Japan's Ambivalent Pursuit of Shareholder Capitalism

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Abstract
Could international financial capital impose shareholder sovereignty on Japan, the ultimate bastion of stakeholder capitalism? As the Japanese economy descended from boom to bust in the early 1990s, government and industry leaders called for a decisive move toward U.S.-style shareholder capitalism. And increasing foreign share ownership exerted strong pressure to adapt corporate governance practices to Anglo-American norms. Yet in practice the government gave firms more options for restructuring, but did not make them more beholden to shareholders. And firms favored superficial adjustments to prop up share prices rather than fundamental changes because they sought to preserve the strengths of their traditional business models. This article explains how marketplace developments, domestic political dynamics, and corporate strategies combined to produce this distinctive pattern of Japanese corporate governance reforms since the 1990s. It concludes with an assessment of the consequences of these reforms for managers, workers, shareholders, and the general public.

Keywords
Japan, capitalism, corporate governance, shareholders, stakeholders

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In August 2018, Senator Elizabeth Warren introduced the Accountable Capitalism Act, which aspires to do no less than to transform the way the U.S. economy operates. It aims to reverse a decades-long trend toward the shareholder model of corporate governance and require large corporations to serve a broader array of stakeholders, especially workers, and to promote the public interest. In fact, as discussed further in the conclusion of this article, there is little evidence that the core features of the shareholder model – such as stock options, share buybacks, mergers and acquisitions, and outside directors – improve long-term corporate performance, and substantial evidence that they undermine economic dynamism and exacerbate inequality. Warren framed her proposal as a return to a more equitable era in U.S. history, but it could just as easily be viewed as a move toward the stakeholder model of Japan. Yet while some American reformers like Warren now decry shareholder capitalism – government and industry leaders in Japan have been pressing for reforms in the other direction.

Japan's ambivalent pursuit of the shareholder model vividly illustrates core features of contemporary capitalism: how even the most entrenched stakeholder systems confront pressure to appease foreign shareholders, yet how national governments and business communities retain considerable leeway in crafting their responses to this pressure. In practice, Japanese businesses have favored tactical adjustments to facilitate restructuring rather than fundamental reforms that might jeopardize valued institutions, such strong collaborative relationships with workers, banks, and business partners.

Japan has now been engaged in this pursuit for a sufficient period of time to permit an initial assessment of the consequences of reforms. At the aggregate level, Japanese corporate profits have been rising over the past decade while investment is flat and the labor share of income has been declining. Even so, some managers have leveraged the reform moment to enhance transparency, accountability, and diversity, and to improve decision-making procedures, as described in detail in the conclusion.

So why would the Japanese ever want to pursue shareholder sovereignty in the first place? The most obvious answer is that the Japanese economy failed so dramatically in the 1990s that this motivated Japanese leaders to question the core institutions of Japanese capitalism, including those associated with the stakeholder model such as the corporate community, patient capital, interlocking business groups, insider corporate boards, and lifetime employment.[1] And just as the Japanese economy was faltering, the U.S. economy was resurging. So that led various government and industry panels to recommend that Japan should learn from American success.

While the financial crisis of the 1990s provided the initial impetus, however, the core motivation for corporate governance reforms has evolved over time. In the first major thrust of reform, roughly from 1995 to 2005, the government aimed to reshape the nation's market infrastructure to help Japanese firms restructure. It did not simply want to make it easier to sell assets and reduce labor costs – although those were certainly elements of the policy – but it sought to empower companies to reduce costs in ways that would preserve and possibly even enhance their institutional strengths. In the more recent round of reforms since 2012, the government has pursued corporate governance as a growth strategy. Administration officials

[1] Henry Hansmann and Reinier Kraakman present the case for international convergence, arguing that a strong consensus that managers should serve the interests of shareholders has driven all major jurisdictions toward similar rules of corporate law and practice. "The End of History for Corporate Law," in Jeffrey N. Gordon and Mark J, Roe, eds., *Convergence and Persistence in Corporate Governance* (Cambridge: Cambridge University Press, 2004), 33-68.

hoped to boost the stock market by implementing reforms that would appeal to investors, especially foreign investors. And some officials, in the Ministry of Economy, Trade and Industry (METI) in particular, sought to raise corporate profitability on the assumption that more profitable firms would be more productive and more competitive, and thereby contribute to higher economic growth.

The Japanese government has not failed to reform. In fact, it has implemented a daunting array of measures designed to reshape Japanese corporate governance. These measures centered particularly on revisions to corporate law, but they also included antitrust, financial regulation, and labor market reforms. Japanese firms have responded to these policy reforms with an equally extensive range of adjustments in corporate structure and strategy.

Yet both the government and industry have followed distinctive patterns in their reforms. The government did not enact radical reforms to empower shareholders but rather incremental adjustments designed to give Japanese firms more options for restructuring operations and reorganizing their boards. In the 1990s, the government allowed companies new mechanisms for reorganization, such as corporate spin-offs and pure holding companies. And it permitted companies to issue stock options and to repurchase shares. But it moved more cautiously with measures that could enhance shareholder rights, shift power to outside directors, or facilitate a market for corporate control. In the early 2000s, the government introduced a new type of corporate board with three committees (*shimeiiinkaitou secchigaisha*) modeled on the American system, but it left this as a choice and not a requirement. Then in the 2010s, it developed a stewardship code to encourage institutional investors to engage actively with companies, and a corporate governance code to specify standards of good governance. But it opted for a soft law "comply or explain" approach to enforcement: companies could either comply with the principles in the corporate governance code or publicly explain whey they did not.

Meanwhile, Japanese firms did not dramatically transform business practices but reorganized to shed costs and to attract investors with measures that were bolder in form than in substance. They focused primarily on incremental cost-cutting measures, including reorganization to lower labor costs or shift losses to subsidiaries. They took advantage of legal reforms to spin off divisions or form pure holding companies. They experimented with stock option programs, stock repurchases, and mergers and acquisitions, but they did so on a scale that remained modest by U.S. standards. After 2015, Japanese firms overwhelming complied with the new corporate governance guidelines, substantially increasing the number of outside directors. They reformed corporate governance to facilitate strategic adjustments and to convince investors that they were serious about enhancing corporate value.

To explain these distinctive patterns, I demonstrate how the institutions of postwar Japanese capitalism shape corporate strategies, even as these institutions evolve.[2] The postwar model featured long-term collaborative relationships between firms and their workers, banks, suppliers, and other business partners.[3] Japanese corporations served this broader community of stakeholders rather than giving priority to the financial interests of shareholders. Japanese corporate boards were comprised of veteran insider managers, not outside directors who were

[2] This framework builds in part on Steven K. Vogel, *Japan Remodeled: How Government and Industry Are Reshaping Japanese Capitalism* (Ithaca, NY: Cornell University Press, 2006), 4-21.

[3] To put this in the terms of the Varieties of Capitalism school of political economy, these relationships constituted a "comparative institutional advantage" for the firms. Peter Hall and David Soskice, "An Introduction to Varieties of Capitalism," in Hall and Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (New York: Oxford University Press, 2001), 36-44.

expected to maximize returns for shareholders, as was common in the United States.[4] And manufacturing firm executives in particular cultivated strong channels of coordination with their workers, and leveraged these channels to incrementally improve production processes. Masahiko Aoki deploys the logic of institutional economics to explain these practices, arguing that firms cultivated these long-term relationships to upgrade workers' skills, reduce the cost of capital, and enhance quality control.[5] Ronald Dore describes similar patterns of behavior, but interprets them in more cultural or sociological terms. He stresses that they cannot be understood without reference to Japanese managers' distinctive loyalty to their workers and business partners, and their preference for high-trust relationships.[6]

Thus Japanese firms tend to rely on these long-term relationships during economic downturns rather than to jettison them. To adopt the language of Albert Hirschman, these relationships foster a propensity toward "voice" (negotiation) over "exit" (severing ties) with these partners.[7] This framework generates specific predictions about how Japanese firms will respond to hard times. They will renegotiate their relationships with partners but they will not abandon them. They will bargain with workers to suppress wages, reduce labor costs, and reallocate workers within the corporate group, but they will not dismiss core workers. They will squeeze suppliers to increase quality or to lower prices, but they will not abandon core suppliers. And they will lean on their main banks to ride out the crisis. With respect to corporate governance, this means that companies will restructure to reduce costs and reorganize to appeal to shareholders, but they will not allow these shareholders to control the corporation. This analytical perspective accounts well for the pattern of corporate governance reform outlined above and described in greater detail below.

These corporate strategies in turn shape companies' preferences for policy reforms. That is, companies ask the government to enact reforms that will give them more ways to adapt to the new market environment while still preserving their comparative institutional advantages. They favor policy options over regulatory requirements, informal codes over binding rules, and a soft law "comply or explain" approach over rigid enforcement. And for the most part, these distinctive preferences have been reflected in reform outcomes.

Of course political dynamics also affect the specific substance of reforms. In the earlier period (1995-2012), the government largely shared industry's concern with facilitating adjustment while preserving valued institutions, so industry preferences alone go a long way toward explaining the substance of reform. In the more recent period (2012–present), however, the Prime Minister Shinzo Abe administration's drive to support the stock market, spur growth, and showcase achievements from "Abenomics" – plus Diet member Yasuhisa Shiozaki's personal passion for corporate governance reform – combined to propel the government to go further with reforms than industry demanded.[8] And the government's "comply or explain"

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[4] Neil Fligstein, *The Transformation of Corporate Control* (Cambridge, MA: Harvard University Press, 1990).

[5] Masahiko Aoki, *Information, Incentives, and Bargaining in the Japanese Economy* (New York: Cambridge University Press, 1988).

[6] Ronald Dore, *Taking Japan Seriously: A Confucian Perspective on Leading Economic Issues* (London: The Athlone Press, 1987), 169-92. Vogel, *Japan Remodeled*, 14-15, analyzes these foundations in terms of three "circles of rationality": a simple cost-benefit analysis, an institutional perspective, and a broader sociological perspective.

[7] Albert Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge: Harvard University Press, 1970).

