.olympus.co.jp/jp/corc/ir/data/tes/2012/pdf/nr20120110\\_2.pdf](http://www.olympus.co.jp/jp/corc/ir/data/tes/2012/pdf/nr20120110_2.pdf).

<sup>66</sup> Third Party Report, *supra*, note 62, at 125.

<sup>67</sup> See Notice concerning decision on candidates for new directors and corporate auditors (February 27, 2012), available at <http://www.olympus-global.com/en/common/pdf/nr120227e.pdf>.

<sup>68</sup> Sumitomo Mitsui Banking Corporation and Bank of Tokyo Mitsubishi UFG Ltd. See *Id.*

<sup>69</sup> See Results of Exercise of Voting Rights at the Extraordinary Meeting of Shareholders (April 20 2012), available at [http://www.olympus-global.com/en/common/pdf/nr120420e\\_02.pdf](http://www.olympus-global.com/en/common/pdf/nr120420e_02.pdf).

<sup>70</sup> Data are from Olympus's website, available at <http://www.olympus.co.jp/jp/corc/ir/stock/information/>

While OECD principles of corporate governance put emphasis on outside directors and their independence as board members,<sup>71</sup> many Japanese companies still have a negative attitude toward introducing outside directors. The federation of Economic Organizations *Keidanren* (経団連), the most influential business association in Japan, has vehemently opposed the mandated rule of outside director on the grounds that outside directors would find it difficult to exercise informed judgment, as they are inexperienced in the practice of execution of operations.<sup>72</sup>

In 2010, the Ministry of Justice established the Legislative Council Corporate Law Subcommittee ("LCCLS") and began debating a proposal to amend the Company Act in response to investors' wishes to strengthen corporate governance. The biggest issue discussed by LCCLS was the mandatory appointment of an outside director. Discussions took place for almost two years by the LCCLS, which consisted of legal academics, bureaucrats from the Ministry of Economy, Trade, and Industry (METI) and the Ministry of Justice (MOJ), and some business leaders from private companies.<sup>73</sup> While some legal scholars and committees from TSE argued for the necessity of mandatory appointments to strengthen corporate governance and attract foreign investors into the Japanese capital market, members from the business world once again strongly opposed the rule on the grounds that "to reinforce the existing statutory audit system is enough" and "there is no sufficient basis that proves that outside directors contribute to firm governance or performance."<sup>74</sup> Members from METI also expressed wary stance on mandating because of the reality that half of listed company still does not adopt any outside directors so far.<sup>75</sup> The final draft stipulated that "listed companies without outside directors will be required under the Companies Act and related ordinances to disclose the reason why appointing an outside director would be inappropriate"<sup>76</sup> like UK's "Comply or Explain" approach.<sup>77</sup>

<sup>71</sup> OECD Principles of Corporate Governance (OECD 2004) at 34, available at [www.oecd.org/dataoecd/32/18/31557724.pdf](http://www.oecd.org/dataoecd/32/18/31557724.pdf).

<sup>72</sup> See, Comment of the Japan Business Federation (Nippon Keidanren) on the OECD Principles of Corporate Governance Draft Revised Text (January 2004), available at <http://www.keidanren.or.jp/english/policy/2004/014.html>.

<sup>73</sup> For more information about the discussion, see Kaisha Hosei Shingikai Kaisha Hosei Bukai (会社法制審議会会社法制部会) [the Minutes of Legislative Council Corporate Law Subcommittee meeting], minutes of LCCLS are available at <http://www.moj.go.jp/shingi1/shingio3500005.html>.

<sup>74</sup> See minutes of 4th LCCLS, at 31–33, 48.

<sup>75</sup> *Id.* at 35–36.

<sup>76</sup> See Kaisha ho sei no minaoshi ni kansuru yôkôan (会社法制の見直しに関する要綱案) [The Draft Outline of Amendments to the Companies Act], (Sep. 7, 2012), available at, [www.moj.go.jp/content/000100819.pdf](http://www.moj.go.jp/content/000100819.pdf).

<sup>77</sup> See BSA Combined Code of Corporate Governance A.3.2.



The criterion of "outside" was also subject to debate. The current Company Act only excludes current and past executive directors, managers, or employees of the company and its subsidiaries from the definition.<sup>78</sup> Therefore, managers or officers affiliated with a parent or sibling company, or bankers who borrow from that company are eligible to become "outside" directors.<sup>79</sup> In fact, these "outside" directors from banks or parent companies play an important role in the governance of Japanese firms.<sup>80</sup> During the debate over the exclusion of these affiliates from the definition of "outside" directors, some members of the business world opposed the exclusion based on the argument that these affiliates are suitable for directors because they have "interests" in the company through capital or business transactions and thus have incentive to raise the corporate value.<sup>81</sup> After the debate, directors and employees of a parent company of the relevant company and certain relatives of the relevant company's directors and employees are excluded from the definition of "outside" director. However, affiliates of financial relationships were not excluded, though they are not eligible to be independent directors under NYSE rules.<sup>82</sup>

### III. DISCUSSION AND ANALYSIS

As we have seen so far, in response to the dissolution of cross-shareholding, it can be safely said that corporate governance in Japan has dramatically converged towards the American style since the 1990s by vitalized shareholder activism, rise of hostile takeover and diversification of the board structure. However, at the same time, some strong features of Japanese corporate governance such as silent domestic shareholder, insider-oriented board still persist 20 years after the start of reform. In many cases, the convergence is far from completion because formal convergence or institutional change, such as reform of ownership and legal rules, has not worked as expected and leads to functional convergence as a result.<sup>83</sup> In this section the paper aims at specifying and analyzing the factors which work as impediments to functional convergence.

