Corporate Governance of the Japanese Enterprise

Prof. Noboru Nakagaki &
D.B.P.H. Dissa Bandara

Executive Summary

While globalization and IT developments are accelerated, the management of the enterprise got a different path and required a proper governance for Japanese corporation. Today’s enterprise adapts itself to the change in the socio-economic system that changes rapidly, suitably, and it is developing management activities in this era of mega competition when only the enterprise which always creates value to the enterprise can survive. Moreover, it is the fulfillment of social responsibility of the corporate ethics which reach even the objectives of environmental management. The most recent research findings categorically evidence that a speedy diversification is taking place among Japanese corporations in terms of corporate governance. Amongst many voluntary and legislative reforms, introduction of executive officer system and outside directors system are attractive. The executive officer system is flatterning more popular at an increasing rate. Meanwhile, the latest corporate governance reforms were able to contribute for the enhancement of the corporate performance of the Japanese enterprises. The latest studies confirm, in statistical terms, the relationship between governance reforms and corporate performance is positively significant.

**Key word**: Corporate Governance, Financial System, Shareholders, Stakeholders, Board of Directors, Committee System, Corporate Auditors, Corporate Executive Officers.

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1. The Background of the Corporate Governance Discussion

Various propositions were put out in order to, make a Japanese socio-economic system reproduce from each field of industry, academic and government entering the 1990’s, with the bubble economic collapse. As for the government level, a policy for the deregulation was enforced under the administrative promotion headquarters of Hosokawa cabinet in 1994, and six reforms were expressed under Prime Minister Hashimoto in 1996. Especially, as for "the financial system reforms", the Ministry of Finance and the Ministry of Justice were requested to carry it out by 2001, having the principle goals of "free, fair and global". That means the adoption of the market principle which was hypothesized as a trustworthy mechanism for the present day Japan. Moreover, that it was anticipated to reform in accordance with the developments in the global financial markets (Kusumoto, 1997). At this moment, the decline of the corporate governance function in the financial and capital market of Japan had already been decided to be pointed out².

The correspondence of the financial authorities of Japan that the Asian Currency Crisis which occurred subsequent to the sudden fall of Thailand Baht in July 1997, had a considerable impact on the socio-economic system of Japan too, and a financial system unable to function originally, and it heavily affected the performance the Japanese enterprises. For example, Hokkaido Takushoku Bank, Ltd., Yamaichi Securities Co., Ltd. and Sanyo Securities Co., Ltd. failed in 1997, and Long-Term Credit Bank of Japan, Ltd. and Nippon Credit Bank, Ltd. failed in 1998, and there were numerous disgraceful affairs discovered. This kind of series of bankruptcies means a greatly damaged basis of financial system of Japan. However, one must not overlook the matter that a change in the management environment in the period of mega competition caused by globalization and information technology (IT) development existed in this background.

² Industry Financial Subcommittee Report of the Ministry of International Trade and Industry indicates the financial issues of Japan. The dependence of large companies on financial markets was identified as one of the problems of capital market after 80’s. These financial issues and the decline were mainly due to the dysfunction of governance structure, which made the background with in the turbulent economic condition. (The Ministry of International Trade and Industry- Industrial Policy Office, Industry Fund Section, 1999)
It works with the management activities of the general enterprise such as the manufacturing industry, commerce, service industry as well directly together, and dysfunction of the financial system is being said even as "lost decade" for 1990s. As a result, various amendments to the Corporate Law and a governmental policy have been enforced. As for the reform of the financial system, during the period, in 1998, the switchover from the enforcement of holding company, opening, formation, enforcement of the financial recall method and the registration system of the securities company to the licensing system in 1999, Mothers (market of high-growth and emerging stocks) opening in Tokyo Stock Exchange in 1999, NASDAQ Japan in Osaka Securities Exchange in 2000, the center of the connection settlement were some significant measures (Nakagaki, 2001). However, even if we are in the 21st century, the signs of recovery cannot be seen in the Japanese economy, and an enterprise is devoted to personal business restructuring\(^3\). The efforts which an enterprise has to bear and to take a certain kind of restoration of trust relations between the people concerned of the enterprise, "the asymmetry of information" which necessitates industry, academic and government to form an environment to reduce such problem and one must work as long as possible (Kobayashi and Kato, 2001).

This situation came to be seen, and came to be discussed as corporate governance, the corporate ethics and a problem of the social responsibility under the business environment in the Japanese enterprise. As for the corporate governance problem, institutions became to show the basis as a personal management posture from their various points of view, and even at present still there is such a belief particularly going on, in some of the enterprises as well. As the background of the corporate governance problem, many writers compelled to list the causes such as changes seen in the employment custom, KEIRETSU, auditor system of the Japanese enterprise and the main bank system, the Ministry of Finance leadership, finance and capital market position and the defects of the legal system.

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\(^3\) A financial system reform isn't always connected with the reform of the enterprise level directly. For example, from the inside of the Japanese capital market, the efforts which makes the transparant principle of the business accounting for the investor have not established (Tanaka, 2001).
2. The Meaning of Corporate Governance

Corporate governance has defined by different scholars in different ways indicating that there is no generally accepted definition. According to Monks and Minow (1995), corporate governance is the relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) the shareholders, (2) the management (led by chief executive officer), and (3) the board of directors. Other participants include the employees, customers, suppliers, creditors, and the community. It is interest so that a modern enterprise may make use of the organization principle of the incorporated company which even big invention in social system is said to and an enterprise scale may become huge, too, and the manager who doesn't have a possession function with the separation of the possession and the management becoming definite may carry out effective management activities in the complicated socio-economic system⁴ (Fukao, 1999). As stated by Jensen (2000), corporate governance is an issue of great concern to owners of common stocks because stockholder wealth depends in large part upon the goals of people who set the strategy of the corporation.

Generally, an enterprise in the discussion of the corporate governance limits it to the large incorporated company of the influence to the socio-economic system, and moreover it is based on the large-scale enterprise. It is surely decided that the problem of that rule exists in the difference in degree if interest relations over the enterprise are complicated and therefore an enterprise is organized with being natural. As for recent

⁴ As Berle and Means (1932) mention, the stockholder of the large company was not able to exercise the right to vote at all in America before 1920's. They became to operate such conditions thereafter. More often control was quietly exercised over a period of years without any active contest such as would give the stockholders an opportunity to chose between two contesting groups. For the most part the stockholder was able to play only the part of the rubber stamp. This description is not necessarily unified Berle and Means (1932) though 'management' is said to 'the manager' too. For example, as for Morikawa (1966), "It is specialized in the administrative function without having a possession function." It points at the professional manager, and a manager. According to Simizu (1998), a manager is caught as top management which is usually consist of a chairman, a president, executive vice presidents, executive directors, managing directors and rank and file directors. According to Fukao and Morita (1997) management is the organization that supervises the person who executes business.
years, moreover, a change is always made in the enterprise in the historical process, and
globalizes, and it is being exposed to the waves of information technology development,
and the socio-economic system particularly puts the influence on the enterprise directly.

In the first place, there is a posture which tries to grapple with from the bottom of the
argument of the corporate governance, within the function of the management which was
overlooked in many ways than a social victory. According to Drucker (1989), following
are the functions of management.