[8] Thus the earlier period fits with Pepper D. Culpepper's model of "quiet politics" in which business preferences prevail on issues of low political salience, while the latter period fits the model less well. *Quiet Politics and Business Power: Corporate Control in Europe and Japan* (New York: Cambridge University Press, 2011).

approach ended up being quite effective in motivating companies to alter their practices, including appointing outside directors.

Government agencies and business interests, plus a few political entrepreneurs like Shiozaki, have dominated the policy process throughout. Japan's largest labor union, the Japanese Trade Union Federation (*nihon roudoukumiai sourengoukai*, or Rengo for short), influenced reform proposals under the Democratic Party of Japan (DPJ, or *Minshutou*) government of 2009-12, as discussed below, but has generally played a peripheral role. Other civil society groups, such as consumer organizations, have not been represented on many of the relevant policy councils, and generally have not chosen to participate in public comments. "The general public is keenly aware of corporate scandals, but not sure what could be done about them," explains Naoko Sakaue of the center-left Democratic Party For the People (DPFP, or *Kokumin Minshutou*). "And only those Diet members with special expertise show much interest."[9]

Corporate Governance Reform 1995-2012: More Options

In the 1990s, as noted above, the government focused primarily on ways to facilitate restructuring without making companies more vulnerable to outsider control.[10] In 1995, it permitted companies to repurchase their own shares, giving them a way to prop up share prices and deter hostile takeovers.[11] In 1997, it introduced stock options, limiting stock options to 10 percent of outstanding shares and requiring those receiving stock options to work for the firms. In 2000, it followed with the Corporate Spinoff Law (*kaisha bunkatsuhou*) to make it easier for corporations to convert divisions into subsidiaries or to sell them off. In 2001, it strengthened the statutory auditing system but also limited directors' liability in shareholder suits. The Japanese Business Federation (*keizai dantai rengoukai* or Keidanren for short) had been concerned about the rise in shareholder suits, and lobbied hard for limits on liability. In the same year, the government limited banks' stock ownership such that Tier 2 capital (ownership in other firms) could not exceed Tier 1 capital (the bank's own equity). This was meant to improve the stability of the banking system, but it also had the effect of reducing banks' holdings of other firms, thus accelerating the unwinding of stable shareholdings.[12]

In 2002, the government permitted large firms to adopt the U.S.-style three-committee board. Firms that chose this form would abolish the statutory audit board and establish new nomination, compensation, and audit committees. Each committee would have at least three members, a majority of whom would be outside directors. The commercial code's definition of outside director, however, included employees of a parent company, a subsidiary of the parent company, or a major shareholder. Keidanren lobbied successfully against requiring firms to adopt the committee system, and also fought off a proposal to require all companies to appoint at least one outside director.

Hedge funds, both Japanese and foreign, became more aggressive after 2000 in pressing companies for higher dividends, share buybacks, and business strategies designed to maximize

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[9] Author's interview with Naoko Sakaue, General Manager, Executive Office, Democratic Party for the People, August 10, 2018.

[10] This article builds on Vogel, *Japan Remodeled*, 91-95, 134-140, and Steven K. Vogel, *Marketcraft: How Governments Make Markets Work* (New York: Oxford University Press, 2018), 92-96.

[11] James R. Lincoln and Michael L. Gerlach, *Japan's Network Economy: Structure, Persistence, and Change* (New York: Cambridge University Press, 2004), 331.

[12] Ulrike Schaede, *Choose and Focus: Japanese Business Strategies for the 21st Century* (Ithaca, NY: Cornell University Press, 2008), 99-100.

returns for shareholders, and some even launched hostile takeover bids.[13] Industry leaders grew concerned that they were vulnerable to takeover in this environment, so METI organized a panel to issue guidelines for takeover defenses in 2005 to help companies determine which strategies would be legal and appropriate.[14] The panel recommended that companies obtain shareholder approval before issuing equity warrants to thwart a takeover, and proposed revising the commercial code to require companies to disclose takeover defense schemes in their business reports.[15] "We had some severe battles between those who wanted the guidelines to facilitate takeovers and those who wanted them to impede takeovers," recalls Noriyuki Yanagawa, a Tokyo University finance professor and a member of the panel. "But ultimately these were just guidelines, not binding rules."[16]

The Diet passed a major revision of the commercial code in 2005 that eliminated the minimal capital requirement for a stock company. The bill broadened the discretionary power of boards of directors. It facilitated mergers and acquisitions, while also expanding companies options' for takeover defenses. And it clarified the designation of the major corporate forms: the stock corporation, the limited liability company, the unlimited partnership, and the limited partnership.

Ulrike Schaede argues that policy and corporate-level reforms combined to produce a "strategic inflection point" in the period from 1998 to 2006 that fundamentally transformed the logic of Japanese capitalism toward one in which firms actively restructure to maximize returns for shareholders.[17] In contrast, I find that Japanese firms resisted wholesale reform both in the political arena and in their own business strategies, leaving a subtle blend of continuity with change.

Corporate Governance Reform 2012-present: Comply or Explain

Foreign shareholder groups became more influential in the corporate governance debate as their stock ownership increased and domestic stable shareholdings declined (Figure 1). By 2005, foreign shareholders counted for about 25% ownership of Tokyo Stock Exchange listed companies, and about 70% of trading activity. The American Chamber of Commerce

[13] John Buchanan, Dominic Heesang Chai, and Simon Deakin, *Hedge Fund Activism in Japan: The Limits of Shareholder Primacy* (New York: Cambridge University Press, 2012).

[14] Ministry of Economy, Trade, and Industry, "Kigyou kachi kabunushi kyoudou no rieki no kakuho matawa koujou no tame no baishuu boueisaku ni kansuru shishin" [Guidelines for Takeover Defenses to Preserve and Enhance Corporate Value and Shareholders' Common Interests] (Tokyo: METI, 2005); Ministry of Economy, Trade, and Industry, "Kinji no shokankyou no henka o fumaeta baishuu boueisaku no arikata" [The Role of Takeover Defense Measures in Light of Changes in the Environment] (Tokyo: METI, 2008).

[15] Zen Shishido suggests that U.S. firms use "poison pills" (takeover defense schemes) to enhance negotiation leverage rather than to block hostile bids, whereas Japanese firms are able to combine their poison pills with cross-shareholdings to prevent hostile takeovers. "Introduction: The Incentive Bargain of the Firm and Enterprise Law: A Nexus of Contracts, Markets, and Laws," in Shishido, ed., *Enterprise Law: Contracts, Markets, and Laws in the US and Japan* (Cheltenham, UK: Edward Elgar, 2014), 37.

[16] Author's interview, May 27, 2015.

[17] Schaede, *Choose and Focus*, 1-2.

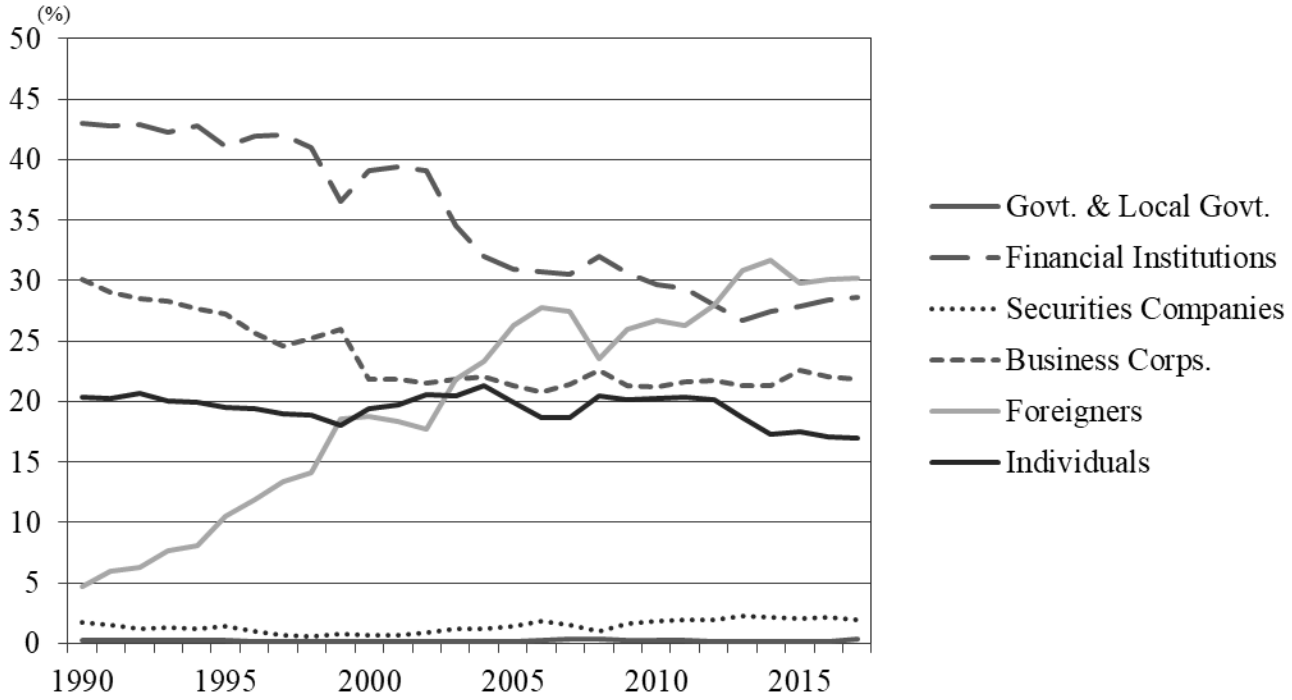

Figure 1. Market Value Owned by Type of Shareholder, 1990-2017 (Percent)
Source: 2017 Share Ownership Survey, Japan Exchange Group
https://www.jpx.co.jp/english/markets/statistics-equities/examination/b5b4pj0000026yq9-att/e-bunpu2017.pdf

(ACCJ) produced an influential report asking the government to issue listing rules to require at least one-third of board members to be independent directors.[18] Nicholas Benes, formerly an investment banker with J. P. Morgan, emerged as a persistent advocate for reform, both through the ACCJ and individually. Benes launched the Board Director Training Institute of Japan (BDTI) to nurture more effective directors in 2009. The Asian Corporate Governance Association (ACGA) published a corporate governance white paper in the same year, stressing that Japanese companies should be required to have independent directors and to improve shareholder rights by making shareholder meetings more open and shareholder voting more accessible.[19] Takaaki Eguchi, a former executive with a multinational investment management firm, reports, however, that the ACCJ and ACGA did not necessarily represent the voice of the investment community in Japan. The corporate governance professionals, such as proxy voting advisors, strongly advocated corporate governance reforms, but most investment managers did not speak out on issues such as requirements for independent directors because they doubted that such formal standards would help.[20] So the vast majority of foreign investors stayed on the

[18] American Chamber of Commerce in Japan, "Improve Shareholder Voting Access and Disclosure to Enhance Corporate Governance and Boost the Credibility of Japan's Public Markets" (Tokyo: ACCJ, 2008).
[19] Asian Corporate Governance Association. "ACGA White Paper on Corporate Governance in Japan" (Hong Kong: ACGA, 2008).
[20] Author's interview, May 28, 2014.

sidelines through Japan's corporate governance debate, despite the fact that the government was designing the reforms with them in mind.