<sup>78</sup> Kaishaho (会社法) [Company Act] Art. 2, Para. 15.

<sup>79</sup> Abe and Jung pointed out that when ownership is concentrated, only "pure" outside directors, who are neither former bankers nor shareholders, increase the sensitivity of the turnover of insiders to company performance. See Naohito Abe & Taehun Jung, *Cross-Shareholdings, Outside Directors, and Managerial Turnover: The Case of Japan*, Hi-Stat Discussion Paper Series (2004) electronic copy available at <http://ideas.repec.org/p/hst/hstdps/do4-38.html>.

<sup>80</sup> See Ransall Morck & Masao Nakamura., *Banks and Corporate Control in Japan*, 65 J.FIN 319-339 (1999).

<sup>81</sup> See, e.g., minutes *supra* note 73; 19th minutes at 29; 21th minutes at 22.,

<sup>82</sup> See NYSE listed company manual 303 A.02(b)(V).

<sup>83</sup> See Ronald J. Gilson, *Globalizing corporate governance: Convergence of form or function*, 49 AM. J. COMP. L. 329-357(2001).

### A. Analytical Framework

As seen in the previous section, one of the features of the recent reform is a gap between legal or regulatory reform and its expected consequences. For example, the legal reform to strengthen the outside monitoring, such as outside directors, has not necessarily lead to the outsider-oriented board. To some extent, this gap comes from the difference between legal framework and business practice in Japan. Although the stakeholder-oriented governance model is also seen in other countries, such as Germany, the basis of the Japanese stakeholder oriented model, such as cross-shareholding, insider-oriented board structure and the life-time employment system, is not defined by law. Japanese corporate law itself is no less shareholder-oriented than the U.S counterpart.<sup>84</sup> Thus, the Japanese model largely depends on Japanese business practices or customs, which creates a considerable difference of ownership influence toward corporate governance. This may help to explain that why it is often explained that the barrier of hostile takeover in Japan is not legal, but "cultural."

This gap between law and practice has long been a primary subject of study in Japan. Social norms that arise from such historical or societal backgrounds, strongly shape the form of corporate governance.<sup>85</sup> The post-war stakeholder oriented corporate governance in Japan has often been described as "Community Firm,"<sup>86</sup> or "Company Community,"<sup>87</sup> which is not purely a legal concept, but more of a practical or sociological concept. The basic perception of this concept is to take a company as a whole with a nexus of constituency, such as employees, customers, banks and shareholders. Under this concept, there is no clear thought that who owns the company.<sup>88</sup> The company was ran and monitored by all constituencies who support the company as if they are members of its communities. These constituencies each have its own interests, shared with this company community. Does this company community still remain after the reform or, if not, how did the characteristic of the company community change under the reform? I will delve into this point through specifying the characteristic of company community in depth by viewing the company as a decision-making group.

The company has been analyzed as a form of decision-making group from a sociological or socio-psychological perspective. While law and economics

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<sup>84</sup> See Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and their Solutions*, 25 DEL.J.CORP.L. 192-200 (2000).

<sup>85</sup> Milhaupt, *supra* note 16.

<sup>86</sup> Takeshi Inagami & D. Hugh Whittaker, *The New Community Firm: Employment Governance and Management in Japan*, Cambridge: Cambridge University Press, (2005).

<sup>87</sup> See Shishido, *supra* note 84.

<sup>88</sup> See Abegglen, *supra* note 17, at 183-191.

have long developed the view of the corporation as a nexus-of-contracts and focused on the function of constituencies towards share price as a criterion value, sociological work has presented alternative views of corporations based on network, power and culture.<sup>89</sup> Unlike agency theory, organizational theory has delved into the power and influence of ownership and board members through their social and network influence. It has also shed light on their functional and environmental difference on firm performance and decision making.<sup>90</sup>

In light of the board, Forbes and Milliken developed a model of board's decision making process with some prior research on group dynamics and work group effectiveness.<sup>91</sup> They pointed out that the effectiveness of boards depends on the social-psychological process, such as interaction and exchange of information. They further argued that the board's ability to work together determined by the cohesiveness of the board influences the board's effectiveness. This "cohesiveness" is a key factor in considering a company as a decision-making group.

Basically, the cohesiveness of a group is determined by some factors such as (1) similarity and attractiveness of group; (2) entry difficulty and liquidity of group members; (3) member's participation in the group's decision-making process; and (4) existence of an external threat.<sup>92</sup> Briefly, the cohesiveness of the group increases when the members of that group are similar, liquidity of members is low, members participate in the decision-making process, and there is an outside threat against the group. In general, the group is more successful in achieving goals if that group has a high-level of cohesiveness<sup>93</sup> because members of high cohesiveness groups trust each other, are better able to influence each other's behavior, and they no longer need to spend their time to establish a trustworthy relationship with other members. In this regard, the board with high cohesiveness can make decision smoother with

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<sup>89</sup> See Gerald F. Davis, *New Direction in Corporate Governance*, 31 Ann. Rev. Soc. 2005 143-162 (2005).