1. Management is about human beings. Its task is to make people capable of joint
performance, to make their strengths effective and their weaknesses irrelevant.
This is what organization is all about, and it is the reason that management is the
critical, determining factor. These days, practically all of us are employed by
managed institutions, large and small, business and non-business. We depend on
management for our livelihoods. And our ability to contribute to society also
depends as much on the management of the organizations in which we work as it
does on our own skills, dedication, and effort.

2. Because management deals with the integration of people in a common venture,
it is deeply embedded in culture. What managers do in the West Germany, in the
United Kingdom, in the United States, in Japan, or in Brazil is exactly the same.
How they do it may be quite different. Thus one of the basic challenges managers
in a developing country face is to find and identify those parts of their own
tradition, history, and culture that can be used as management building blocks.
The difference between Japan's economic success and India's relative
backwardness is largely explained by the fact that Japanese managers were able
to plant imported management concepts in their own cultural soil and make them
grow.

3. Every enterprise requires commitment to common goals and shared values.
Without such commitment there is no enterprise, there is only a mob. The
enterprise must have simple, clear and unifying objectives. The mission of the
organization has to be clear enough and big enough to provide common vision.

4. Management must also enable the enterprise and each of its members to grow
and develop as needs and opportunities change. Every enterprise is learning and
teaching institution. Training and development must be built into it on all levels—
training and development that never stop.

5. Every enterprise is composed of people with different skills and knowledge doing
many different kinds of work. It must be built on communication and on individual
responsibility. All members need to think through what they aim to accomplish—
and make sure that their associates know and understand that aim.

6. Neither the quantity of output nor the "bottom line" is by itself an adequate
measure of the performance of management and enterprise. Market standing,
innovation, productivity, development of people, quality, financial results—all are
crucial to an organization’s performance and to its survival. Non-profit
organizations too need measurements in a number of areas specific to their
mission. Just as a human being needs a diversity of measures to assess his or
her health and performance, an organization needs a diversity of measures to
assess its health and performance.

7. Finally, the single most important thing to remember about any enterprise is that
results exist only on the outside. The result of a business is a satisfied customer.
The result of a hospital is a healed patient. The result of a school is a student who
has learned something and puts it to work ten years later. Inside an enterprise,
there are only costs.

Drucker doesn't catch an enterprise as an organization which just pursues a profit, and
tries to catch it as a property of mankind joint ownership to share the result for an
enterprise which produces by the people concerned. In other words, a modern enterprise
doesn't consist of relations between the manager and the owner (stockholder), but it
takes cooperation with the people concerned such as a client, an employee and a
community too.

Discussing about corporate governance isn't easy, because various problems complicate
the people concerned of the modern enterprise. It is needed to be pointed out here that
generally the problem of the corporate governance is being discussed from the side of
the (1) management of the enterprise first of all, (2) social harmony as to the validity and
(3) as to the legal observance, as logical order. It stands in the extensive point of view
and decides to argue in this paper without particularly standing.
A point of an argument is different even if it depends on whether the enterprise made the target of the corporate governance at the same time is a so-called public incorporated company. Generally fund-raising is possible through the securities market, and a public incorporated company is a company where the character based on fundamentals of law being introduced to the public in the structure that the governance system of the administrative structure stands up to the securities market reflects on Corporate Law (Uemura, 2002). One must argue the problem of the corporate governance separately in a public incorporated company and is not another form of organization, and we usually discuss the corporate governance of a public incorporated company.

3. A Goal for an Enterprise and Corporate Governance

The Japanese enterprise restored from the waste emptiness after World War II is being blessed with the excellent managers in the various fields. For example, there were too many outstanding managers like Konosuke Matsushita of Matsushita Electric Industrial Co., Ltd., Masaru Ibuka, Akio Morita of Sony Corp., Kiichiro Toyoda of Toyota Motor Corp. and Soichiro Honda, Takeo Fujisawa of Honda Motor Co., Ltd. These managers shared the management ideology backed by good feelings of the corporate mission\(^5\). It is created with the originality, and there is a thing which is common to the leading enterprise of the world which said an educational background, a sense of responsibility and private consideration denial in that basis.

However, an eye wasn't turned to an excellent manager's so far not producing. In other words, the matter that the business administration was continued by the manager who had a few things which had a good feeling of the mission on the extension line of the rapid growth term, too, is changed, here even today with that a defect on the side of the socio-economic system of Japan is being said and a satisfactory monitoring function being not shown (Itami, 2000a).

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\(^5\) The management ideology of the Japanese enterprise is composed by more than one element, for example, according to Okumura (1994) 1. company ideology 2. management philosophy, 3. management policy, and 4. mission (Okumura, 1994).
Incidentally, a goal for an enterprise is ignored, and corporate governance can’t be argued. Though it is needless to say that it varies in the manager’s ability, the developmental stage, the type of industry, and so on. The goal for an enterprise can be distinguished in a short-term goal of financial affairs (financial objectives) generally and medium-to-long-range strategic goal (strategic objectives). Though it maintained "the trust dealings" that it stood up in the long-term point of view, the management technique of the Anglo-Saxon type is adopted, and a Japanese enterprise cannot but be put inside of the flow of the globalization in recent years and information technology in a part so far.

As for the management technique of the Anglo-Saxon type, with stockholder centered principle, market competition principle, individualism (see table 01) to compare in the employee centered principle, trust dealings principle, group principle which formulated the Japanese style management.

<table>
<thead>
<tr>
<th>Financial objectives</th>
<th>Strategic objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth in revenue</td>
<td>A bigger market share</td>
</tr>
<tr>
<td>Growth in earnings</td>
<td>Quicker design-to market times than rivals (an ability to get newly developed products to market quicker)</td>
</tr>
<tr>
<td>Higher dividends</td>
<td>Higher product quality than rivals</td>
</tr>
<tr>
<td>Bigger profit margins</td>
<td>Lower costs relative to key competitors</td>
</tr>
<tr>
<td>Higher returns on invested capital</td>
<td>Broader or more attractive product line than rivals</td>
</tr>
<tr>
<td>Attractive economic value added (EVA) performance</td>
<td>Better e-commerce and internet sales capabilities than rivals</td>
</tr>
<tr>
<td>Strong bond and credit ratings</td>
<td>Superior on-time delivery</td>
</tr>
<tr>
<td>Bigger cash flows</td>
<td>A stronger brand name than rivals</td>
</tr>
<tr>
<td>A rising stock price</td>
<td>Superior customer service compared to rivals</td>
</tr>
<tr>
<td>Attractive and sustainable increases in market value added (MVA)</td>
<td>Stronger global distribution and sales capabilities than rivals</td>
</tr>
<tr>
<td>Recognition as a “blue-chip” company</td>
<td>Recognition as a leader in technology and/or product innovation</td>
</tr>
<tr>
<td>A more diversified revenue base</td>
<td>Wider geographic coverage than rivals</td>
</tr>
<tr>
<td>Stable earnings during periods of recession</td>
<td>Higher level of customer satisfaction than rivals</td>
</tr>
</tbody>
</table>