In 2009, the Democratic Party of Japan (DPJ) ousted the LDP, which had dominated Japanese politics for more than fifty years.[21] The DPJ proposed its own plan to revise corporate law, including a strengthening of disclosure rules and a requirement for at least one employee representative as a statutory auditor. Interestingly, Rengo pressed for representation among auditors, but not directors. "We felt this was a more realistic goal," explains Kawashima. "The labor representatives would participate in monitoring, but not management."[22] Japanese labor unions tend to be more active on labor-specific issues, where they have greater expertise and better access to the government, than on corporate law.[23] And the private sector unions, which have the greater stake in corporate governance issues, tend to be more moderate than the public unions.[24] They are organized as enterprise unions, giving them more of a common interest with management than the sectoral or national unions common in the United States. Moreover, government, industry and labor forged a social compact in the postwar era whereby core workers gained employment security in exchange for labor peace.[25]

The Commercial Code Subcommittee of the Ministry of Justice's Legislative Council recommended a requirement of at least one outside director in an interim report in December 2011. The subcommittee had been leaning against a requirement, but two major corporate scandals, Olympus and Daio Paper, brought political pressure to take a tougher line.[26] In public comments on this draft, associations representing lawyers, accountants, and auditors, as well as the ACGA and the Tokyo Stock Exchange (TSE) supported this requirement, while Keidanren, the Japan Association of Corporate Executives (Keizai Doyukai), and the banking association opposed.[27] The subcommittee proposed a compromise: the "comply or explain" approach of the United Kingdom. The DPJ administration drafted legislation reflecting the subcommittee report in 2012, but it lost power before it was able to pass the bill.[28]

The LDP returned under Prime Minister Shinzo Abe in December 2012, and incorporated corporate governance reform into the famed "third arrow" of Abenomics. The government had some short-term success with the first two arrows, monetary and fiscal stimulus. The yen weakened, exports increased, the stock market surged, and the economy grew steadily if not rapidly. The administration referred to the third arrow as its longer-term growth strategy, including a broad range of "structural" reforms: agricultural reform; pharmaceutical market

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[21] The DPJ merged with the Japan Innovation Party (*Ishin no Tou*) and Vision of Reform (*Kaikaku Kesshuu no Kai*) in March 2016, and renamed itself the Democratic Party (*Minshintou*). The Democratic Party then split prior to the October 2017 election, with some members joining the Party of Hope (*Kibou no Tou*), and others forming a new Constitutional Democratic Party of Japan (*Rikken Minshutou*). The Democratic Party merged with the Party of Hope in May 2018, forming the Democratic Party for the People (*Kokumin Minshutou*).

[22] Author's interview, August 6, 2018. The union documented its proposal more fully in "'Juugyouin sennin kansayaku' ni taisuru rengou no kangaekata' [Rengo's Position on Employee-Nominated Auditors], July 15, 2010.

[23] See Steven K. Vogel, "Japan's Labor Regime in Transition: Rethinking Work for a Shrinking Nation," *Journal of Japanese Studies* 44, no. 2 (2018): 261-262.

[24] Rengo was formed as a merger of two private-sector union federations in 1989, and it absorbed the largest public-sector union federation in 1990.

[25] Sheldon Garon and Mike Mochizuki, "Negotiating Social Contracts, in Andrew Gordon, ed., *Postwar Japan as History* (Berkeley and Los Angeles, CA: University of California Press, 1993), 145-166.

[26] Shuuya Nomura, "Kaishahou kaisei no doukou ni tsuite" [Trends in Corporate Law Reform], *Shihon shijou* 321 (May 2012): 54-55.

[27] *Nihon Keizai Shimbun* (February 9, 2012), 18.

[28] *Nikkei Bijinesu* (October 18, 2013).

reform; deregulation zones in major cities; labor market reform – and corporate governance reform. These reforms had a critical virtue in an era in which Japan's government debt to GDP ratio exceeded 200%: they promised higher economic performance with only minor budgetary costs. And corporate governance faced the least political resistance of all: it was a policy with modest support, but little opposition. And if the government were able to craft it to address industry concerns, then it could move forward relatively quickly. Masahiko Shibayama, a ruling Liberal Democratic Party (LDP) Diet member with a legal background, who helped to draft the government's proposals, identifies three key goals of the reforms: ensuring healthy corporate governance, making Japanese companies more attractive to investors, and raising returns on equity. "The DPJ draft did not go far enough," he charges. "We really want companies to change their behavior, so we devised a rather ambitious proposal."[29]

The government submitted a corporate law reform bill in November 2013, which passed in June 2014 and went into effect in May 2015. It required companies to have one outside director or to publicly explain why they do not. Companies would be allowed to select a third corporate governance structure, a company with supervisory committee (*kansatouiinkai secchigaisha*), in addition to the traditional company with a company auditor board (*kansayakukai secchigaisha*) and the U.S.-style company with three committees permitted in 2002. Under the new structure, the audit committee would be given supervisory functions regarding the nomination and compensation of directors.

Yasuhisa Shiozaki, the Acting Chairman of the LDP's Policy Research Council, played the leading role in the corporate governance reform. Shiozaki was a former Bank of Japan official known for his expertise in financial affairs, who had served as Chief Cabinet Secretary in the first Abe administration (2006-07). Benes, the American reform advocate, advised Shiozaki to stick with the comply or explain framework rather than to push for a statutory requirement for outside directors. The business community had already accepted the comply or explain concept under the DPJ, Benes figured, so Shiozaki would be best off to accept that and then press for results through a detailed "soft law" corporate governance code.[30] Shiozaki recalls the subtle negotiations over how to structure the deliberations:

> I engaged in an intensive back-and-forth exchange of drafts with the Financial Services Agency by e-mail. I wanted the FSA to handle the corporate governance code because the TSE is a private company and the listed companies are its clients, so it cannot push through things those clients do not want. Eventually we agreed that the FSA and TSE would jointly organize the council of experts. So this was a government proposal, with the council delegated to work out the details.[31]

The FSA did not want to handle the corporate governance code because it would be vulnerable to pressure for concessions from politicians (other than Shiozaki). Thus the TSE was vulnerable to pressure from industry, and the FSA was vulnerable to pressure from politicians. "Each side has a weak point," explains one central participant in the negotiations. "So if the FSA and TSE work together, then that should work."[32]

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[29] Author's interview, May 27, 2014.
[30] Benes interview; Nicholas Benes, " How Japan's Corporate Governance Code Was Born," Board Director Training Institute blog, 2015; online at https://bdti.or.jp/en/blog/en/cgcodejapanbirth/.
[31] Author's interview, May 29, 2014.
[32] Author's interview, May 29, 2014.

In May 2014 the party issued its economic revitalization plan.[33] Shiozaki drafted many of the sections related to corporate governance, with some help from Shibayama. Shiozaki also conferred with his party colleagues, but he only compromised with a few specific edits to appease the most persistent ones:

> When we had a draft of our report, I presented it at an LDP meeting. Some colleagues registered objections but I only listened to the ones who stayed after, not to those who left partway through. We revised specific language in response to this input.[34]

For example, Shiozaki softened the language regarding reforms to the commodity derivative market to appease a leader of the party group on economic and industry issues (*keisanzoku*). And he revised a clause on the regulation of electronic bank transfers in response to a Diet member representing bank interests. He had hoped to go beyond a recommendation that banks reduce their industrial holdings to specify a requirement, but a cabinet member shot down that proposal.

The FSA moved first with a stewardship code aimed at institutional investors. An FSA council of experts set out standards for how these investors should engage with investee companies to maximize returns for their clients over the long term.[35] "The stewardship code is like herbal medicine (*kanpouyaku*)," declares Ryozo Himino, Deputy Director General of the Corporate Accounting and Disclosure Division at the FSA. "It induces change slowly but steadily."[36] As of August 2018, 233 institutions had formally accepted the stewardship code, yet only 32 corporate pension plans had signed on.[37] The stewardship code was revised in 2017 to stipulate that institutional investors should disclose their voting records for investee companies for all agenda items, and asset managers should establish governance structures to prevent conflicts of interest.[38]

The FSA-TSE joint Council of Experts began deliberations in August 2014, and announced the code in June 2015. The unveiling of the code coincided with a strong stock market rally, confirming government leaders' belief that corporate governance reforms would appeal to investors.[39] The TSE followed with new listing requirements. Listed firms would not only have to comply or explain with respect to outside directors, but they would have to publish their principles for holding other firms' shares, criteria for voting as shareholders, basic management philosophy, and policies on executive appointments, remuneration, and shareholder relations.