<sup>90</sup> See e.g., David L. Kang & Aage B. Sorensen, *Ownership Organization and Firm Performance*, 25 ANN. REV. SOC. 121-144 (1999); Gerald F. Davis & Henrich R. Greve, *Corporate Elite Networks and Governance Changes in the 1980s*, 103 AM.J. SOC 1-37 (1997) See also Ruth V. Aguilera et al., *An Organizational Approach to Comparative Corporate Governance: Cost, Contingencies, And Complementarities*, 41 King's College London Management Research Paper (2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=955043](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=955043).

<sup>91</sup> Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors As strategic Decision-Making Groups*, 24 ACAD. MGMT. REV. 489-505(1999).

<sup>92</sup> See Daniel J. Beal et.al., Cohen, R., *Cohesion and Performance in Groups: A Meta-Analytic Clarification of Construct Relation*, 88 J. APPLIED PSYCHOL., 989-1004 (2003).

<sup>93</sup> See Mullen Brian & Carolyn Cooper, *The Relationship between Group Cohesiveness and Performance: An integration*, 115 J. PSYCHOL. BULL. 210-227 (1994).

extensive discussion since members no longer need to communicate internal matter and to make new trustworthy relationship with other members.<sup>94</sup>

However, a high cohesiveness also has a serious side effect because it indicates some structural faults within the organization which negate the individual freedom of discussion. This detrimental effect is known as "groupthink."<sup>95</sup> When groupthink occurs, group members try to minimize conflict and reach a consensus decision without critical evaluation of alternative ideas and opinions. Furthermore, by isolating themselves from outside influences, it also leads to a loss of individual creativity, uniqueness, and independent thinking.<sup>96</sup> According to Janis, groupthink occurs in highly cohesive groups with internal structural problems, especially when the group lacks outside opinion and the group leader has a dictator-like leadership style.<sup>97</sup> Thus, certain degree of diversity, such as members with diverse backgrounds, is important for the board to avoid the detrimental effect of groupthink.<sup>98</sup> Especially, groupthink can be prevented if non-core members challenge the view of the core members.<sup>99</sup> Membership diversity can be substituted by internal differences in viewpoints, ideas, and opinions that pertain to the content of tasks. Conformity is a key detrimental effect of groupthink. Conformity is often described as pressure from the majority against one's beliefs,<sup>100</sup> which may be helpful or problematic to group decision-making depending on each situation.<sup>101</sup> Conformity arose when group cohesiveness is high. Conformity can cause strong pressure toward uniformity of group opinion, such as self-censorship, illusions of unanimity, guards against dissent majority opinion.<sup>102</sup> Groupthink has been used to analyze some defective decision-making process in U.S. history.<sup>103</sup>

This group concept appears to be applicable both to shareholders and board members. A company can be described as a decision making group with two sub-groups, shareholders and the board. This group concept might be helpful in analyzing the nature of Japanese companies for the following reasons. First, as stated in the previous section, Japanese corporate law and

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<sup>94</sup> See Forbes, *supra* note 91.

<sup>95</sup> Irvine L. Janis, *Groupthink: Psychological Studies of Policy Decisions and Fiascoes* (Boston, Houghton Mifflin 1983).

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 174-177, 248-250.

<sup>98</sup> See Forbes *supra* note 91 at 497-499.

<sup>99</sup> Janis, *supra* note 95 at 266.

<sup>100</sup> Solomon E. Asch, *Social Psychology* (New York, Prentice Hall 1952).

<sup>101</sup> See Janis, *supra* note 95 at 5.

<sup>102</sup> *Id.* 175.

<sup>103</sup> See, e.g., Janis, *supra* note 96 at 15-241; Andrew Howard, *Groupthink and Corporate Governance Reform: Changing The Formal And Informal Decision-making Process of Corporate Boards*, 20 S. CAL. INTERDISC.L.J., 425-458 (2011).

some judicial decisions grant broad authority to shareholders with regard to the management and control of the company such as distribution of dividends, executive compensation, and the adoption of poison pills. Thus, shareholders can be considered a decision-making group of the company, as well as the board. Second, as we have seen, proxies of the company, such as management, directors, employee, creditors, and shareholders are strongly tied to each other and have power either directly or indirectly to participate in the decision making process through cross-shareholding, insider-oriented boards, employees, client and bank stock ownership. Thus, these constituencies can be regarded as a decision-making group, rather than different groups of which interests are clearly conflicting.

From this perspective, the typical Japanese company can be classified a highly cohesive group, on both the shareholder and board level. Needless to say, cross-shareholding creates a similarity and attractiveness of groups by sharing interests, such as a long-term business relationship and stabilized voting for management proposal, between shareholders and the company. Also, bank or employee ownership also contributes to building strong ties of these group members. In terms of liquidity, share turnover ratio of banks and business corporations is much lower than that of foreign investors.<sup>104</sup> Some listed companies adopt shareholder special benefit plans, *Kabunushi-Yutai* (株主優待) which gives individual shareholders nontaxable annual gifts other than dividends, such as company products, discounted transportation tickets, and gift certificates, in order to incentivize individual shareholders to hold their shares continuously.<sup>105</sup> These strong ties do not necessarily link to stock price or other short term economic benefit; rather, are regarded as a tool for building long-term relationships between members and the company group.