Source: Thompson and Strickland (2001)
Needless to state, a modern enterprise is under the severe management environment which can't survive if it doesn't cope with the speed of the change in the socio-economic system suitably. Therefore, when a goal for an enterprise is formulated, one must always keep renewing a goal for every business which an enterprise is developing with paying attention to the developmental process which an enterprise is set up. For example, a manager ascertains which of the regenerated term, innovative term, stable business concerned is located in, and establishes a goal by the business, and he must connect it to the goal for an enterprise which coordinates them. (see table 02)

Table 02
A goal for a business by the development stage of the Japanese enterprise

<table>
<thead>
<tr>
<th>An innovative term</th>
<th>Stable term</th>
<th>Regenerated term</th>
</tr>
</thead>
<tbody>
<tr>
<td>The clarification of the management ideology, enterprise ethics</td>
<td>The exhibition of the president's administrator mind</td>
<td>How to think about president's philosophy, view of life</td>
</tr>
<tr>
<td>The clarification of the critical mind in the future, building of the plan</td>
<td>The activation of all the management processes</td>
<td>The strong growth, will of the president</td>
</tr>
<tr>
<td>The recognition of our strength</td>
<td>The personality which isn't imitated by other companies</td>
<td>The sharp insight of the president</td>
</tr>
<tr>
<td>The new product development which isn't cut off</td>
<td>Globalization</td>
<td>A president's severe judgment</td>
</tr>
<tr>
<td>An interaction with the new product development and the development of ability</td>
<td>Information technology</td>
<td>The attitude of the shaft foot from the president's Japanese type management to the Anglo-Saxon type management</td>
</tr>
<tr>
<td>Idea conversion strategy</td>
<td>The product pole of research and development</td>
<td>The exhibition of the president's entrepreneur mind</td>
</tr>
<tr>
<td>Full-scale conversion strategy</td>
<td>The promotion of research and development of the simultaneous progress type</td>
<td>Resigning of the president’s guarantee of employment, life-time employment system</td>
</tr>
<tr>
<td>Diversification</td>
<td>Speed</td>
<td>Top composition becomes proper.</td>
</tr>
<tr>
<td>Advancement into China</td>
<td>The transparency of the financial management</td>
<td>The introduction of the outside officer</td>
</tr>
<tr>
<td>The thorough search of the market competition</td>
<td>The fair sex of the personnel administration</td>
<td>The reduction of the managing director / officer</td>
</tr>
<tr>
<td>Management withdrawal</td>
<td>The achievement of the sales rate of profit more than the average</td>
<td>The abolition of the heredity system</td>
</tr>
<tr>
<td></td>
<td>The introduction of the big room system</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The joint ownership of sense of crisis</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The introduction of the marketing strategy that it doesn't end</td>
<td></td>
</tr>
</tbody>
</table>

Source: Simizu (2002)
There is a fundamental goal for an enterprise in the creation of value though it has various goals for an enterprise by the developmental stage, the type of industry, the manager ability, and so on. Globalization and information technology development, occurring at the moment, create a turbulent management environment, and there is a heavy burden on the shoulders of present day managers. The interchange of the precise information must exist between the people concerned who transfer authority to the manager at the same time.

However, in practice the boards of Japan’s major corporations currently represent the interests of the company and its employees as a collective (as distinct from the interests of individual managers and employees), not the interests of shareholders (Monks and Minow, 1995). Therefore, the inactivity of the achievement of the Japanese enterprise contributed to the bubble collapse too, and the movement to reexamine the governance structure of the incorporated company is stressed. For example, it proceeds with the reform of the management system of the Japanese enterprise to the introduction of the outside director, the introduction of the executive officer system, KEIRETSU and crossholding of stocks, the fulfillment of the auditor system, and so on including the amendment of the Corporate Law.

4. The Corporate Governance of the US Enterprise

When the structure of the corporate governance of the Japanese enterprise is examined, the case of the US enterprise which had a long experience in the territory of the corporate governance so far is supportive. As for the US as well, the scandal of Enron and WorldCom involves various disgraceful affairs of the enterprise made a considerable impact on the socio-economic system⁶. On the other hand, the matter was relating to non-banking in the US because a banking system is made dispersion and it was dealt with large quantities of stock possession of the enterprise by the bank and as a better treatment measure for the wound, the pension fund, the insurance, the investment company was adopted though the difficulty of the monitoring function of the enterprise was renewed⁷. Moreover, the point which a Japanese enterprise should refer to isn't rare as far as the corporate governance of the enterprise is concerned because an investor who invests most of the individual property in the stock and sticks to the mind set of
average person (Hashimoto, 2001).

As for the US, the ratio of the institutional buyer is represented by an individual owner and CalPERS is high, and the ratio of the so-called stable stockholder is sometimes low, and a strain relation between the stockholder and the manager keeps strong owing because low ratio of stable stockholder of the enterprise, being maintained always⁹. For

6 The nation's attention, from the halls of Congress to Main Street, has been riveted on an accounting scandal, a subject so abstruse it rarely makes the front page. But as the tawdry chapters in the Enron fiasco unfold like some penny dreadful, with explosive revelations of hidden partnerships, shredded documents, and shocking conflicts of interest, it's clear that the fall of Houston-based Enron is in a class by itself. Everything about this debacle is huge: a $50 billion bankruptcy, $32 billion lost in market cap, and employee retirement accounts drained of more than $1 billion. The lapses and conflicts on the part of Enron's auditor Arthur Andersen are equally glaring. Andersen had been Enron's outside auditor since the 1980s, but in the mid-1990s, the firm was given another assignment: to conduct Enron's internal audits as well. In effect, the firm was working on the accounting systems and controls with one hand and attesting to the numbers they produced with the other. And the ties went even deeper: Enron's own in-house financial team was dominated by former Andersen partners. Then, as the firm began its last, rapid plunge toward bankruptcy, the Andersen auditors began frantically tossing records of their work into the shredder. (Business Week, Asian Edition, 2002).

7 The modern banking laws-McFadden, Glass-Steagall, the Federal Deposit Insurance Corporation Act, and the Bank Holding Company Act- should not be seen as fragmenting the banking system. Fragmentation arose in the 19th century; the modern laws cemented it. There is no history of powerful bank financiers that the New Deal shattered; they always were fragmented (Roe, 1994).