Keidanren officials accepted this outcome because it fell short of a requirement, but they maintained some reservations. Specifically, they worried that companies that chose to explain rather than to comply would suffer a negative image, and that the comply option in the code would evolve into a de facto requirement.[40] This is precisely what Benes had in mind, and more

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[33] Liberal Democratic Party, "Nihon saisei bijon" [Japan Revitalization Vision] (Tokyo: LDP, May 23, 2014).
[34] Author's interview, May 29, 2014.
[35] Financial Services Agency, "Principles for Responsible Investors: Japan's Stewardship Code" (Tokyo: FSA, 2014).
[36] Author's interview, May 27, 2014.
[37] Financial Services Agency, "Stewardship Code: 233 Institutional Investors Have Signed Up to the Principles for Responsible Investors as of August 31, 2018" (Tokyo: FSA, 2018); online at https://www.fsa.go.jp/en/refer/councils/stewardship/20160315.html.
[38] Financial Services Agency, "Corporate Governance Reform in Japan," briefing materials, June 14, 2017.
[39] *Shuukan Touyou Keizai* (June 11, 2016), 78.
[40] Author's interview with Yasuhisa Abe, Director, Business Infrastructure Bureau, Keidanren, May 29, 2014.

or less how things unfolded, as detailed below. Chihiro Kawashima, Director of Rengo's Department of Economic and Social Policy, reports that Rengo officials were not happy with the reform process because they were excluded from the council of experts, but they were generally satisfied with the outcome, because the code explicitly recognized the importance of stakeholders in its second clause.[41]

Parallel to the LDP-FSA-TSE process, METI officials were considering measures to boost Japanese firms' profitability. They were increasingly convinced that low returns on equity (ROE) not only made these firms less attractive to foreign investors, but also made them less productive and less competitive. In essence, they started to see corporate governance reform as a more central element of industrial policy. "In the 1980s or 1990s, it was OK if your ROE was low," explains one METI official. "But now with globalization in the 21st Century, companies can leave Japan. The positive cycle of investment in R&D and infrastructure is no longer supporting the economy. So we need to shift to a new positive cycle: the financial path."[42] Specifically, investors would engage with companies more effectively, leading to greater corporate value, including higher profits, productivity, and competitiveness. METI organized a Study Group to Promote Japan's Earning Power (*nihon no kasegu chikara soushutsu kenkyuukai*) led by Kunio Ito, a prominent finance professor at Hitotsubashi University, and the council issued its report in 2014.[43] METI then organized working groups to promote dialogue between investors and firms to raise corporate value over the medium and long term. METI's approach raises a critical question, however, to be addressed in the conclusion of this article: Would higher profits bring higher wages and investment, or would they come at the expense of wages and investment?

METI also followed up the corporate governance code with specific guidelines designed to maximize corporate value over the long term. The guideline report stressed that boards should focus on long-term planning and delegate detailed decisions to the executive team. Companies should establish nomination and compensation committees with a majority of outside directors, and appoint at least one outside director with management experience. Companies should publicly disclose the role of any retired executives or government officials who serve as senior advisors (*soudanyaku* or *komon*).[44] Foreign investors in particular complained that these advisors were not adding value for their firms.[45] "We expect our guidance on advisors to have a substantial impact," predicts one METI official, "because there have been some sensational news reports on this."[46]

The Abe administration also supported more women in corporate leadership, including board members, via its "Womenomics" initiative. This initiative included policies to make it easier for mothers to work outside the home and to encourage companies to appoint more female executives. The Diet passed the Promotion of Women's Participation and Advancement in the Workplace Law (*josei katsuyaku suishinhou*) in 2015, requiring companies with 300 or more

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[41] Author's interview, August 6, 2018. Also see Yuko Suzuki, "Kooporeeto gabanansu to roudoukumiai no yakuwari ni tsuite" [On the Role of Labor Unions in Corporate Governance], *DIO* (November 2017).
[42] Author's interview, May 27, 2014.
[43] Ministry of Economy, Trade, and Industry, "Nihon no 'kasegu chikara' soushutsu kenkyuukai" [Study Group to Promote Japan's Profitability] (Tokyo: METI, 2014). METI used a quite different name for the project in English-language materials: "The Ito Review of Competitiveness and Incentives for Sustainable Growth."
[44] Ministry of Economy, Trade, and Industry, "Kooporeeto gabanansu shisutemu ni kansuru jitsumu shishin" [Practical Guidelines for Corporate Governance Systems] (Tokyo; METI, March 31, 2017).
[45] *Nihon Keizai Shimbun* (September 27, 2017), 2.
[46] Author's interview, September 12, 2017.

employees to publish data on the number and status of female employees and to develop action plans for promoting women in the workforce.

In essence, the government sought to facilitate corporate restructuring and to make Japanese firms more attractive to foreign investors without jeopardizing managers' autonomy or undermining valued management practices. Keidanren and other interest groups fought to insure that committee-style boards were not required; that companies retained viable mechanisms to defend against hostile takeovers; and that companies continued to serve a broader array of stakeholders, not only shareholders. They also opposed a requirement for outside directors, succeeding for many years but ultimately compromising.

The Ministry of Justice subcommittee launched yet another review of corporate governance reform in April 2017, as dictated by the law passed in 2014. The subcommittee focused on whether to make outside directors compulsory, how to structure performance incentives for directors, and how to streamline procedures for shareholder meetings.[47]

Corporate Governance in Practice 1995-present

So has all of this reform activity produced real change at the corporate level? Have corporate adjustments been formal or substantive, profound or superficial? This section reviews the evidence from aggregate data, industry surveys, and company case studies. Japanese corporate governance practices have evolved gradually in response to legal and regulatory changes, the stewardship and corporate governance codes, and the subsequent guidelines. In the 1990s and early 2000s, companies focused primarily on restructuring to cut costs.[48] Firms experimented with various types of reorganization, including the introduction of semi-autonomous business divisions, more fully autonomous internal "companies," and pure holding companies. They sold off stakes in affiliates to strengthen their balance sheets and spun off divisions to reduce labor costs.

Japanese firms reduced labor costs gently, avoiding layoffs if at all possible. They pared down the workforce via attrition; they negotiated wage restraint; and they cut back on variable expenses like overtime. And in a distinctively Japanese approach, they transferred workers to affiliates, effectively deploying their corporate groups as employment networks. Gregory Jackson finds that Japanese firms were far less likely than U.S. firms to have workforce reductions greater than 10 percent in 1991 (5.9% of Japanese firms versus 20.6% of US firms) and 2001 (2.0% versus 9.2%).[49] Japanese job tenure actually increased during its period of economic stagnation, from 10.9 years in 1990 to 12.0 years in 2005 and 11.9 years in 2016.[50] Japan's distinctive approach to labor adjustment moderated social dislocation by preserving employment for core workers, but it took a toll over the long term by suppressing wages, reducing job opportunities for younger workers, and raising the share of non-regular workers in the workforce.[51]

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[47] Masayuki Hirata, "Kigyou touchitou ni kansuru kiritsu no minaoshi kentou ga susumu – houseishinbukai no doukou to kaishahou no minaoshi" [Corporate Governance Regulations Under Review: The Legislative Council Subcommittee and the Revision of Corporate Law], *InfoCom Newsletter* (October 26, 2017).

[48] Vogel, *Japan Remodeled*, 115-204, covers this earlier period of corporate reform in greater detail.

[49] Gregory Jackson, "Stakeholders Under Pressure: Corporate Governance and Labor Management in Germany and Japan," *Corporate Governance: An International Review*, *13* (2005): 419-28.

[50] Ministry of Health, Labor and Welfare, "Chingin kouzou kihon toukei chousa" [Wage Structure Basic Survey] (Tokyo: MHLW, 2017).

[51] Vogel, "Japan's Labor Regime in Transition."

Managers expanded investor relations activities and announced various symbolic measures designed to please investors, but they were slower to make large-scale or more substantive changes. Some took advantage of the corporate law reforms to introduce stock options and share buybacks. Most firms limited stock options to a small number of executives and restricted them to relatively small bonuses. Whereas an American CEO earned 11% of compensation from base salary, 19% from bonuses, and 70% from long-term incentives in 2016; a Japanese CEO received 58% from base salary, 28% from bonuses, and 14% from long-term incentives.[52] U.S. CEOs earned 265 times the income of an average worker in 2016, while Japanese CEOs made 58 times the income of an average worker.[53] In 2012, companies began to offer employee stock ownership plans (*kabushiki kyuufu shintaku*), which are less cumbersome to administer than stock options. The number of companies offering these plans boomed from 6 in 2014 to 331 in 2017, according to a Mizuho Trust & Banking survey.[54]

Companies used buybacks to insulate themselves from shareholder pressures by maintaining share prices at an acceptable level and to protect themselves from hostile takeovers. They would often announce buybacks near the end of the financial year to maximize the impact on the share price. Yet share buybacks never approached the scale common in the United States (Figure 2).

Japanese institutional investors gradually became more vocal in the 2000s. Some began to monitor performance more closely and to adopt more active investment strategies to increase returns. Domestic and foreign hedge funds achieved modest returns from activist strategies in the early 2000s, but their efforts subsequently stalled. Moreover, the hedge funds failed in their broader effort to reorient the business strategies of the target firms.[55] M&A activity increased, but it did not reach U.S. levels (Figure 3). The courts supported takeover defenses in several key cases, such as the Steel Partners - Bulldog Sauce case in 2007, so this deterred hostile takeover attempts in subsequent years. Hostile takeover bids remain rare, and very few to none have been successful – depending on one's definition of "hostile."[56] According to Thomson Reuters, from 1991 through 2017, the United States had 425 hostile takeover attempts, and Japan had 16 (Figure 4).

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[52] Willis Towers Watson, "Executive Compensation Bulletin: CEO Compensation Comparisons in Five Developed Countries," November 16, 2017; online at https://www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2017/11/Executive-Compensation-Bulletin-CEO-comp-comparisons-five-developed-countries.

[53] Anders Melin, "Executive Pay," *Bloomberg QuickTake* (January 22, 2018); online at https://www.bloomberg.com/quicktake/executive-pay.

[54] *Nihon Keizai Shimbun* (August 6, 2017), p. 1.

[55] Buchanan, Chai, and Deakin, *Hedge Fund Activism in Japan*, 153-239.

[56] See Culpepper, *Quiet Politics and Business Power*, 46, on the definition of "hostile."