The life-time employment and internal promotion of the board is a critical factor in the creation of cohesiveness, especially for board members and employees. Internal promotion of directors can make the long corporate ladder and hierarchy among firms an incentive for each employee to remain in firms for a long term with stability. Although the structure has changed, employment turnover ratio in Japan is still much lower than other developed countries. Employees indirectly participate in the company's decision-making process through vertically promoted director from their section. The entry

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<sup>104</sup> See Hideaki Miyajima (宮島英昭) & Hoda Takaaki (保田隆明), *Henbo suru Nihon Kigyo no Kozo wo Ikani Rikai suruka* (変貌する日本企業の所有構造をいかに理解するか) [How to understand changing ownership structure of Japanese companies], FSA Institute Discussion Paper Series (March 2012), 46 figure 4, available at <http://www.fsa.go.jp/frtc/seika/discussion/2011/11.pdf>.

<sup>105</sup> For example, Bull-Dog Sauce adopts this plan. It distribute annually their products 1000 yen (\$10) worth of their products for shareholders who own more than 1000 shares, 4000 yen(\$40) worth for more than 4000 shares. This unique plan has long been used by manager as a means to hold stabilized or loyal individual shareholders. The number of companies introduced this plan has increased from 9.7% of listed company in 1992, to 29.7% in 2012. See Daiwa investor relations *Kabunushi Yutai* (株主優待) Guide 2013 (2012), data is available at <http://www.daiwair.co.jp/pdf/pr121101.pdf>.

difficulty of the board is extremely high because only a limited number of employees who successfully climbed up the corporate ladder become board members. This makes board position highly prestigious for both board members and employees. Thus, under the internal promotion system, the cohesiveness of board is very high. This tendency is strengthened when the company has a long history and a long-term employment system. The relatively low executive compensation in Japan can be explained as one tool to strengthen a tie between employees and directors.

Lifetime employment also requires employees and board members to have firm-specific skills and knowledge.<sup>106</sup> This requirement of firm specific knowledge diminishes demand and market for labor and managers. In the U.S., independent directors are empowered when shareholder value, as represented by stock prices, becomes the primary corporate objective.<sup>107</sup> Also, they are largely supported by a large managers market and reputational sanctions.<sup>108</sup> On the other hand, the interests of employees and management in Japanese companies have been strongly tied and it is predominant among the primary corporate objectives. Thus, the Japanese labor and managers market has been quite small despite the huge size of its economy and number of companies.

With this background, the Japanese company has long enjoyed high productivity and performance through maintaining this group cohesiveness, trading stabilized ownership structure and employment in exchange for weak external monitoring on the company's decision making process. On the other hand, it has contained the potential hazard of groupthink if their internal monitoring system does not work for some reasons.

How does this cohesiveness affect the corporate governance reform? One of the most plausible propositions is that high cohesiveness leads to the decline of external opinion and the diversity of members due to strong conformity arising from cohesiveness. Also, high cohesiveness tends to eliminate alternative options due to the groupthink. In other words, high cohesiveness strengthens the tendency of a company to avoid external monitoring. Some prior research points to this tendency. Davis and Stout find that family ownership helped ward off hostile takeover efforts in the 1980s.<sup>109</sup> Schnepfer and Guillen find that the frequency of hostile takeovers increases with the protection of shareholder rights and decreases with the protection of

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<sup>106</sup> See Mitsuru Wakabayashi, *Management Career Progress in a Japanese Organization* (Ann Arbor, University of Michigan Press 1980).

<sup>107</sup> Jeffery N. Gordon, *The rise of Independent Directors in the United State, 1950–2005: of the Shareholder Value and Stock Market Prices*, 59 STAN.L.REV. 1465–1568 (2007).

<sup>108</sup> Ronald W. Masulis & Shawn Mobbs, *Independent Director Incentives: Where do talented directors spend their time and energy?*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2017977](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2017977).

<sup>109</sup> Gerald F. Davis; Suzanne Stout, *Organization Theory and the Market Corporate Control: A Dynamic Analysis of the Characteristic of Large Takeover Targets, 1980–1990*, 37 ADMIN SCI. Q.625, 627 (1992).

banking rights through examining data from 28 countries.<sup>110</sup> Research on corporate governance reform in Germany suggests that family firms are still reluctant to adopt Anglo-American corporate governance structure despite the whole country's corporate governance conversion.<sup>111</sup> Shareholder rights work as external monitoring. Needless to say, family company with block family shareholder is the most cohesive group.<sup>112</sup> Thus, these German family firms are reluctant to accept outsider-oriented governance because strong conformity comes from their membership structure, in exchange for their decision making advantage. In the following section, I will review the reform and its influence in Japan on this point.

### B. Group Cohesiveness as Impediments of Conversion

First, how does group cohesiveness work in hostile takeover, one of the most typical external monitoring scenarios? The Bull Dog Sauce case answers this question. As stated above, one of the most important facts of this case is that the defensive measure was approved by most of Bull Dog's shareholders, including most individual shareholders. Surprisingly, the stock price of Bull-Dog Sauce declined significantly due to sales of stock in the market soon after the tender offer period and never came back to the tender price, despite the fact that most shareholders did not tender.<sup>113</sup> Also, Bull-Dog Sauce suffered significant extraordinary loss 2.1 billion yen (US\$21million), which was equivalent to one-fourth of the company's gross profit, due to the triggering of defensive measures which are designed to dispose that amount of cash in Steel Partners.<sup>114</sup>

These facts imply that shareholders, including cross-owned companies, financial institutions, and individual shareholder, did not act for purely economic motives. This somewhat puzzling voting behavior can be explained by group cohesiveness. The cohesiveness of Bull-Dog Sauce, like other typical

<sup>110</sup> William D. Schneper & Maruo F. Guillen, *Stakeholder Rights and Corporate Governance: A Cross-National Study of Hostile Takeovers*, 49 ADMIN SCI. Q. 263-295 (2004).

