Challenges for Japanese Corporate Governance in the Age of Globalization

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Three Forms of Globalization

   Can Japan develop a system of governance that satisfies foreign investors?

2. Globalization of Japanese Business Activities
   To what extent will central authority be delegated to overseas subsidiaries?

3. Globalization of Japanese Governance
   Can Japanese management and governance systems be integrated with overseas operations?
I. Globalization of Financial Markets: Problems of Japanese Governance (Foreign Investors)

- Are they prioritizing the interests of employees over shareholders?
- Is monitoring of management sufficient?
- Are the business advice and monitoring functions of the board adequately separated?
- Does the president have too much power over top-level appointments?
- Why does there seem to be a reluctance to change despite poor business performance?
Reference Material

Corporate Governance on our Minds: Olympus and Woodford
Formalistic Debate over whether to Require Outside Directors for the Past 15 Years

- Institutional Investors: Insider-dominated systems do not protect the interests of shareholders and depresses Japan’s stock market

- Business Groups: Each company should develop a corporate governance system that suits its needs; there should be no uniform, mandatory rule
Are Japanese Corporations Responsive to Shareholders?

- Why is influence of foreign investors weak?
- Diverse ownership structure in Japan...but
- Cross-shareholding system still functions
- Other Japanese domestic shareholders are complacent
- Are core employees at Japanese companies still regarded as the “real” long-term stakeholders?
What is a “Truly Effective” Corporate Governance System? Strengthening the Monitoring Environment

- The “secret” of the U.S. corporate governance system is...not independent directors per se
- Providing the means (“tools”) for ANY potential supervisor of management to be effective

1. Information (internal and public disclosure)
2. Enforcement (particularly private litigation)
3. Role of external gatekeepers
II. Globalization of Business: Board Function

- Can the board of directors continue to decide daily business matters as Japanese companies become larger and more global?
- Responses: introduction of “company” system (and holding company system, committee company system, hybrid, etc.)
- Common feature: greater delegation of daily decision-making to a lower level
Trouble with Globalization: Toyota’s Recall

- Was information on the original problem in Europe transmitted to the company’s U.S. subsidiary? Did local managers in the U.S. have sufficient authority?
- Does this indicate a limit to the generally successful model of Japanese manufacturing?
- Subsequent reform at Toyota
Reference Material


Company with Auditors: Toyota 2010

TMC's Corporate Governance
Emphasizing Frontline Operations + Multidirectional Monitoring

- Shareholders
  - Board of Corporate Auditors
    - Majority are outside corporate auditors
  - External Accounting Auditor
    - Audit for consolidated financial statements and internal control over financial reporting
  - Board of Directors
    - Senior Managing Directors
    - Managing Officers
  - Disclosure Committee
  - Internal Auditing Department (internal control systems)

- International Advisory Board
- Labor-Management Council
- Joint Labor-Management Round Table Conference
- CSR Committee*
- Toyota Environment Committee
- Stock Option Committee

* Review issues relating to corporate ethics, legal compliance, risk management, social contribution, and environmental management.
Company with Committees: Sony

Corporate Governance Structure

- Shareholders’ Meeting
  - Appointment/dismissal
  - Make proposals to appoint/dismiss Directors

- Board of Directors
  - Determine committee members
  - Monitor performance of their duties
  - Coordinate

- Nominating Committee
  - Make proposals to appoint/dismiss independent auditor

- Compensation Committee
  - Determine compensation

- Audit Committee
  - Monitor performance of their duties

- Management
  - Corporate Executive Officers
  - Internal Audit Division
  - Corporate Executives
Asahi Glass—Hybrid Company with Auditors
III. Globalization of Governance Systems

- Premise: every Japanese company knows that the domestic market is shrinking
- Result: every Japanese company has overseas expansion plans, even many “wholly domestic” companies (for example, Kewpie)
- Issue: How will Japanese companies modify their domestic management and corporate governance structures for global operations?
Scenarios on Globalization

1. Prior overseas expansion conducted by relatively independent international division—how to reintegrate into governance structure? (example, YKK)
2. Gradual overseas expansion: initially tries simply to apply Japanese methods to overseas subsidiary—but adjustment will be necessary
3. Sudden large overseas acquisition—how to integrate? (examples, Japan Tobacco, Asahi Glass)
Problem of Integration—"Vertical" Companies and "Horizontal" Control

- As each "company" expands globally, how can uniform policies be enacted and implemented?
- Must all Japanese companies begin to act like trading companies—with a focus on investment and risk management?
- What is the basis or standard for global integration? Will Japanese corporate culture work globally?
IV. Possible Change: Three Trends to Watch

❖ Ownership: continuing decline of cross-shareholding and beginning of more active role for domestic institutional investors
❖ Board structure: emergence of “hybrid” structure to strengthen board function and monitoring
❖ Globalization: evolution of management and corporate governance in response to expansion
Recent Developments

- Amendment of Companies Act and comply or explain approach for one outside director
- Strengthening and disclosure of proxy voting standards and voting results
- FSA stewardship code
- TSE’s new JPX-Nikkei Index 400
- LDP discussion of corporate governance code
Conclusion

- Japanese corporate management and governance evolving due to both governance pressures and business necessity in the age of globalization.
- Progress may be dictated by three emerging trends: 1) role of domestic institutional investors, 2) hybrid structures, and 3) overseas expansion AND integration.
- Question: Will current innovative practices at individual companies result in a code of best practices that can be applied more widely to improve corporate governance in Japan?