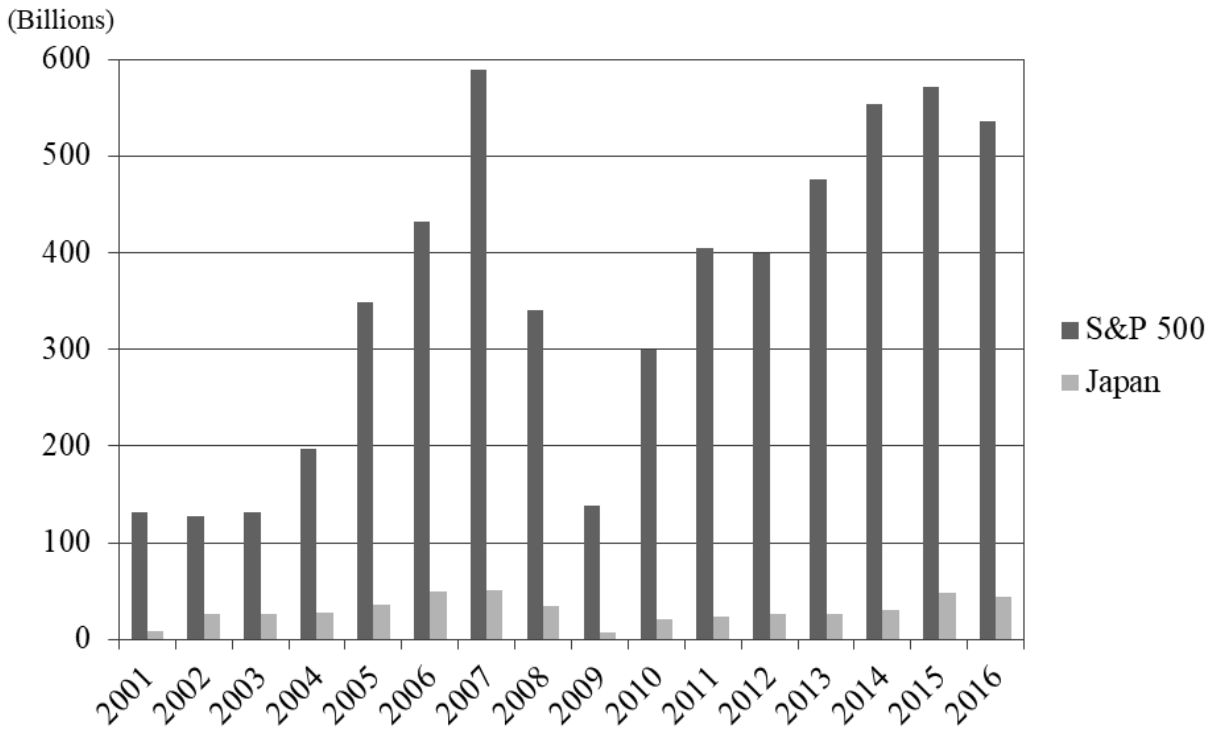

Figure 2. Share Buybacks in Japan and the United States, 2001-2016 ($US billions)
Sources: S&P 500, Daiwa Institute of Research
https://us.spindices.com/indices/equity/sp-500

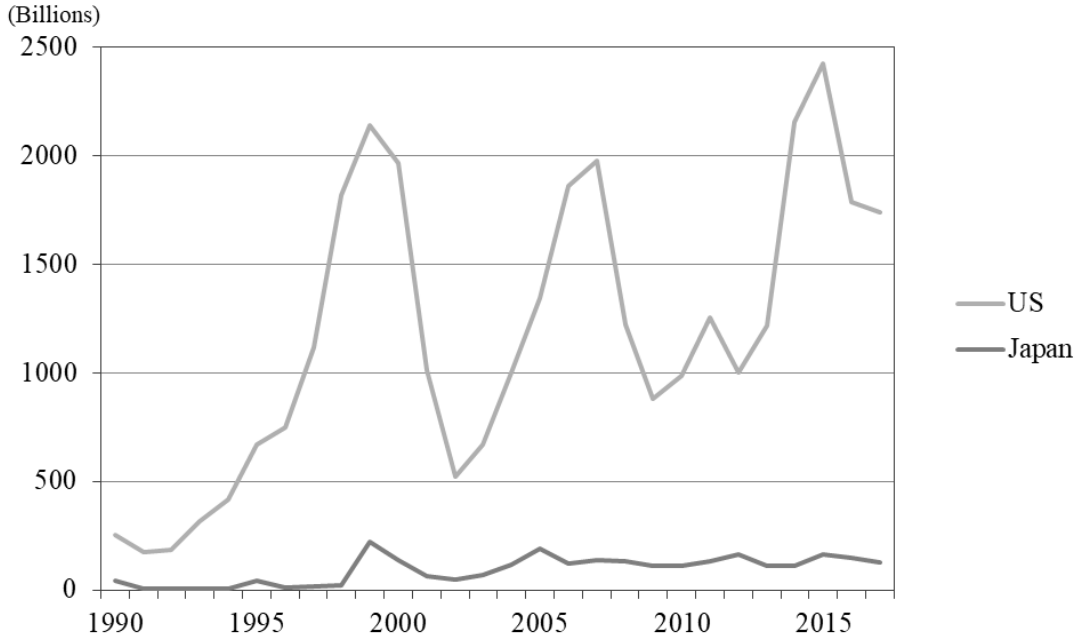

Figure 3. Mergers and Acquisitions in Japan and the United States, 1990-2017 ($US billions)
Source: Institute for Mergers, Acquisitions and Alliances (IMAA)
https://imaa-institute.org/m-and-a-statistics-countries/

Most Japanese firms reduced the size of their boards and adopted an executive officer (*shikkou yakuin*) system that permitted those excluded from the board to preserve their social status while allowing the companies to streamline the actual decision-making. The average size of boards dropped from more than 13 members in 1992 to 8-10 since 2005.[57] Only about 3% of listed companies opted for the three-committee boards that had been permitted in 2002. Many firms added outside directors, but some managers continued to believe that outside directors were more likely to undermine good management than to enhance it, so they did not provide directors with the information they would need to be effective. With the corporate law reform bill in 2014, the Corporate Governance Code in 2015, and the corporate governance guidelines in 2017, listed corporations overwhelming complied by appointing at least one outside director; and many added more (Table 1).[58] But 15.3% of outside directors did not qualify as independent directors according to TSE standards.[59] Female outside directors increased from less than 4% of the total for TSE First Section companies in 2011 to 11.6% 2018. Only 1.8% of outside directors were non-Japanese.[60]

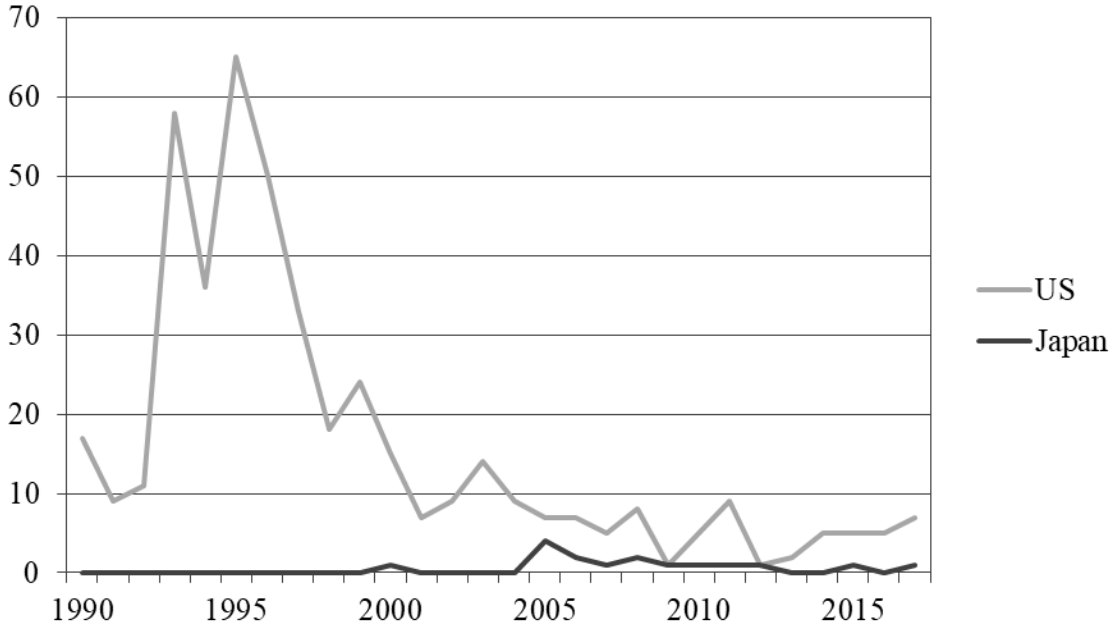

Figure 4. Number of Hostile Takeover Bids in Japan and the United States, 1990-2017
Source: Thomson One, All Mergers & Acquisitions

[57] Kenichi Osugi, "Nihon kigyou no torishimariyakukai no hensen to kadai" [Changes and Issues for Japan's Corporate Boards], METI CGS Study Group presentation, July 19, 2016.
[58] In contrast, U.S. companies in the S&P 500 had an average of 9.2 independent directors and 1.6 non-independent directors in 2017. "Spencer Stuart U.S. Board Index: A Perspective on U.S. Boards," 2017; online at https://www.spencerstuart.com/-/media/ssbi2017/ssbi_2017_final.pdf?la=en&hash=DADA958C9B4F21467A69938FF1C44D490AB93D58.
[59] Tokyo Stock Exchange, "Kooporeeto gabanansu hakusho 2017" [White Paper on Corporate Governance 2017] (Tokyo: TSE, 2017), 80.
[60] *Nihon Keizai Shimbun* (September 16, 2018), 7.

Table 1. The Increase in Outside Directors at Listed Companies, 2013-18

	2013	2014	2015	2016	2017	2018
Companies with Two or More Outside Directors (percentage)	18.0	21.5	48.4	79.7	88.0	91.3

Source: Tokyo Stock Exchange

Meanwhile, a substantial share selected the new corporate form (Table 2). Firms tended to prefer it over the three-committee board because they could meet the requirement for an outside director by reappointing an external auditor as an outside director. As of 2018, 34.3% of TSE First Section companies had nominating committees and 37.7% had compensation committees, which are only required for the three-committee boards but recommended for all companies under the corporate governance guidelines.[61]

Table 2. The Board Structure of TSE First Section Firms 2005-2018

	2005	2010	2014	2015	2016	2017	2018
Companies with Kansayaku Boards	97.1	97.4	97.5	91.4	78.8	75.0	72.7
Companies with Three Committees	2.9	2.6	2.5	2.7	3.1	3.1	2.9
Companies with Supervisory Committees	0	0	0	5.9	18.1	21.9	24.4

Source: Japan Association of Corporate Directors, "Joujou kigyou no kooporeeto gabanansu chousa" [A Survey of Corporate Governance in Listed Firms], August 1, 2018, 10.