<sup>111</sup> Anja Tuschke and Marius Luber, *Corporate Governance in Germany: Converging Towards Shareholder Value-Oriented or Not So Much?* 75-92 *The Convergence of Corporate Governance* (Abdul A. Rasheed & Toru Yoshikawa ed, Palgrave Macmillan 2012).

<sup>112</sup> See John A. Davis & Rita M. Herra, *The Social Psychology of Family Shareholder Dynamics*, 11 FAM. BUS. REV. 253-259 (1998).

<sup>113</sup> Tanaka, *supra* note 59, at 12 figure 4.

<sup>114</sup> See, Tokubetsu Sonshitsu no Keijo oyobi Gyoseki Yoso-no Shusei ni kansuru Oshirase (特別損失の計上と業績予想の修正に関するお知らせ) [Report of Extraordinary Loss and Lower Earnings Estimates] (August 7, 2007), available at [http://www.bulldog.co.jp/company/pdf/070807\\_IR3.pdf](http://www.bulldog.co.jp/company/pdf/070807_IR3.pdf).

Japanese companies, was high. Unlike some successful proposals such as in the Aderans case, the majority of Bull-Dog's shares were owned by insiders who shared interests with the company, although there was no controlling insider shareholder. Bull-Dog's long corporate history and strong insider-oriented board structure,<sup>115</sup> and most importantly, emergence of the external threat of a foreign hedge fund, which had not been familiar to most Japanese company, contributed to create the strong cohesiveness of the shareholder group. This arrangement was comprised of cross-owned shareholders, employees and officer shareholders or even individual shareholders. Prior to the annual shareholder meeting, the Bull-Dog management repeatedly published the vehement statement of support from their employees or business partners against Steel Partners online.<sup>116</sup> This might strengthen the sense of the unanimity of the company's opinion. It is not hard to imagine that this high cohesiveness and conformity eliminated the evaluation of alternative ideas and external opinions, such as tendering shares, evaluation of defensive measures and stock price. This finally led to extremely high approval rate, despite the detrimental economic effect associated with this defensive measure. In this sense, this conformity derived from high cohesiveness makes shareholder approval a reinforcement of management decision, rather than majoritarian connotation.<sup>117</sup>

On the country level, data presented in the first section indicates that the cohesiveness of shareholders is still high, despite the decline of cross shareholding. The relatively small role of domestic institutional shareholder's activism on corporate governance, such as shareholder proposals and shareholder voting, indicates that these shareholders are still tied to the company and contribute to the build up of the cohesiveness of shareholders. This connection is reinforced if the shareholders are affiliates of the company's main banks. Also, the high cohesiveness and conformity help to explain the dormant discussion and brief shareholder meeting,<sup>118</sup> despite the diminishing of *Sokaiya* through regulatory reform.

The Olympus case is one of the most prominent examples to explain how group cohesiveness works with Japanese corporate governance. In this case, the Olympus board had high cohesiveness and contained internal problems. As stated, all directors and statutory auditors that committed this concealment are former employees of the company and were promoted through internal promotion process under lifetime employment. Also, as the

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<sup>115</sup> All Bull-Dog directors were former employees of the company.

<sup>116</sup> See Steel Partners ni yoru kokai Kaitsuke ni taisuru Ishi-hyomei (「スティール・パートナーズによる公開買付け」に対する意思表示) [Statement against a Tender Offer by Steel Partners] (June 8, 2007), available at [http://www.bulldog.co.jp/company/pdf/070608\\_IR2.pdf](http://www.bulldog.co.jp/company/pdf/070608_IR2.pdf)

<sup>117</sup> See Curtis J. Milhaupt, *Bull-Dog Sauce for the Japanese Soul? Courts, Corporations, and Communities-A Comment on Haley's View of Japanese Law*, 8 WASH. U. GLOB. STUD. L. REV. 359 (2009).

<sup>118</sup> See SHOJI HOMU, *supra* note 49.



third party committee report pointed out, the board members from each employment section were indifferent to other sections. This strong sectionalism draws the malfunction of monitoring. The board lacked appropriate personnel who were familiar with financial matters.<sup>119</sup> Although there had been a certain number of outside directors, they were hesitant to raise questions because of their lack of management knowledge and the decision making process was undermined by the strong initiative of the chairman.<sup>120</sup> Thus, these outside directors did not reduce high cohesiveness. These malfunctions of the decision-making process, such as the lack of external voice and excessively strong leadership, are powerful signs of groupthink which leads to defective decision making.<sup>121</sup> The most detrimental effect of groupthink that occurred in this case was strong conformity which blocked the board members from objectively evaluating dubious M&A deals, and work as guards against outside directors to dissent or participate in the discussion vibrantly. In this case, the concealed loss was not caused by the accused directors or auditors but by active investment conducted by former management. Nevertheless, the succeeding management continued to conceal it for more than ten years for fear of a negative impact on the company, not on their individual reputations. There is no indication that succeeding management gained any economic benefit from concealing the loss caused by former CEOs. At the criminal trial, Toshiro Shimoyama, a former CEO, admitted the accused fact and stated that he was afraid of the impact of publishing the unrealized loss on the "company," not on himself. This indicates that the scandal was brought by excessive loyalty formed through high cohesiveness of the Olympus board, just like other scandals occurred Japan after bubble era.<sup>122</sup> In this sense, this scandal is not simply a result of managerial self-enrichment.