8 As for CalPERS (The California Public Employees' Retirement System), at the end of 1999, an operating asset actively with a public pension fund of the American firm was maximum of US$ 155 billions. CalPERS has suggested principles for good governance in Japan, such as (1) Shareholders Have a Duty to Exercise Responsibilities as Corporate Owners. (2) Japanese Corporate Boards Should Consider the Interests of, and Strive for Accountability Toward, All Shareholders. (3) Japanese Corporate Boards Should Use the Corporate Governance Principles Developed by the Corporate Governance Forum of Japan as a Benchmark of Their Duties and Responsibilities to Shareholders. Of these, CalPERS views the following principles as most significant: (a) Corporate Boards Should Include Directors Who are Truly Independent from the Corporation and its Affiliates. (b) The Size of Japanese Corporate Boards Should be Reduced to Enable Effective and Efficient Decision-Making Regarding the Company's Strategic Plan and Executive Performance. (c) Japanese Corporations Should Appoint Auditors Who are Truly Independent from the Corporation and its Affiliates. (4) Development and Periodic Review of Best Practice Guidelines Should Continue and Reviewing Bodies Should Include Investors Based Outside Japan. (5) Best Governance Practices in Japan Should Include Elements that Strengthen Management Accountability to Corporate Owners through the Director-Shareholder Relationship. (www.calpers-governance.org, 2003) And, as for the participation in the corporate governance of CalPERS, with ①, manager, a dialog to the State of ③ Congress and the government such as SEC was included in addition to the dialog with ② stockholder (Miwa, 1999).
example, boards of directors are collected by a chairperson and the scale is comparatively small with about thirteen people, and an outside director\textsuperscript{9} is taken as\textsuperscript{10} member of the board of directors actively reverse intra-office director a few as much as possible. The annual survey of the largest 100 boards conducted by the executive search firm SpencerStuart evidenced that the boards were shrinking gradually, with half of the boards surveyed having 13 or fewer compared to the average of 15 few years ago. And, US enterprises are having a nomination committee, a reward committee (compensating committee), a finance committee and an executive committee (approves important decisions between full board meetings. There are many efforts to step beyond the legal definitions of a board's duties and develop more specific descriptions of the responsibilities of the directors. Nowadays board of directors has basically five functions as follows (Monks and Minow, 1995).

1. Select, regularly evaluate, and, if necessary, replace the chief executive officer. Determine management compensation. Review succession planning.
2. Review and, where appropriate, approve the financial objectives, major strategies, and plans of the corporation.
3. Provide advice and counsel to top management.
4. Select and recommend to shareholders for election an appropriate slate of candidates for the board of directors; evaluate board processes and performance.
5. Review the adequacy of the system to comply with all applicable laws/regulations.

A director plays the leading part of the reform in the US, and the center of the power is changing from the intra-office director to the outside director, too (Mahoney, 1933). But, a manager whom performance is excellent is elected as the executor by the board of directors and a monitoring doesn't necessarily do daily business as far the US enterprise is concerned. There is no much point in arguing over the definition of an independent

\textsuperscript{9} A listed enterprise prevents manager's reckless running, and New York Stock Exchange guarantee the investor's profit. Because manager's reckless running occurred one after another, subsequent to the introduction of at least two outside directors in 1956. The permanent establishment of the inspection committee was added to the condition of listing in 1978 (Tamura, 2002).

\textsuperscript{10} According to the annual survey of SpencerStuart investigation company, the board of directors of a large enterprises (100 companies), though there were 15 people in 1998, half of the boards of directors of the investigation in 1993, there were only 13 people (Monks and Minow, 1995).
director, or the existence or make up of board committees, or the procedures for electing directors if the information they obtain is inadequate. What can even the most luminous and well motivated director do if he or she lacks required, accurate or timely information? (Monks and Minow, 1995). Because of this, it always has the foundation like in the Enron matter mentioned above.

**Figure 01**

The structure of the monitoring function of the US enterprise

![Diagram of the structure of the monitoring function of the US enterprise](image)

5. The Structure of the Corporate Governance of the Japanese Enterprise

The Japanese enterprise is in a period of mega competition, and gropes for the new corporate strategy, and it is devoted to building of the organization structure as mentioned above. The organization structure of Japanese enterprise will be heterogeneous within the high level of global pressure instead of the conventional structure. For example, as shown in table 03, it has stock cross-holding, and having a higher number of stable stockholders. 719 companies out of 731 (98.4%) have stable stockholders and most of the Japanese large companies are being maintained a stable

<table>
<thead>
<tr>
<th></th>
<th>All Companies</th>
<th>Owner Management</th>
<th>Group Management</th>
<th>Subsidiary company Related company</th>
<th>Not applicable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parent company</td>
<td>25.5</td>
<td>4.2</td>
<td>12.7</td>
<td>84.9</td>
<td>10.1</td>
</tr>
<tr>
<td>Other group enterprises</td>
<td>30.9</td>
<td>26.6</td>
<td>32.0</td>
<td>39.7</td>
<td>24.6</td>
</tr>
<tr>
<td>A main customer, client</td>
<td>61.6</td>
<td>61.5</td>
<td>68.7</td>
<td>41.1</td>
<td>68.1</td>
</tr>
<tr>
<td>Main bank</td>
<td>83.9</td>
<td>86.0</td>
<td>85.0</td>
<td>78.8</td>
<td>84.1</td>
</tr>
<tr>
<td>Other Japanese banking agencies</td>
<td>79.1</td>
<td>75.5</td>
<td>85.9</td>
<td>65.8</td>
<td>79.7</td>
</tr>
<tr>
<td>Other Japanese enterprises</td>
<td>14.7</td>
<td>17.5</td>
<td>16.3</td>
<td>6.2</td>
<td>18.8</td>
</tr>
<tr>
<td>A foreign banking agency</td>
<td>2.9</td>
<td>4.9</td>
<td>2.5</td>
<td>2.7</td>
<td>1.4</td>
</tr>
<tr>
<td>Other foreign enterprises</td>
<td>1.8</td>
<td>0.7</td>
<td>3.0</td>
<td>0.7</td>
<td>0.0</td>
</tr>
<tr>
<td>Founder and that family</td>
<td>32.5</td>
<td>85.3</td>
<td>22.7</td>
<td>11.0</td>
<td>21.7</td>
</tr>
<tr>
<td>Management</td>
<td>40.9</td>
<td>49.0</td>
<td>43.2</td>
<td>30.1</td>
<td>34.8</td>
</tr>
<tr>
<td>Employee stock meeting</td>
<td>75.2</td>
<td>79.7</td>
<td>78.4</td>
<td>66.4</td>
<td>68.1</td>
</tr>
<tr>
<td>Labor union</td>
<td>1.4</td>
<td>1.4</td>
<td>1.9</td>
<td>0.0</td>
<td>1.4</td>
</tr>
<tr>
<td>Others</td>
<td>3.2</td>
<td>3.5</td>
<td>3.3</td>
<td>1.4</td>
<td>5.8</td>
</tr>
<tr>
<td>N.A.</td>
<td>1.0</td>
<td>1.4</td>
<td>1.1</td>
<td>0.0</td>
<td>1.4</td>
</tr>
<tr>
<td>The number of samples</td>
<td>719</td>
<td>143</td>
<td>361</td>
<td>146</td>
<td>69</td>
</tr>
</tbody>
</table>

Source: Nitta (2000)

Note:
1. Targeted at 8000 persons (chairman, president, executive vice president, executive director) randomly from 1307 listed enterprises of Tokyo Stock Exchange,
3. Effective answer rate: 15.1%, (1 person was chosen from 1 an enterprise – Total of 731 companies)
stockholder according to the investigation of Inagaki Research Group. Further, the main stable stockholder depends on the main customer, client, employee stock meeting, the owner management, all of the group center enterprises and the subsidiary company, related company, the main bank and other Japanese banking agencies. It begins to waver, and KEIRETSU system collapses in the period of mega competition; at the same time the stable stockholder of the banking agency and crossholding of shares as the stable stockholder between the enterprises becomes rare with the reorganization of the banking agency proceeding in the financial system reforms gradually due to the decline of the banking agency's own ability of management, too. While collapsing, most of the large companies tended to shift from indirect financing to direct financing. However, still the small enterprises keep their more weight on banks as usual due to the restrictions and / or the underdevelopment of the venture capital and IPO of the securities companies.