Of listed companies, 31.6% had fully complied and 61.4% had complied with more than 90% of the 73 principles in the code as of July 2017.[62] Institutional investors report, however, that company governance statements are pro forma, lacking information specific to the companies. In a Nomura Securities survey, 90% of institutional investors reported that they had read few or none of these statements.[63] Items with high explain (non-compliance) rates included electronic voting/ English annual general meeting notices (57.7% explain), board evaluation (44.7%), remuneration reflecting mid-to-long term growth (31.4%), English language disclosure

[61] Tokyo Stock Exchange, "Kooporeeto gabanansu kaikaku no doukou" [Trends in Corporate Governance Reform], August 9, 2018.
[62] Tokyo Stock Exchange, "Kooporeeto gabanansu no shinten to shagai torishimariyaku e no kitai," [Progress in Corporate Governance and Expectations for Outside Directors], January 11, 2018; online at https://www.boj.or.jp/announcements/release_2018/data/rel180129c2.pdf.
[63] *Shuukan Touyou Keizai* (November 20, 2017), 79.

(30.0%), independent director input on remuneration/nomination (25.7%), and two or more independent directors (20.6%).[64] According to a TSE member survey, 71% of companies were conducting evaluations of board performance in 2017, up from 55% in 2016 and 36% in 2015.[65]

A METI survey conducted in 2016 found that 39% of companies had redefined the scope of responsibilities of the board in the year since adopting the code. Almost all reported that outside directors were fully meeting expectations (54%) or mostly meeting expectations (43%). Most experienced some trouble in complying with the code, greatly (46%) or somewhat (37%). Some reported that something did not go well in implementing corporate governance reform, either a lot (6%) or somewhat (28%). One company reported its frustrations particularly stridently: "The code reflects one-sided superficial Western values. It is not universal, and not persuasive. So it certainly cannot convince top managers who have succeeded with completely opposite values to accept a new paradigm."[66]

Meanwhile, Japan's corporate governance reforms did not curb corporate scandals. If anything, there was an acceleration of embarrassing incidents, with several major scandals in 2017 alone, including Nissan (improper inspections), Mitsubishi Materials (falsifying data), and Kobe Steel (falsifying data). The most egregious scandal erupted in 2015, when it came out that Toshiba had overstated profits by about 152 billion yen from 2008 to 2014. Yet Toshiba had been consistently ranked as one of Japan's best governed companies. It was at the vanguard of corporate governance reforms, introducing a U.S.-style three-committee board in 2003. Christina Ahmadjian contends that Toshiba faltered not despite its governance reforms but because of them. Specifically, Toshiba's attempt to forge a hybrid of Japanese stakeholder and U.S. shareholder governance encouraged and enabled accounting fraud, and prevented its detection.[67]

As another way to discern the balance of continuity and change in Japanese corporate governance, I conducted follow-up field research on two case study companies from an earlier project: Toyota and NEC.[68] Toyota is the classic case of a firm that benefits from the core features of the Japanese model, including stable labor relations and close collaboration with core suppliers, which constitute the firm's comparative institutional advantage. Even as the Japanese economy faltered in the 1990s, therefore, Toyota executives saw no reason to change their ways. As of the early 2000s, managers not only insisted on preserving "lifetime" employment, but they stressed the importance of strong channels of communication with workers. They affirmed that Toyota's close collaboration with suppliers enabled it to lower costs, enhance quality, and spur innovation. They resisted board reform until 2002, when they reduced the number of board members from 58 to 27 and established 39 new non-board posts of executive officer. In a 2003 interview, however, Chairman Hiroshi Okuda remained adamant that the firm did not need outside directors. "At Toyota we feel that outside directors could not possibly understand our business. If we brought them in, they would just get in the way." I pressed him on this point:

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[64] Tokyo Stock Exchange, "How Listed Companies Have Addressed Japan's Corporate Governance Code," (Tokyo: TSE, January 16, 2017), 5.
[65] *Nihon Keizai Shimbun* (September 22, 2017), 2.
[66] Ministry of Economy, Trade, and Industry, "Kooporeeto gabanansu ni kansuru kigyou ankeeto chousa kekka" [Corporate Governance Company Survey Results] (Tokyo: METI, March 2017), 128.
[67] Christina Ahmadjian, "Corporate Governance Reform and the Toshiba Scandal: Did a New System Hide an Old Mess?" (presentation at the Center for Japanese Studies, University of California, Berkeley, March 6, 2017).
[68] The earlier period is covered in more detail in Vogel, *Japan Remodeled*, 164-167, 170-174.

"But don't you feel pressure from foreign shareholders to change your ways?" He hesitated only for a moment. "Not so far," he shrugged.[69]

In 2017, however, Toyota managers reported that they had changed their view on outside directors after the global financial crisis of 2008 and a quality control crisis that went public in 2009. They reduced the number of directors from 17 to 11 in 2011, and brought in three outside directors in 2013. The board would focus more on advice and monitoring, not operational details, and the outside directors would contribute new perspectives. The staff provided an extensive training program for these directors from 2013 to 2015. Toyota also experimented with a distinctive twist on the stakeholder model, designing an outreach program in 2016 for about 3000 stakeholders, including members of the community, employees, suppliers, and salespeople. Managers explained the firm's long-term strategy in the hope of enhancing the firm's collaboration with these partners. Toyota has maintained strong ties with its core suppliers, including ownership stakes, but it now justifies these investments more explicitly to shareholders. "We have a strong sense of crisis these days," reports Hiroshi Suzuki, Project General Manager of the Corporate Affairs Department, "But our corporate culture has not fundamentally changed."[70]

NEC faced more severe challenges in the 1990s than Toyota, so naturally it was more aggressive in reorganizing, selling assets, reducing labor costs, and reforming corporate governance. It suffered a 151 billion yen loss in fiscal 1999, and responded with a major restructuring plan to reduce fixed costs, restructure finances, and strengthen corporate governance. It would reduce capital expenditures by 20%, and management expenses and research and development by 10% each. It would reduce its worldwide workforce by 15,000 in three years, with 9000 (7 percent of total domestic) coming from domestic operations, and 6000 (21% of total overseas) from overseas. It even sold the headquarters building, although it continued to occupy the building. It reorganized itself into three divisional "companies" to target different customer groups. And it reduced the board of directors from 37 members to 17. NEC's financial condition deteriorated once again with the bursting of the information technology bubble in 2000, and it embarked on even more drastic reform. It targeted a 30% decrease in materials costs, further rationalized the semiconductor business, sold off factories, and accelerated the shift of production offshore. In 2003, it launched yet another revival plan, disbanding the internal company system and creating a more lateral structure with nine operational divisions designed to promote synergy across computers and communications. And it introduced a key performance index (KPI) to link business unit performance with the company's overall financial goals.

Hence NEC was a relatively early mover in corporate governance reform. In 2010, it created nomination and remuneration committees (with 3 of 5 directors from the outside for each). Since 2012, 5 of 11 total board members are from the outside, just short of a majority. Yet 3 of 8 outside directors and auditors come from the Sumitomo Group.[71] "We want our outside directors to serve as monitors, but we also want them to help us move into new areas and give us advice," reports Hirokazu Matsushima, Head of the Global Public Policy Relations Office. "Perhaps we do not give them as much of a role as we should."[72]

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[69] Author's interview, June 18, 2003.
[70] Author's interview, September 14, 2017.
[71] NEC Corporation, *Anyuaru repooto 2017* [Annual Report 2017] (Tokyo: NEC, March 2017), 42-43, 47-48.
[72] Author's interview, September 19, 2017.

Citi Research's study of NEC and seven other leading electronics companies provides a revealing view into how financial analysts evaluate corporate governance. It breaks governance into four categories, each accounting for 25% of the total score: outside directors, including total number and share of outside directors with close ties to the firm; board structure, including the type of board and whether the committee chairs are outsiders; separation of monitoring and operations, measured by the share of directors with operational responsibilities; and the role of outside directors, including where they come from and their primary concerns as board members. NEC comes in second to last place (ahead of Sharp) with an overall governance score of 29 of 100. Citi Research then combines NEC's governance score with past performance (27) and improvement (35) scores to generate a composite score of 30 for governance and profit-oriented management, placing it dead last. The Citi Research analysts are particularly critical of the strong Sumitomo Group presence on the board, charging that the board lacks independence.[73] In contrast, Sustainalytics gives NEC a top environmental, social, and governance (ESG) rating of 84 out of a possible 100, with a 95 score for environmental, 83 for social, and 67 for governance.[74]

The Questionable Case for the Shareholder Model

This brings us to the most critical question of all. Does all of this activity make Japanese corporate governance better or worse? I address this question by reviewing four different types of evidence. First, I survey the record of the shareholder model in its paradigmatic case, that of the United States. Second, I review scholarship on the relationship between corporate governance reforms and corporate performance in Japan. Third, I present some data on profits, wages, and investments in Japan to understand how corporate performance has changed in recent years. And fourth, I examine the situation on the ground based on qualitative field research: interviews with managers and directors from various companies. In the process, I recognize the multiplicity of goals of corporate governance, including raising corporate performance, improving decision-making processes, and monitoring manager behavior. While it may be impossible to draw a bright line between good and bad reform, I posit that corporate governance reform at its best should deliver greater transparency and accountability, and result in both higher returns for shareholders and higher wages for workers – not higher returns at the expense of lower wages.