The process of CEO removal says a lot about the influence of group cohesiveness and its fraying. A former CEO, Michael C. Woodford, started his career at the English medical equipment company which was acquired by Olympus and promoted as an executive officer of Olympus in 2008 and CEO in 2011.<sup>123</sup> Although he was a former employee of Olympus, most of his career was spent in Europe. The appointment of an Englishman as CEO clearly reflects the globalization of the company's business. However, the former management who appointed him, did not expect his appointment to reveal the dubious, long hidden loss since group cohesiveness was not as important for him as for other internally promoted directors. In other words, his career and nationality encouraged him to challenge the view of core-board members. However, his piercing the cohesiveness and conformity of board members caused backlash. The fact that this former CEO was removed because of

<sup>119</sup> See Chosa Houkokusho *supra* note 65, at 145.

<sup>120</sup> See *Id.* at 125.

<sup>121</sup> See Janis, *supra* note 95.

<sup>122</sup> See Dore, *supra* note 19 at 372-73.

<sup>123</sup> See Third Party Report, *supra* note 62, at 177.

"differences in management style" with unanimous approval at a board meeting suggests the conformity created by cohesiveness of board instigated the exclusion of external voice and deprived other members from thinking carefully about alternatives, such as immediate investigation of hidden loss. Although other directors did not have enough information about the hidden-loss at that time, this hastily unanimous action can only be explained through strong conformity from groupthink.

The aftermath of the removal also presents intriguing results. While a highly cohesive board resulted in removing the dissenting CEO, this did not necessarily mean the end of the discussion. High ratio of foreign investors demanded the company to investigate the allegation caused by Woodford and made the company establish the third party committee, which finally lead to the revelation of the scandal. Just as the foreign CEO stirred the cohesiveness of the board, foreign investors shook the conformity of the group and succeeded in bringing external voice into the company. At the same time, however, the voting outcome of extra general shareholder's meeting, which allowed some current officer and main bank officer to sit in board members, also showed that other shareholders, such as banks and business corporations, still keep in line with company and highly regard group cohesiveness of the company. This suggests that although the strong influence of foreign investors or directors can break high cohesiveness, the management of Olympus and many domestic shareholders still value a conventional cohesiveness.<sup>124</sup>

On the country level, a low percentage of company with committee or outside directors reflects that many Japanese companies still value the cohesiveness of board members and ties between board and employees highly. The discussion held at LCCLS also suggests how cohesiveness, especially the tie of employee and management under lifetime employment, is still highly regarded on the country level. At the LCCLS, member of the business world defended the existing business practice of Japanese companies, such as strong ties among constituencies or traditional company's internal monitoring.<sup>125</sup> As stated, the incentive of monitoring for interested outside director, such as from parent companies is repeatedly emphasized.<sup>126</sup> These features, at least to some extent, can be translated as group cohesiveness. Also some members pointed out the lack of appropriate outside directors. One of LCCLS members from the TSE commented that "even globalized large companies answered that they do not introduce outside directors because there is no appropriate person."<sup>127</sup> This comment reflects well the current situation of Japanese corporate governance which still largely depends on directors' firm specific skills, and the difficulty of appointing appropriate outside directors from the small Japanese managerial market.

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<sup>124</sup> See Hiroko Tabuchi & Makiko Inoue, *Olympus Shareholders Shake Off Scandal*, N.Y. Times, April 20, 2012, available at [http://www.nytimes.com/2012/04/21/business/global/olympus-shareholders-shake-off-scandal.html?\\_r=0](http://www.nytimes.com/2012/04/21/business/global/olympus-shareholders-shake-off-scandal.html?_r=0).

<sup>125</sup> See minutes of LCCLS, *supra* note 73, 81.

<sup>126</sup> See minutes of LCCLS, *supra* note 82.

<sup>127</sup> See minutes of 21th LCCLS, at 2.

This case and discussion pertains to the board structure indicates how lifetime employment, stability of employment, and internal promotion of board of directors are deeply rooted and highly regarded in Japanese companies as a mechanism of increasing group cohesiveness, even after some legal reform and corporate scandals pertain to board structures. Also, the grave question looms out from the case and discussions is that to find a proper outside director for high cohesive companies would be a heavy burden because high group cohesiveness requires a high level of firm-specific skills and knowledge to communicate with other members effectively, which lead to the small managerial market.

One example shows that the linkage between lifetime employment and internal promotion is the extremely low ratio of woman directors. While it varies by firms, the number and percentage of women directors in Japanese companies is much lower than that of the United States or many other countries.<sup>128</sup> Under lifetime employment and internal promotion system, employees have to stay and continue to work in a same firm in order to climb corporate ladder. This makes it extremely difficult for woman to become directors which are regarded as a final step of corporate ladder.