**Figure 02**

The structure of the monitoring function of the Japanese enterprise

![Diagram showing the structure of the monitoring function of the Japanese enterprise](source: Nakagaki (2003))

(a) Director System
The position of main bank and KEIRETSU (the enterprise groups) collapses, and it is going in the direction of the solution as mentioned above to have the cross-holding of the stock through business restructuring. Moreover, the bureaucracy control termed as "1940
system" began to disappear too. At present the condition is to grapple with the new management strategy instead of life-time employment system and seniority system of the typical Japanese management to face the mega competition in the new Japanese enterprise".

A speed from the indirect finance to the direct finance is accelerated through the financial system reform, and a so-called main bank system collapses, and supervisory functions by the banking agency or the enterprise group decreased, too. Moreover, the attention is shifted to the structure of the monitoring function of the international level, and it is profitable to the stockholder of the Japanese enterprise when foreign stockholder's rates increase rapidly with individual owner's rates increasingly and the Japanese enterprise itself involving to the process of the globalization deeply.

On the other hand, as for Japan, a shareholders' meeting, board of directors, auditor system is laid down, and this system has a history of more than 100 years after 1899 when the Corporate Law was enforced. The board of directors composed by all of the directors engages in decision making of the company about the business execution, and has authority to supervise the business execution by the representative director. (Corporate Law articles 260 - clause 1) As for the Japanese enterprise, a representative director is elected, (see table 04) and the authority of the business execution is entrusted. There are a few cases that supervisory authority is exercised because it can be said that it shows a tendency to decrease recently and there are many members of the board of directors in comparison with the non-Japanese enterprises and it is difficult to execute business as a joint act of all of the directors. And, it is the present condition that the outside director whose active rate is low. Independent director or outside director system (see table 05 for recent reforms) is another kind of experience to the existing conventional Japanese corporate governance framework. As mentioned by Hiroyuki (2003), independent directors are directors who do not execute business transactions at the large corporation; who have not served as director or manager or otherwise been employed by the large company or its subsidiaries; who do not presently

11 Under the wartime regime, Japanese type management was able to pursue an employee's joint profit, at the same time to utilize indirect finance. Bureaucratic control and the structure of the fiscal administration and the land system of the wartime regime moved the Japanese enterprise successfully in 1940s to the front (Noguchi, 1995).
serve as a director employed by its subsidiaries, or as a corporate executive officer or manager or are otherwise employed at either the large company or its subsidiaries. This concept was initially introduced by Sony Corp. in May 1997 as a voluntary piece of reform. The amendment to the Corporate Law in 2002, allowed Japanese enterprises to introduce this component legally. However, as shown in figure 03, little less than 40% of the outside directors are still coming either from the holding company, group or main bank showing the ruined features of the "1940s system".

**Figure 03**
The Originating Point of Outside Directors

![Pie chart showing the distribution of outside directors](image)

Source: Policy Research Institute of Ministry of Finance (2003a)

Furthermore, an auditor meeting becomes nominal, and the improvement of the monitoring function is being shouted including the revision of the Corporate Law for a long time (see figure 02).
Table 04
The number of director, employee and directors by type of enterprise

<table>
<thead>
<tr>
<th></th>
<th>All Companies</th>
<th>Owner Management</th>
<th>Group Management</th>
<th>Subsidiary company Related company</th>
<th>Not applicable</th>
</tr>
</thead>
<tbody>
<tr>
<td>The director total</td>
<td>17.5</td>
<td>15.8</td>
<td>18.9</td>
<td>15.9</td>
<td>17.0</td>
</tr>
<tr>
<td>The number of employee and directors</td>
<td>8.3</td>
<td>8.0</td>
<td>8.6</td>
<td>7.6</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Source: Nitta (2000)
Note: Same as the note in table 3

Table 05
A reform in recent years about the director, board of directors
Unit: percent and the number of companies

<table>
<thead>
<tr>
<th></th>
<th>All the Companies</th>
<th>Already Introduced</th>
<th>in the process of introduction</th>
<th>No idea to reform</th>
<th>Not applicable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction of the number of directors</td>
<td>100.0 (731)</td>
<td>48.6</td>
<td>26.9</td>
<td>23.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Introduction of the executive officer system</td>
<td>100.0 (731)</td>
<td>4.2</td>
<td>37.8</td>
<td>54.9</td>
<td>3.1</td>
</tr>
<tr>
<td>Introduction of the outside director</td>
<td>100.0 (731)</td>
<td>22.7</td>
<td>17.1</td>
<td>57.0</td>
<td>3.1</td>
</tr>
<tr>
<td>Counselor, advisor abolition and check</td>
<td>100.0 (731)</td>
<td>21.3</td>
<td>25.7</td>
<td>49.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Introduction of upper limited age officers</td>
<td>100.0 (731)</td>
<td>65.1</td>
<td>15.2</td>
<td>17.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Officer reward gap expansion</td>
<td>100.0 (731)</td>
<td>18.3</td>
<td>41.6</td>
<td>36.3</td>
<td>3.8</td>
</tr>
<tr>
<td>Introduction of Stock option system</td>
<td>100.0 (731)</td>
<td>5.3</td>
<td>34.7</td>
<td>56.4</td>
<td>3.6</td>
</tr>
<tr>
<td>Introduction of management head conference</td>
<td>100.0 (731)</td>
<td>28.7</td>
<td>21.8</td>
<td>46.1</td>
<td>3.4</td>
</tr>
</tbody>
</table>

Source: Nitta (2000)
Note: Same as the note in table 3
(b) Auditor System

A shareholders' meeting, a board of directors and the authority of the auditor's duty were often changed in the long history. Especially, the auditor's term expands from the 3 years from 2 years, and as for large companies, number of auditors are increased by more than 3 people from more than 2 people by the revision of the Corporate Law in 1993.

However, because it didn't function as expected, various proposals were shown to the system of the auditing, introduced by large companies and the external auditors as well from each direction. Strengthening of the auditor's inspection and duty of the external auditor isn't necessarily connected with the proper corporate governance and the market evaluation for the enterprise is in the comment of the Organization for Economic Corporation and Development\(^\text{12}\). On the other hand, a Japanese Corporate Governance Forum announces "Revised Corporate Governance Principles" on 26th October, 2001. These symptoms indicated the defects of the corporate governance function of the Japanese enterprise prevailing at the time.