The specific measures associated with the U.S. shareholder model do not have a proven track record of improving long-term corporate performance in their country of origin. Even a cursory look at the literature on the costs and benefits of elements of the U.S. model generates a rather startling conclusion: Japanese policy makers and corporate executives have enacted many reforms in the absence of clear evidence that these reforms actually do any good. Proponents of the shareholder value model believed that managers would more faithfully represent shareholder interests if their compensation were more closely tied to stock performance through stock options.[75] Yet in practice stock options reward managers for good performance but do not punish them for bad performance; they shift returns from shareholders to top managers; and they

[73] Citi Research, "Nihon oute denki no gabanansu" [The Governance of Japan's Large Electronics Firms] (Tokyo: Citi Research, July 6, 2017).
[74] *Nihon Keizai Shimbun* (June 13, 2017), 18.
[75] Michael C. Jensen and Kevin J. Murphy, "Performance Pay and Top Management Incentives," *The Journal of Political Economy* 98 (1990): 225-264; discussed in William Lazonick and Mary O'Sullivan, "Maximizing Shareholder Value: A New Ideology for Corporate Governance," *Economy and Society* 29 (2000): 15-16.

increase inequalities in compensation. They give executives incentives to engage in speculation and manipulation at the expense of investments to foster innovation, boost employment, and promote long-term growth. Executives speculate by overstating the company's performance and then exercising their options, and they manipulate the share price with buyback programs.[76] Buyback programs divert resources from investment in productive capabilities and compensation for workers, so they undermine growth, job stability, and economic equality. Over the long run, these management practices have impaired corporate performance and weakened the U.S. economy overall.[77]

The U.S. experience suggests that mergers and acquisitions are as likely to destroy value as to create it. Robert Bruner reviews the academic literature on the costs and benefits of mergers and acquisitions, and cites multiple examples within each of the following categories: studies reporting positive returns to target firm shareholders, studies reporting positive returns to buyer firm shareholders, and studies reporting negative returns to buyer firm shareholders.[78] An S&P Global Market Intelligence study of M&A deals from 2001 through 2017 finds that acquirer shares underperformed the market and those of rival firms in the same industry. Compared to the companies' peer group, net profit margins and returns on capital and equity fall; earnings per share grow less quickly; and both debt and interest expenses increase.[79]

Likewise, studies on the U.S. experience have not reached a consensus on the link between outside directors and firm performance. Bhagat and Black find that firms with more independent boards do not perform any better than other firms. They also note that low-profitability firms have a tendency to increase the independence of their boards, but that this does not help their performance. They conclude that the large and sustained rise in the share of outside directors on U.S. corporate boards since the 1970s cannot be explained simply as a response to economic pressures to choose more efficient governance structures, but more likely reflects changes in conventional wisdom and possibly legal pressures as well.[80] Duchin, Matsusaka and Ozbas find that the relationship between outside directors and firm performance hinges on the cost of acquiring information about the firm. When that cost is low, outside directors strengthen performance.[81]

The literature on the relationship of these various features of shareholder capitalism to corporate performance is less extensive in the Japanese case, partly because Japan has introduced these features more recently and on a smaller scale. Hasegawa, Kim, and Yasuda find that stock

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[76] Lucian A. Bebchuk and Jesse M. Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Cambridge, MA: Harvard University Press, 2004); Efraim Benmelech, Eugene Kandel, and Pietro Veronesi, "Stock-Based Compensation and CEO (Dis)incentives," *The Quarterly Journal of Economics* 125 (2010): 1769-1820; Don Warren, Mary Zey, Tanya Granston, and Joseph Roy, "Earnings Fraud: Board Control vs CEO Control and Corporate Performance – 1992-2004," *Managerial and Decision Economics* 32 (2011): 17-34; and William Lazonick, "The Fragility of the U.S. Economy: The Financialized Corporation and the Disappearing Middle Class," in Daniel Breznitz and John Zysman, eds., *The Third Globalization: Can Wealthy Nations Stay Rich in the Twenty-First Century?* (New York: Oxford University Press, 2013), 232-276.

[77] Lazonick, "The Fragility of the U.S. Economy;" William Lazonick, "Profits Without Prosperity: Stock Buybacks Manipulate the Market and Leave Most Americans Worse Off," *Harvard Business Review* (September 2014), 2-11.

[78] Robert F. Bruner, *Deals From Hell: M&A Lessons That Rise Above the Ashes* (Hoboken, NJ: John Wiley, 2005).

[79] *Economist* (October 7, 2017), 74.

[80] Sanjai Bhagat and Bernard S. Black, "The Non-Correlation Between Board Independence and Long-Term Firm Performance," *Journal of Corporation Law* 27 (2002): 231-73.

[81] Ran Duchin, John G. Matsusaka, and Oguzhan Ozbas, "When Are Outside Directors Effective?," *Journal of Financial Economics* 96 (2010): 195-214.

option plans have not improved firm performance in Japan.[82] Among the early adopters of outside directors in Japan, those companies whose stock outperformed the industry average roughly matched those whose stock underperformed the average. Many companies discovered that outside directors did not improve corporate governance, and some outside directors resigned after brief periods of service.[83] Shinya Miwa reviews various studies on the relationship between outside directors and corporate performance in Japan and performs his own analysis, finding no significant positive effect.[84] Likewise, Takuji Saito reports that he finds no significant relationship between an increase in outside directors and corporate performance for First Section firms, and some evidence of a negative impact on share valuations for Second Section firms.[85] A Mitsubishi UFJ Trust and Banking study finds that the appointment of outside directors correlates with better stock performance and higher ROE for its full sample of firms but not for the sub-sample of large firms. If anything, in fact, large companies with more outside directors had lower ROE.[86] The government's 2016 economic report finds, however, that those companies that have increased the number of independent directors have higher ROE than those that have reduced them or maintained the same number.[87]

Now let us turn to the aggregate data on Japanese firm performance, especially during the period of more extensive corporate governance reforms in the 2010s. At a superficial level, the data from the period since the global financial crisis conjures a straightforward Marxist interpretation: profits are up, and wages are down. ROE has risen sharply from a post-crisis low in 2009, although it remains well behind the United States (Figure 5). Return on assets (ROA) has risen even more steeply, and ROA may be the more appropriate indicator since it is less vulnerable to short-term manipulation.[88] During the same period, the labor share of income has declined steadily (Figure 6).[89] And capital investment is flat, rising ever so slightly after 2009, but not close to keeping pace with the increase in operating profits (Figure 7). Corporate research and development (R&D) as a share of sales has been declining in Japan, while rising in

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[82] Nobuhisa Hasegawa, Hyonok Kim, and Yukihiro Yasuda, "The Adoption of Stock Option Plans and Their Effects on Firm Performance During Japan's Period of Corporate Governance Reform," *Journal of the Japanese and International Economies* 44 (2017): 13-25.

[83] *Nikkei Weekly* (August 5, 2002), 12.

[84] Shinya Miwa, "Empirical Analysis of the Influence of Outside Directors on Japanese Firm Performance," in Norio Kambayashi, ed., *Japanese Management in Change: The Impact of Globalization and Market Principles* (Tokyo: Springer, 2015), 35-50.

[85] Saito speculates that the costs of selecting outside directors may outweigh the benefits for small firms. "Torishimariyakukai ni kansuru jisshou bunseki: kaishahou kaisei (heisei 27-nen) kooporeeto gabanansu koodo no eikyou" [Empirical Analysis of Boards of Directors: The Impact of the 2015 Commercial Code Revision and the Corporate Governance Code], presentation for the Commercial Code Subcommittee of the Legislative Council, September 6, 2017.

[86] Mitsubishi UFJ Trust and Banking, "Shagai torishimariyaku no dounyuu to kigyou kachi" [The Introduction of Outside Directors and Corporate Value] (Tokyo: Mitsubishi UFJ Trust and Banking, 2015).

[87] Cabinet Office, *Heisei 28-nendo nenji keizai zaisei houkoku* [2016 Annual Economic and Fiscal Report] (Tokyo: Cabinet Office, 2016), 118.

[88] Kiyoshi Takata, "Kigyou riekiritsu o iji shita nihon keizai" [The Japanese Economy Has Maintained Corporate Profits], *Fainansu* (December 2016), 70-77.

[89] If we look further back in time to include the period of more gradual reforms; beginning in 1995, for example; then the straightforward combination of higher returns for capital and lower returns for labor does not hold. ROE/ROA and the labor share of income both fluctuate, but with no clear pattern. The labor share of income has also decreased in the United States since 2009, but not in France, Germany, or Italy. Ministry of Economy, Trade, and Industry, "Seisansei kyoukyuu shisutemu kakumei" ni mukete [Toward a Productivity and Supply System Revolution] (Tokyo: METI, October 2017), 9.

the United States.[90] Labor productivity remains below France, Germany, Canada, and the United Kingdom, as well as the United States, and has been declining relative to the United States since 1990.[91]

Figure 5. Return on Equity in Japan and the United States, 2003-2016 (percent)
Source: Factset Database - Japan MSCI: Valuation, US MSCI: Valuation

Hence at the aggregate level, one might well conclude that corporate governance reforms have led Japanese companies to deliver higher returns to shareholders and lower returns to stakeholders, especially workers, and to favor short-term returns over long-term investments. Yet Rengo's Kawashima does not blame corporate governance for the declining labor share of income, but views it rather as the result of labor-management negotiations.[92] And the center-left opposition parties do not seem overly concerned either. "The Japanese Communist Party loves to talk about the labor share, and they think it should be set by law," stresses the DPFP's Sakaue. "But we believe in management freedom and capitalism, so we think it should be determined through wage negotiations."[93]

Financial Services Agency (FSA) officials categorically deny that corporate governance reforms have undermined the stakeholder model. "We want to preserve the strengths of the Japanese system, like good labor-management relations and long-term employment," stresses Toshitake Inoue.[94] The defenders of the reforms have a point in the sense that Japan has stopped far short of the United States in many areas, such as executive compensation, buybacks, M&A, and hostile takeovers, as noted above.

[90] Ibid., 27.
[91] Ibid., 8.
[92] Author's interview, August 6, 2018.
[93] Author's interview, August 10, 2018.
[94] Author's interview with Toshitake Inoue, Director, Accounting and Disclosure Division, Policy and Markets Bureau, Financial Services Agency, August 6, 2018.