Although lifetime employment has greatly changed because of other reforms since the 1990s,<sup>129</sup> supporters of the Japanese employment practices, such as lifetime employment has increased over the past ten years. According to research conducted by the Japan Institute for Labor Policy and Training, the support rate of lifetime employment has increased from 72.3 percent to 87.5 percent.<sup>130</sup> Recent Japanese labor law developments have been designed to safeguard the interests of employees.<sup>131</sup> Also, successful companies like Canon do not have an outside director despite its high foreign ownership. Thus, it is not likely that the liquidity of labor market will soon converge toward the U.S. level.

Perhaps, one of the other salient social facts which reflect a high cohesiveness is the small role of Japan's judiciary. A small formal legal system, with the smallest number of attorneys or judges per capita of any major industrialized countries, has long been studied from cultural and sociological

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<sup>128</sup> See Fujishima Yuzo, *Torishimariyakukaino Tayosei* (取締役会の多様性) [The Diversity of the board of directors] 23, *DIR Keiei-Senryaku-Kenkyu* [Study of Management Strategy] 11-21, available at <http://www.dir.co.jp/research/report/esg/esg-report/09112402cg.html> (2009); see also, 2011 CWDI Report: WOMEN DIRECTORS OF THE FORTUNE GLOBAL 200 (2011), available at <http://www.globewomen.org/cwdi/CWDI%202011%20Fortune%20Global%20200%20Key%20Findings.htm>.

<sup>129</sup> See Abe, *supra* note 29.

<sup>130</sup> Dai Rokkai Kinro-Seikatsu ni kansuru Chosa (第六回勤労生活に関する調査) [6th Survey of Work and Life] at 3 chart 1-1, available at <http://www.jil.go.jp/press/documents/20120508.pdf>.

<sup>131</sup> Takashi Araki, *Changes in Japan's Stakeholder Model, Corporate Governance and Managerial reform in Japan*, (D Hugh Whittaker & Simon Deakin eds., Oxford University Press 2009).

perspectives.<sup>132</sup> In light of corporate governance, this is associated with the insignificant roles of shareholder litigation, public legal enforcement, and in-house lawyers. This can be one of consequences of high cohesiveness. Needless to say, the judiciary functions as a typical external monitoring mechanism. Thus, although sources of foreign funds, such as Steel Partners, are not reluctant to use the judiciary, insider shareholders have not been active in taking legal steps to dispute decisions. Rather, they tend to solve problems internally. This contrasts sharply with the U.S. practice, where a large number of judicial decisions and huge legal sanctions strongly incentivize and promote the introduction and the independency of independent directors.<sup>133</sup> Although the number of attorney in Japan has increased as a result of recent judicial reforms,<sup>134</sup> the role of judiciary as a whole on corporate governance is still much smaller than that of the United States or other developed countries and the demand for lawyers are still questionable.<sup>135</sup>

In short, while reforms on ownership and relevant laws certainly work as drivers of corporate conversion, the effect of the reform on corporate governance has been impeded by companies' group cohesiveness, derived from existing ownership, board members and employee structure. This may be true on both the country and the firm level.

### C. Future Prospects

The persistence of group cohesiveness, however, does not necessarily mean an impasse of convergence, nor backlash toward traditional form. It should be noted that the high cohesiveness of the Japanese company group was formed during post-war period and is actually a rather recent innovation.<sup>136</sup> Thus, future changes in the business environment will promote further change or create new forms. Taking into account the shrinking domestic economy, rapidly aging society and expected fierce and rapid competition from emerging Asian countries, it will be hard for many Japanese companies to maintain the current strong tie of capital and labor. These

<sup>132</sup> See, e.g., John O. Haley, *The Myth of the Reluctant Litigant*, 4 Japanese Study 359–390 (1978); Mihaupt, *supra* note 16 at 17–18.

<sup>133</sup> Gordon, *supra* note 107.

<sup>134</sup> The number of attorneys almost doubled from 2000 (17,707) to 2012 (32,134). See Nichibenren (日弁連) (Japan Federation of Legal Associations) Bengoshi-Hakusho (弁護士白書) [White paper of Attorneys] 2012, at 81, available at [http://www.nichibenren.or.jp/library/ja/publication/books/data/hakusyo\\_tokusyu2012\\_2.pdf](http://www.nichibenren.or.jp/library/ja/publication/books/data/hakusyo_tokusyu2012_2.pdf).

<sup>135</sup> For more information about current situation of Japanese attorney, see Bruce E. Aronson, *The Brave World of Lawyers in Japan Revisited: Proceedings of A Panel Discussion On the Japanese Legal Profession After the 2008 financial Crisis and The 2011 Tohoku Earthquake*, 21 PAC RIM L. & POL'Y J. 255–292 (2012).

<sup>136</sup> Milhaupt, *supra* note 16 at 10–11.

competitions will require firms to make more innovative decisions, which are often weakened by groupthink. Globalization of companies can push for convergence, just like what happened in the Olympus case. The detrimental effects of groupthink derived from high cohesiveness can be mitigated by bringing diversity into the board and ownership. The critical point is that there is no consensus on the ideal corporate governance form. The interests of shareholders and stakeholders are both valued under the OECD principle.<sup>137</sup> Even corporate convergence optimists do not disregard stakeholder's interests.<sup>138</sup> Extensive literature on corporate convergence around the world has shown an emergence of hybridization of local system and shareholder oriented governance system,<sup>139</sup> rather than complete conversion. Each nations' governance form may be suitable for its specific legal and social environment. Although it is not dominant, these hybrid forms have gradually emerged in Japan as well.<sup>140</sup> Thus, the future direction of Japanese corporate governance will be, or should be determined in order to create a mixed or hybrid form, not two extremes.