As for main points of the tentative plan, a representative director reported the management's conditions of the company at least six times per year to the auditor, and it was decided that he assumed responsibility for an explanation for the auditor meeting. The auditor's term was set at four years with "the point rope" announced after that, and moreover a director thought that he/she had to report the condition of the business to the auditor (Corporate Law amendment for large companies) more than once in three months. But, as for the small company, Corporate Law does not applicable\(^\text{13}\). As for "the urgent suggestion", when the necessary conditions of the outside auditor were made stern and was elected, it got the agreement of the auditor meeting, and it was decided that a board of directors proposed it to the shareholders' meeting beyond all the auditors' halves as for the number as well as for the auditor's election bill. When the president of

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\(^{12}\) The Organization for Economic Corporation and Development proposes a form that "the present system" and "a new system" are chosen to apply independently as per the law. Though the form of the system council was said as "the set meal form", it looks like "the cafeteria form" (Chuo Aoyama Accounting Corporation (2002))

\(^{13}\) As for setting the auditor's term as four years, it is a consideration of the strengthening independence of auditor's social position, because it does not necessitate the reason for the resignation (Suenaga, 2000).
the executive committee who is the president of the board of directors as the best person in charge of the rule mechanism and the best person in charge of the business execution thinks that it should be distinguished, the auditor (external auditor) who was independent as a member of the auditor meeting is appointed, and proper activities are shared between the intra-office auditors, and principally it is an independent inspection. And, when it is decided with a revised principle, the board of directors establishes a nomination committee, a reward committee and an inspection committee as the internal organization and it is an evaluation of the inspection of the certified public accountant. The certified public accountant's selection, dismissal and the improvement of the evaluation of the internal control, internal audit and control environment are with the inspection committee.

Moreover, CEO is nominated, and it isn't decided that he/she takes up a reward, the commissioner of each committee of the inspection, and he/she is distributing thought to distinguishing business execution from the rule mechanism.

The committee recognized establishing the company system consequently in the revision of Corporate Law in 2002, and a major revision was done as for the board of directors as well. Though the choice of the establishment of committee system isn't forced and it is only a choice which should be determined by the management of the enterprise (Sawaguchi, 2002). The enterprise which chose an establishment committee system can't maintain the auditor system as there is a separate 'audit committee' within the proposed three committees.

Anyway, though the details that were connected with the revision of Corporate Law relating to the auditor system create some corporate governance problems in relations with the enterprise disgraceful affairs like in the US. It is a fact that concern for the auditor or the auditor meeting rose after the Corporate Law revision in 1993, and the existence of the full-time auditor became a serious problem (see table 06 for an auditor's attribute) and table 07 shows the current trend of priority within the Japanese enterprise.
**Table 06**

*An auditor's attribute*

<table>
<thead>
<tr>
<th>Full-time work, part-time work</th>
<th>The number (percent)</th>
<th>Inside the office/ outside the office</th>
<th>The number (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A full-time auditor</td>
<td>82 (67.2)</td>
<td>An intra-office auditor</td>
<td>58 (47.6)</td>
</tr>
<tr>
<td>A part-time auditor</td>
<td>40 (32.8)</td>
<td>Outside office auditor</td>
<td>63 (51.6)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Both (served concurrently in several companies.)</td>
<td>1 (0.8)</td>
</tr>
<tr>
<td>Total</td>
<td>122 (100.0)</td>
<td>Total</td>
<td>122 (100.0)</td>
</tr>
</tbody>
</table>

Source: Kikuchi and Hirata (2000)

Note:
1. The questionnaire investigation (100 companies) conducted by Japanese auditor society
2. The investigation period was October, 1999.

**Table 07**

*The priority trend*

<table>
<thead>
<tr>
<th>concentration on</th>
<th>The first place</th>
<th>The second place</th>
<th>The third place</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stockholder</td>
<td>63 (51.6)</td>
<td>31 (25.4)</td>
<td>16 (13.1)</td>
</tr>
<tr>
<td>Manager</td>
<td>26 (21.3)</td>
<td>27 (22.1)</td>
<td>14 (11.5)</td>
</tr>
<tr>
<td>Employee</td>
<td>7 (5.7)</td>
<td>32 (26.2)</td>
<td>55 (45.1)</td>
</tr>
<tr>
<td>Creditor</td>
<td>0 (0.0)</td>
<td>6 (4.9)</td>
<td>2 (1.6)</td>
</tr>
<tr>
<td>Customer</td>
<td>1 (0.8)</td>
<td>5 (4.1)</td>
<td>10 (8.2)</td>
</tr>
<tr>
<td>Main bank</td>
<td>1 (0.8)</td>
<td>2 (1.6)</td>
<td>4 (3.3)</td>
</tr>
<tr>
<td>Local resident</td>
<td>0 (0.0)</td>
<td>0 (0.0)</td>
<td>0 (0.0)</td>
</tr>
<tr>
<td>Client</td>
<td>20 (16.4)</td>
<td>14 (11.5)</td>
<td>16 (13.1)</td>
</tr>
<tr>
<td>Others</td>
<td>0 (0.0)</td>
<td>0 (0.0)</td>
<td>0 (0.0)</td>
</tr>
<tr>
<td>Non-response</td>
<td>4 (3.3)</td>
<td>5 (4.1)</td>
<td>5 (4.1)</td>
</tr>
<tr>
<td>Total</td>
<td>122 (100.0)</td>
<td>122 (100.0)</td>
<td>122 (100.0)</td>
</tr>
</tbody>
</table>

Source: Kikuchi and Hirata (2000)

Note: Same as the note in table 06
(c) Executive Officer System

In the US, a director’s control function was reduced (a lot of M&As and business restructuring are developed in the large scale in the 1980’s) though it thought that director’s duties were the supervision (watch) of the long-term management strategy and a decision for the election, evaluation, reward of the top management which was renewed today. The objective of corporate managers often conflict with those of the shareholders who own the company. Laws and regulations enacted since the 1930s have effectively put most of the power in the hands of management, frequently at the expense of the interest of the owners of the corporation. At the same time, boards of directors have tended to go along with management and to ignore the interests of the very party they were created to protect (Jensen, 2002). The takeover boom of the 1980s brought the subject of corporate governance forward as a revolution was mounted against the power complexes at corporate headquarters. The mergers, acquisitions, leverage buyouts, and leveraged restructurings of the 1980s constituted an attack on entrenched authority that was long overdue. Control of the corporation was transformed from a means of perpetuating established arrangements into a market place where the highest bidder made certain that the owners’ interests would prevail.

In Japan, Sony Corp. introduced an executive officer system in June, 1997, and subsequently it was found as a successful attempt. Law didn’t require an executive officer system, but it came from the activation of the management thinking persistently. Thereafter many enterprises introduced an executive officer system and were able to extend the achievements especially in the international market. Companies like Sony Corp., Hitachi Co., Ltd., Toshiba Corp., Komatsu Co., Ltd., C. Itoh & Co., Ltd., and Showa Shell Oil such as a joint management enterprise with the foreign capital and Orix Corp. are some real world examples of achieving set targets within the context of increasing pressure of foreign shareholders.

The enterprises which introduce the executive officer system are identified as the radical management reform agents (Yoshida, 2000). The Japanese enterprise is in a period of mega competition, and the ability of management is raised, and lives, and this means that an executive officer system suppose to be an effective governing tool. The board of directors thinks that the management supervision which supervises CEO’s management
execution function and the majority of the member of the board of directors decides that composition of outside directors (the director who doesn't serve as a management executive person, employee concurrently). Advanced management strategy under the supervision by the board of directors and originality has shown the maximization of long-term value of an enterprise and it is really decided that a CEO can concentrate the personal ability of management. For that the authority of the board of directors is transferred to each committee and the revision of law is necessary (Morita, 2000). The amended bill on March 18, 2002 was evaluated as the revision of the postwar system. According to this amendment, the selective introduction of the committee system which moves toward outside director like in the US enterprise has to exclude auditor system\textsuperscript{14} as mentioned above.

