

Research Focus

Japan's gradual transformation in corporate governance

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Anderson*

Japan has recovered from a 'lost decade' of economic stagnation over the 1990s, but this has been a 'found decade' for civil and criminal justice law reform, especially in corporate and securities law. Yet, have liberalisation and globalisation in those fields led to major changes in the 'law in action'? Does this represent 'Americanisation' of Japan's corporate governance system, focusing on shareholders rather than other key stakeholders such as 'main banks', core employees, and partners within diffuse corporate groups (*keiretsu*)? This book joins a 'new generation' of scholarship on Japanese law and the economy.

Like other major post-industrial democracies moving into the 21st century, Japan is undergoing a 'gradual transformation' in socio-economic arrangements. Unlike the 'great transformation' that engendered the welfare state in the mid-20th century, the current shift is back towards more market-driven governance. Yet, entrenched legal and social norms and institutions mitigate the pace and influence the direction of this shift. Consequently, the ways in which the transformation occurs and its overall extent vary among countries, although some identifiable patterns are emerging world-wide.

All of these wide-ranging reforms emerged from recommendations in 2001 by the Japanese Government's blue-ribbon Judicial Reform Council ('JRC'). The JRC sought to transform Japan from a system based on *ex*

ante regulation by public authorities, into one involving more indirect socio-economic ordering based more on *ex post* remedies pursued primarily by citizens themselves. Yet, implementation of these radical proposals has been limited by incrementalist 'reformist conservatism'.

With its emphasis on employee welfare, inter-locked shareholdings and monitoring by a key debt financier (the 'main bank' system), Japanese corporate governance was regarded as well suited to achieving strong business results compared to the 'insider' model emphasising shareholder primacy. But when Japan slumped into recession, the Japanese company was increasingly no longer regarded as a viable alternative. Massive reforms to Japanese corporate and commercial law, culminating in the 2005 consolidated Company Law and the 2006 amendments to securities regulations, promised a more market-responsive and transparent model of corporate governance. For example, the new company law provides a new future for the governance of smaller enterprises under an industrial policy aimed at promoting market entry for new, innovative venturers. It enables smaller companies to customise their management structures and *ex ante* share schemes to better suit their business needs.

With Japan back to steady economic growth since 2002, and many new legal reforms firmly in place, it is timely to re-consider how Japanese corporate governance has changed

during the era following the collapse of Japan's 'bubble economy' of the late 1980s. Has Japan really reached the 'end of history', forsaking its own institutions for a shareholder primacy model centred on more arms' length, Americanised market-driven relationships? Or has there been evolution rather than revolution, perhaps even a salutary reaction to shareholder primacy? Several authors conclude that there has indeed been a gradual transformation rather than radical upheaval.

The general conclusion is that Japanese corporate governance has been undergoing a gradual transformation especially over the last decade, but this certainly does not amount to a reverse 'great transformation' now dismantling the welfare state. Nor can it yet be concluded that there has been an 'Americanisation of Japanese law'. Despite an emerging 'shareholder fundamentalism' in takeovers law, generally, this field and areas such as directors' duties remain heavily based on case law developments, which are inevitably messier and more long-term in their impact. However, the role of Japan's formal court system in influencing corporate policy and practices is also becoming apparent. For example, growing activism since the late 1990s has constrained high-interest unsecured consumer lending, in turn impacting on Japan's core banking sector. Nonetheless, Japan's Supreme Court is certainly not the US Supreme Court. And already, the complex case law developments lends weight to calls for a more

streamlined and market-sensitive dispute resolution body that functions outside regular court processes.

In Japan, main banks and core (lifelong) employees play important *de facto* roles in corporate governance as monitors of managerial performance in many Japanese corporations. Japan's main banks may continue to play a considerable role in Japanese corporate governance, but, themselves face a new regulatory environment following the implementation of Japan's 'Big Bang' reforms in the late 1990s and are also increasingly subjected to scrutiny through the court system. However, lifelong employment is a governance technique that is not universal, ahistorical nor neutral, and so does not seriously affect the heterogeneous, transient and political dimensions of corporate governance.

Empirical analysis shows that many of Japan's largest companies in 2008 (compared to 1988) remain in the 'Top 40', however, many are now organised through pure holding companies, after a post-War prohibition was abolished in 1997 and, many have gone through divestitures and restructuring, reflecting and prompting successive corporate law reforms in that field since the late 1990s. Greater flexibility in corporate finance, another feature

of the reforms, is evident in the remarkable displacement of banks and insurance from among the top three shareholders in today's blue-chip companies. Nominees, probably institutional investors (including ever-growing foreign investors), have taken their place. On the other hand, corporate law reforms have had less effect in other areas, such as the committee-based corporate form and caps on directors' liability exposure. The impact appears more diffuse, as in the practice of downsizing boards of directors while introducing more executive officers. Hostile takeovers also represent one, of now very few areas, where legislation has still not been addressed comprehensively.

Research by practitioners and academics from various disciplines—from Australia, Japan and elsewhere—examines closely Japan's 'gradual transformation' in multiple fields, including lifelong employment, main bank finance, small and medium enterprise policy and governance, monitoring mechanisms in listed companies, and mergers and acquisitions in the broader context of foreign direct investment. None of the authors subscribes to the 'culturalist' view that the Japanese *don't like law* due to traditional Confucian values. Nor are they completely convinced by the 'institutional

barriers' perception that the Japanese *can't like law*, due to problems accessing the courts and so on, or the 'elite management' theory holding that the Japanese are *made not to like law* since such barriers are maintained to constrain unpredictable socio-economic change. Nor do they adopt more recent accounts derived from neo-classical economics, that the Japanese *do like law*—rationally settling disputes out of court and otherwise behaving in accordance with the relatively clear shadow cast by the law. Instead, analyses of the in this book largely accord with recent 'hybrid theorists' in Japanese law studies, who find generally that the Japanese *sometimes like law, but sometimes don't*. The methodology and conclusions are relevant for broader comparative corporate law scholarship, policy-making and business-level applications.

This article summarises the introductory chapter of our co-edited book, Luke Nottage, Leon Wolff and Kent Anderson (eds) *Corporate Governance in the 21st Century: Japan's Gradual Transformation* (Edward Elgar, Cheltenham, forthcoming September 2008). A fuller version of that chapter will also be available via www.ssrn.com and www.law.usyd.edu.au/anjel.

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Events

13 March, *Parliamentary Seminar presented by Deputy Prime Minister, and Minister for Physical Planning and Mining, of Papua New Guinea, Dr Puka Temu, Canberra*

26–27 March, *East Asia Forum Dialogue, Sydney*

Crawford Seminars*

4 March, *Flexibility and ambition in the Doha Round agricultural negotiation*, David Vanzetti, Crawford School

11 March, *How soon can donors exit from post conflict countries?*, Satish Chand, Crawford School

18 March, *Water as an economic good: the role of water economics and water values in European water policy*, Roy Brouwer, Institute for Environmental Studies, Vrije Universiteit Amsterdam, The Netherlands

25 March, *Property rights, investment and the environment*, Emma Aisbett, Crawford School (Foundation seminar)

**Seminars are held at 12.30pm in Seminar Room 4, Crawford Building

Publications

Asia Pacific Economic Papers

369, *China and East Asian energy: prospects and issues*, Vol II, Parts I and II

New Books from Asia Pacific Press

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