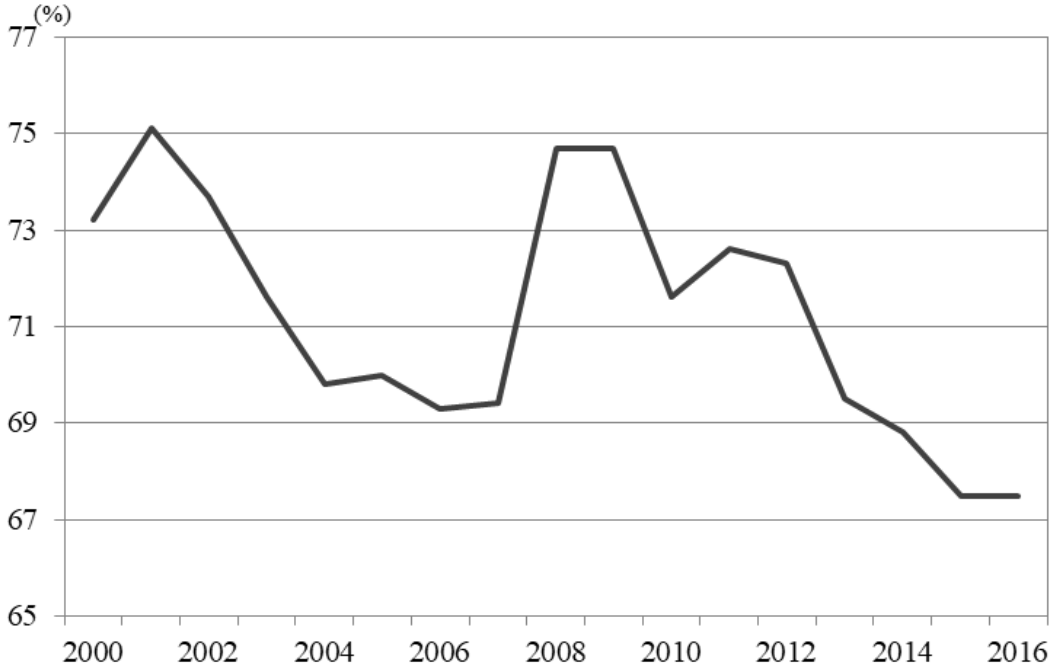

Figure 6. Labor Share of Income 2000-2016
Source: Ministry of Finance, Financial Statement Statistics of Corporations

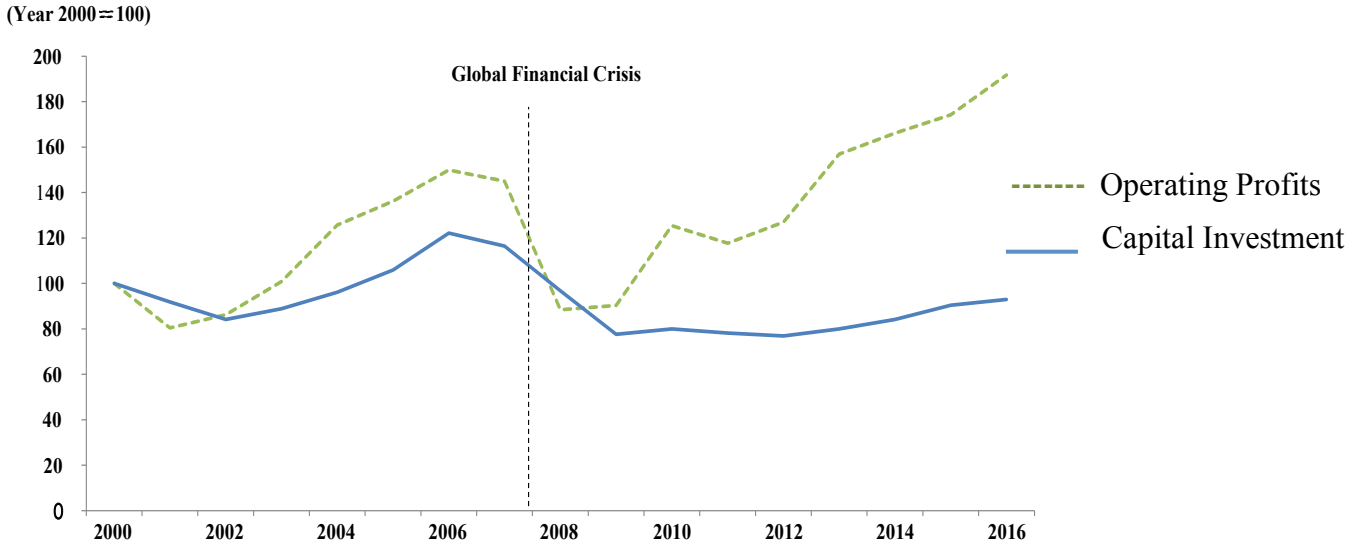

Figure 7. Operating Profits and Domestic Capital Investment (excluding software) 2000-2016
Source: Ministry of Economy, Trade, and Industry, "Seisansei kyoukyuu shisutemu kakumei" ni mukete [Toward a Productivity and Supply System Revolution], October 2017, 6.

There is a further challenge to the simple labor exploitation thesis. In a contemporary industrial economy, workers themselves are capitalists via their pension plans. So workers benefit from corporate profits, and suffer from corporate losses, along with the capitalists – albeit

not to the same degree. That means that Japanese pensioners are losing out because lower domestic ROE results in lower returns on their investments. This does not eliminate the possibility of labor exploitation, but it does complicate the picture. Gourevitch and Shinn model how workers could become a third core interest group in corporate governance debates in addition to managers and shareholders, but in practice workers have not played this role in Japan to date.[95] "We have not really thought about how corporate governance could affect workers as pensioners," reports Rengo's Kawashima. "But in our capacity as contributors, we do ask public and private pension funds to consider environmental, social, and governance (ESG) factors in their investment decisions.[96]

Meanwhile, at the ground level some corporate governance reforms appear to be doing some real good. For example, Yasuchika Hasegawa, former CEO and Chairman of the Board of Takeda Pharmaceutical and a former Chairman of the Keizai Doyukai, claims that the corporate governance code has stimulated a shift in governance practices and corporate attitudes at his firm. Takeda adopted the new company with a supervisory committee structure in 2016. It created nomination and compensation committees, with outside director majorities (2 of 3) and chairs, and the board cannot reverse committee decisions. It has used the reform as an opportunity to invigorate debate on the board, delegate more specific tasks to committees, and leave more operational decisions to the divisions. "We are making decisions more quickly and delegating more effectively," Hasegawa reports. "I do not see any downside from these reforms."[97]

Of course, the former CEO and chairman of a Japanese company might be inclined to portray corporate governance reform at his own company in a favorable light. So I interviewed several non-Japanese outside board members who have been critical of Japanese management practices, and they report that corporate governance reform has transformed their own boards positively. Carsten Fischer, an outside director at Seiko and a former internal director at Shiseido, contends that most Japanese boards simply focus on getting through a predetermined agenda on time, and have not changed their actual practices despite the new code. But when asked about Seiko, he insists that change is real. The top executives have actively sought input from outside directors to bring in new perspectives, including the competitive environment and societal issues. Fischer does not view his role at a Japanese firm as one of pressing the firm to maximize returns to shareholders. "In the U.S. an outside director represents shareholders," he explains, "but here my role is to represent the wider range of stakeholders."[98]

Christina Ahmadjian, who has conducted research on Japanese corporate governance as a professor at Hitotsubashi University, and has at times criticized Japanese practices, now finds herself practicing what she preaches as an outside director at Mitsubishi Heavy Industries and the Japan Exchange Group, which runs the Tokyo Stock Exchange. Yet she reports that MHI President Shunichi Miyanaga has leveraged board reform to enact major improvements in five years. He cut the board size, brought in tough outside directors, empowered outside voices, and adopted the new company with a supervisory committee structure, including the optional nominations committee. The board has pressed managers to shed problematic divisions and embraced a more financially oriented strategy. MHI has retained corporate group representatives

[95] Peter A. Gourevitch and James Shinn, *Political Power and Corporate Control* (Princeton: Princeton University Press, 2005).
[96] Author's interview, August 6, 2018.
[97] Author's interview, September 13, 2017.
[98] Author's interview, September 14, 2017.

on the board, but these have been among the toughest critics of the status quo. Ahmadjian's role is to raise questions, and to challenge assumptions. "They want me to represent the outside world," she reports. "They figure if they can explain their strategy to me, then they can explain it to anyone. So I get to play the obnoxious foreigner."[99]

For another perspective, I spoke with Jun Kurihara, an outside director at Ono Pharmaceutical. He contends that the corporate governance code does not make much difference at many companies, and some reforms just mean more payments to accounting and law firms. Yet Ono's reforms were meaningful because the company brought in outside directors for specific purposes: one to offer accounting expertise and Kurihara to provide a more international perspective. The accounting expert pressed the company to perform better cost analysis, to cut excess spending, and to increase profits. And Kurihara contributed new perspectives on corporate social responsibility that have enhanced the community's trust in the corporation. "Most companies do not want outside directors to speak out or to criticize, so they end up as window dressing," he concludes. "But companies that use outside directors well can make real improvements."[100]

In sum, corporate governance reform is an opportunity, not a solution in itself. All else equal, the deeper structural dynamics of capitalism push directors that are not themselves stakeholders to shift returns from stakeholders to shareholders. Stock options can allocate returns toward top managers and encourage a focus on short-term returns. Share buybacks can raise shareholder returns at the expense of investment and wages. At the same time, however, corporate governance reform is not just about increasing returns to shareholders. It also aims to improve decision-making procedures and to enhance the accountability of managers. And some elements of corporate governance reform, such as increasing the diversity of directors and strengthening corporate disclosure, promise benefits with little risk of a downside. As stressed throughout this article, the institutions of the Japanese political economy favor reforms of form over substance, and tactical adjustments over fundamental transformations of business practices. So Japan will not converge on the U.S. model of capitalism. And on the whole, as argued above, that is for the best. But along the way, some enlightened directors and managers may find a way to seize the opportunity of reform to find win-win solutions that benefit both shareholders and the broader spectrum of stakeholders.

[99] Author's interview, September 18, 2017.
[100] Author's interview, September 14, 2017.

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