Certainly, as for the enterprise that a monitoring function has already taken root in the enterprise culture, introduces an executive officer system. This has been considered as the best framework and some have suggested this system to all Japanese enterprises whether it is a small enterprise or a large enterprise (Okada, 1998).

(d) Latest Reforms to the Corporate Governance Mechanism
As per the above discussion, it is clear that there is a series of reforms adopted in Japan both voluntarily and legally. Among these reforms, introduction of new corporate structure amending the Corporate Law in 2002 is the greatest step to develop the governance setup. The driving force of the amendment to the Corporate Law is to create a more effective and independent system for monitoring the way individual companies are run, as well as to improve the efficiency of management decision-making process. It allows an option to large Japanese corporations to establish three committees within the board of directors and to appoint executive officers external to the board with effect from April 2003, as stated below.

\textsuperscript{14} As for this amended bill, a large (capital 500,000,000 yen or a large company of debt 20,000,000,000 yen and more) company has the choice of having the auditor system or the committee system. It is not strengthening of the auditor system, rather, strengthening of the monitoring function of the board of directors. It can think that is being planned. And for established companies there are three committees such as a nomination committee, an inspection committee and a compensation committee. It should be necessary to put a reward committee and an executive post in established company and can't maintain an auditor. (Kawai, 2002)
1. Nomination Committee
2. Compensation Committee
3. Audit Committee
4. Corporate Executive Officers

A company adopting the new system may not have statutory auditors (kansayaku). Considering the above, the proposed corporate structure that expects to enable the board of directors to properly delegate substantial management authority under the latest amendment is graphically sown in figure 04.

According to the latest amendments to the Corporate Law, the board of directors has the right to elect and remove the directors who formulate these committees. The committees should be comprised of at least three board members; the majority of each committee should be composed of outside (independent) directors. Therefore, companies must have at least two independent directors on their boards if they wish to continue with the proposed US-style corporate structure (see Figure 01 for the corporate structure of the US enterprise).

The nomination committee originates the proposals relating to the election and removal of corporate directors that will be submitted to the shareholders' meeting. The board of directors however, retains the authority to appoint corporate executive officers and remove them. The compensation committee outlines the amount of compensation each board member and each corporate executive officer (sikkoyaku) is to receive. The final decision on the matters relating to compensation is rest with the compensation committee.
The figure 05 compare the element of two corporate governance systems and table 08 provides more details about the characteristics of each system.
Besides the above committees, companies that adopt the US style of corporate governance will have to appoint representative corporate executive officers-sikko yaku external to the board, who will be responsible for the day today business operations (Ministry of Justice 2002a; Ministry of Justice 2002b).

The legislative reforms are currently moving in two separate directions while some reforms focus on strengthening the board of Director’s monitoring function in optionally a new way, others (e.g. Law for Partial Revision of the Corporate Law Concerning Special Exemptions to the Corporate Law as Related to Corporate Auditing – 2001) focus on
strengthening the functioning of corporate auditors. According to our perspective, this is a kind of attempt to maintain the conventional corporate governance frame by strengthening the position of corporate auditors while responding the requirements of the global setup.

Table 08
Features of Two Corporate Structures

<table>
<thead>
<tr>
<th></th>
<th>Newly Proposed System</th>
<th>Traditional Governance System</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employing Outside</td>
<td>At least two Outside Directors</td>
<td>At least two Outside Statutory Auditors</td>
</tr>
<tr>
<td>Personnel</td>
<td></td>
<td>At least one Outside Director</td>
</tr>
<tr>
<td>Number of Directors</td>
<td>Three or more</td>
<td>Ten or more</td>
</tr>
<tr>
<td>Targets of Shareholder</td>
<td>Directors and Statutory Officers</td>
<td>Directors and Statutory Auditors</td>
</tr>
<tr>
<td>Lawsuits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term of Directors</td>
<td>One year</td>
<td>Two years (maximum)</td>
</tr>
<tr>
<td>Establishment of</td>
<td>Nomination Committee</td>
<td>Major Asset Committee (at least 3 members)</td>
</tr>
<tr>
<td>Committees</td>
<td>Compensation Committee</td>
<td>Board of Auditors (majority Outside Auditors)</td>
</tr>
<tr>
<td></td>
<td>Audit Committee (at least 3 members for each with majority</td>
<td></td>
</tr>
<tr>
<td></td>
<td>outsiders)</td>
<td></td>
</tr>
<tr>
<td>Nature of Director Duties</td>
<td>Supervising statutory officer, determining Managerial</td>
<td>Supervising Representative Directors, Determining Operational</td>
</tr>
<tr>
<td></td>
<td>Policies and appointing committee members and Statutory</td>
<td>Policies, and consigning tasks to a Decision Making Sub-committee</td>
</tr>
<tr>
<td></td>
<td>Officers</td>
<td>regarding major assets</td>
</tr>
<tr>
<td>Execution of Business</td>
<td>Representative Statutory Officers &amp; other Statutory</td>
<td>Representative Directors &amp; other Directors</td>
</tr>
<tr>
<td>Operations</td>
<td>Officers</td>
<td></td>
</tr>
<tr>
<td>Disclosure of Remuneration</td>
<td>Determined and reported by the Compensation Committee</td>
<td>If determine by the AGM that cannot be determined or non-</td>
</tr>
<tr>
<td></td>
<td></td>
<td>monitory remuneration will be provided, reason for such</td>
</tr>
<tr>
<td></td>
<td></td>
<td>should be disclosed</td>
</tr>
</tbody>
</table>

Source: Based on Disa Bandara (2003b)
Key Issues Evolving with the New Structure

The introduction of changes to an existing system might create some problems due to variety of reasons. Similarly, there are some issues with the latest proposal. Among them, picking up a suitable type of board for the company is a significant issue. According to Ministry of Justice (2002a), with the introduction of the committee system, the Corporate Law has allowed three types of corporate structures to coexist in Japan as shown below.

i. The Conventional corporate structure (with a corporate auditor system only)
ii. The intermediate corporate structure – Jyuyozaisan-iinkai (both a corporate auditor system and a major asset committee)
iii. The new structure – linkai-to-secchi-kaisha & sikkoyaku (corporate auditor system is eliminated and the three committees and the corporate executive officer system)

The above optional situation allowed by the Corporate Law evidences that Japan is not prepared to change it's own way of governance overnight even though there are some drawbacks with the present system as discussed above. Japan has allowed having a compromise and it is up to the corporation to decide whether to select the type i, ii or iii mentioned above in the long run. However, in anticipation of the corporate culture realizes the appropriateness of one of the above, corporations themselves in a trouble to select one out of the three.