As stated above, high cohesiveness is a "two-edged sword."<sup>141</sup> Although its weakness becomes salient recently, there is no doubt that this high cohesiveness had long contributed to high performance in post-war Japan, especially for the manufacturing industries. The hybrid governance model in Japan would creatively use the advantage and disadvantage of cohesiveness. All-or nothing reforms will not work as expected and may cause adverse effects if it lacks careful consideration of this existing group cohesiveness. Thus, bringing many outside directors without the appropriate knowledge of the specific businesses into the board could drive up the cost of decision-making enormously, which would probably outweigh the benefit. Also, considering the strong support for the traditional long-term employment system and reluctance to external monitoring, it might not be likely, at least in the near future, that strong external monitoring such as hostile takeover or active shareholder lawsuits will be accelerated towards the U.S. level.

One suggested direction toward hybrid governance in Japan is to bring "creative internal conflict" or diversities into company group, to revitalize the decision making process and mitigate the risk of groupthink. Some internal conflicts, and revitalized discussion arise from it, can create better and creative group decision-making. Outside directors can be a key to create this internal conflict. As stated, in terms of preventing groupthink, the role of outside

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<sup>137</sup> OECD, *supra* note 71.

<sup>138</sup> Hansmann & Kraakman, *supra* note 5.

<sup>139</sup> See Tuschke, *supra* note 111. See also, Hicheon Kim and Ji-hwan Lee, *Transformation of Corporate Governance in Korea, The Convergence of Corporate Governance* 137–168 (Abdul A. Rasheed & Toru Yoshikawa ed, Palgrave Macmillan 2012).

<sup>140</sup> See, e.g., Hideaki Miyajima, *Institutional Change and its Economic Consequence in Japan: The bright and dark sides of hybridization*, RIETI discussion paper (Aug 2012) electronic copy available at [http://www.rieti.go.jp/en/publications/act\\_dp.html](http://www.rieti.go.jp/en/publications/act_dp.html).

<sup>141</sup> Diversity is vis-à-vis, see Forbes, *supra* note 91 at 497.

directors should be emphasized by challenging majority opinions repeatedly and continuously, regardless of his/her beliefs or personal interests. Given that the lifetime employment is still strongly supported by both Japanese workers and business leaders, and the market of labor and management is still small, the dominance of outside directors in the board will be unlikely to happen in the majority of Japanese companies in the near future. However, this challenging can be effective even if outside directors are minorities, as long as they have proper, diversified personal backgrounds different from the core-members. To bolster and clarify the position of outside directors from both legal and internal rules, the expansion of managerial market is essential to promote this outside directors' challenge.

Internal conflicts will be brought about by other mechanisms. For example, to strengthen and clarify the responsibility and stewardship of domestic institutional investor in terms of corporate governance can lead to better governance as long as such responsibility is based on sound corporate governance principles. Introduction of fixed-term or mid-career recruitment into certain senior posts or bringing certain number of woman onto boards can also mitigate the adverse effect of groupthink, incentivize diversified employees, and create a better market for labor and outside directors. To separate the power of CEO and directors, and reinforce the power of statutory auditors can be helpful to strengthen the internal monitoring. Establishing an appropriate whistle-blowing system in the company also might help to promote a sound relationship among employees. Considering the strong side effect of high cohesiveness presented in Olympus case or other recent corporate scandals,<sup>142</sup> these creative conflicts and diversity would be a key driving force to form hybrid governance. Of course, how these conflicts work in the group is highly dependent on each group's business and other environmental factors. Thus, reform toward hybrid should be done on both the country and the firm level. Also, considering the complementarities of these factors, reform should be done with a horizontal view, including company, labor and securities law, and employment practices.

## CONCLUSION

As we have seen, Japanese corporate governance reforms have bounced back and forth between convergence with global trends and persistence of cultural norms. Japan has long remained a homogeneous society and egalitarianism is still deeply rooted in the society compared to the United States. Given that the current business world still highly respects the value of group cohesiveness, such as lifetime employment, it is unlikely that Japanese companies will adopt shareholder-oriented model right away. However, global

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<sup>142</sup> For example, the Daio Paper scandal also invoked a discussion in regards to a defective insider-oriented board. See Hiroko Tabuchi, *Another Scandal Unsettles Corporate Japan as Paper Maker Accuses Ex-Chairman*, available at [http://www.nytimes.com/2011/10/29/business/global/new-scandal-presses-corporate-japan.html?\\_r=0](http://www.nytimes.com/2011/10/29/business/global/new-scandal-presses-corporate-japan.html?_r=0).

competition and declining economy may certainly promote diversification, whether or not companies are willing to do so. Until now, and in the future, cohesiveness of ownership, board members and employees has been key factors of corporate governance in Japan on both the firm and the country levels. It is not clear that when and how Japanese companies will or should find their own, firm specific, hybrid models; however, the reform will and must continue. Thus, corporate governance in Japan will continue to present a valuable evidence of both global convergence and its limits.