Another evolving problem with the new proposal is finding a majority of independent directors. Because of the inherent nature of business relations prevailed in the Japanese traditional setup, mainly due to keiretsu and cross-holding systems most of the qualified people for the post are interrelated and this network restricts the quality of independence. On the other hand some Japanese corporations refuse the outside director system asking ‘what do they know about our company? According to a survey conducted by the Japan Association of Corporate Auditors (2003) only 1.3% of companies like to have independent directors. Similarly there is no much acceptance for the proposed audit committee system also. According to the 2003 survey results of the Japan Association of Corporate Auditors, only 13 of 2513 companies intended to introduce an audit committee to replace the statutory auditor. These current issues relating to the new corporate
structure are further elaborated by the expressions of global level business leaders in Japan, showing a substantial resistance to the latest proposal. For example,

1. 'Corporate governance in Japan requires a system that is suited to Japanese society' (Minoru Makihara – Chairman, Mitsubishi)
2. ‘...definitely opt for a Japanese style form of governance with greater independence for the statutory auditor...The spirit of outside directors has virtually collapsed in the US. I wonder why Japan wants to make the same mistake.’(Fujio Mitarai – President, Canon)

Some Recent Empirical Evidence
The executive director system, outside director system and the stock option system are the main elements of the new proposals introduced by some of the Japanese corporations. Even though it is too early to evaluate the success of the new style, several organizations compelled to investigate the progress so far. In the midst of them, Policy Research Institute of Ministry of Finance conducted a comprehensive survey in 2003, using 876 companies listed on the Tokyo Stock Exchange. Based on the survey data we would like to present the following analysis.

(i) Executive Officer System
The executive officer system is becoming popular at an increasing rate due to the recent

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reforms. According to figure 06 and 07, 33% of the firms have declared they have introduced an executive officer system. Compared to the 1999 survey, the growth rate of companies adopted this system is 153.8%. When comparing the figure, the percentage of companies that do not plan to introduce the system has fallen a little compared to 1999.

(ii) Outside Director System
The outside director system is also becoming popular even though the rate of increase is lower than the executive officer system. According to figure 08 and 09, 35% of the sample firms declared they have introduced outside director system. Compared to the 1999 survey, the growth rate of companies adopted this system is 16.7%, however there was no considerable development like in the introduction of executive officer system. Lack of talented people available for the post of outside director is often pointed out as the reason for such slow rate of introduction.

![Figure 08](image)
**Introduction of Outside Directors 1999**
- Not Interested: 42%
- Planning to Introduce: 27%
- Determined to Introduce: 1%
- Already Introduced: 30%

![Figure 09](image)
**Introduction of Outside Directors 2003**
- Not Interested: 29%
- Planning to Introduce: 33%
- Determined to Introduce: 3%
- Already Introduced: 35%

Source: Same as in Figure 06.

However, the above survey report categorically mentions that there is no significant relationship between corporate performance and the introduction of executive officer system or the outside directors. In contrast with the hypothesis formulated by some figures, introduction of such systems failed to increase the performance, demonstrating that all the elements of the US model will not exactly work in the Japanese corporations.
(iii) Stock Options

Employment of Stock option system also considerably improved after amending the Corporate Law. According to figure 10 and 11, 32% of the companies successfully adopted stock option by the year 2003, compared to 1999, it is a 166.7% increase. As evidenced by the figures, 17% of the companies will introduce the system immediately. On the other hand, the ratio of the companies opposing to introduce the system is still a little lower than 50%.

![Figure 10](image1)
**Introduction of Stock Options 1999**
- Not Interested: 53%
- Already Introduced: 12%
- Determined to Introduce: 3%
- Planning to Introduce: 32%

![Figure 11](image2)
**Introduction of Stock Options 2003**
- Not Interested: 49%
- Already Introduced: 32%
- Determined to Introduce: 2%
- Planning to Introduce: 17%

Source: Same as in Figure 06.

6. The Future Goal of Japanese Corporate Governance

The lack of understanding and corporate leadership within the 1990's and many other series of symptoms including the enterprise disgraceful affairs caught in the general meeting, the insider trading, loss covering, the violation of the Antimonopoly Law, the illegal donation, the talks dealings and so on categorically have shown the Japanese corporate governance problem. Subsequent to the bubble blast, it was clear that the manager's arbitrary decision and director's fidelity duty was in question. On the other hand, it comes to be seen in the ability of management of the Japanese enterprise, and the argument to concern corporate governance around the private enterprise and the academic circles has been increasingly popular. While globalization and IT developments are accelerated, the management of the enterprise got a different path (average persons'
concern has ever changed drastically) and required a proper governance for Japanese corporation. Moreover, this intimidating situation is not only for Japan, but also for the entire socio-economic system of the world. Within this turbulent environment the Japanese style management system has to be reexamined and to build a new or enhanced management system since it showed some drawbacks even though it worked very well for the industrializing Japan during the past half a century.

Today's enterprise adapts itself to the change in the socio-economic system that changes suddenly suitably, and it is developing management activities in the period of mega competition when only the enterprise which always creates value to the enterprise can survive. Because of that, though it is natural, the same organization structure will not appropriate to win the management game, and it is demanded to grope always for the structure of the new business management. There is a case that value of an enterprise is created within the frame of the corporate governance and it is the model which can be varied corresponding to the change in the management environment and one should finally aim at giving careful consideration to the management environment of the enterprise concerned. In other words, the function of the corporate governance is different by the management strategy which complies with the developed management activities, the culture, the industry structure, the competition conditions, the possession structure and the one related to trust between the people concerned.

When considering the history of Japanese governance function, the shareholders' meeting was dominated other than shareholders and the managers failed to act as the agent of the stockholder. As far as the global trend is concerned both change of managerial practices and necessary amendments to the Corporate Law and another corporate-related laws are a must. For example, in the US, various members of the committees were able to add value to the corporation. Moreover, an elected manager carries out efficient management activities to the investor, the employee, the client and the community, and has the duty to provide the results as information. Moreover, it is the fulfillment of social responsibility of the enterprise ethics which reach even the objectives of environmental management. Hence, from the broader point of view, corporate governance in the modern enterprise plays a part of public vessel in the socio-economic system.
The most recent research findings categorically evidence that a speedy diversification is occurring among Japanese corporations in terms of corporate governance. Amongst many voluntary and legislative reforms, introduction of executive officer system and outside directors system are attractive. The executive officer system is flattering more popular at an increasing rate. Compared to the situation prevailed three-four years ago, the growth rate of companies adopted the new system is more than doubled. The outside director system is also becoming more popular even though the rate of increase is lower than the executive officer system. Nevertheless, conventional boards were comprised of members who were internally promoted based on seniority or rank, now, becoming greatly diversified ensuring proper segregation between ‘execution’ and ‘monitoring’. Meanwhile, the latest corporate governance reforms were able to contribute for the enhancement of the corporate performance of the Japanese enterprise. The latest studies confirm, in statistical terms, the relationship between governance reforms and corporate performance is positively significant. Nonetheless, there is no significant relationship between corporate performance and introduction of ‘executive officer system’ or ‘outside director system’ even though there was a good response for the implementation of such systems. This indicates that particular set of components of governance system working effectively in the US for some time may not work similarly in Japan due to many environmental and cultural differences. Therefore the corporate governance reforms for Japan should be generated purely within the Japanese context considering the mind set of corporate Japan rather than imitating one’s steps.

References


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