REFORMING JAPANESE CORPORATE GOVERNANCE

A THESIS
SUBMITTED TO THE
STANFORD PROGRAM IN INTERNATIONAL LEGAL STUDIES
AT THE STANFORD LAW SCHOOL,
STANFORD UNIVERSITY
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
JURIS SCIENCE MASTER

By
Lisa Ono
May 1997
Abstract

The objective of this thesis is to suggest how Japan should reform its corporate governance system based on the concern that the Japan's current monitoring mechanism allows corporate managers to neglect returns on equity in favor of maximizing the other kinds of benefits accruing from relationship within the corporate group, so-called kigyo-shudan, that is becoming increasingly problematic due to the changes both in the Japanese and the global economy.

This thesis attempts to answer whether introducing U.S.-style institutional investor activism in Japan is desirable for Japanese corporate governance, which forms of activism are useful in the Japanese corporate structure, considering particular problems with existing monitoring mechanism and if institutional-investor activism cannot effectively monitor corporate management, what reforms would establish an effective monitoring mechanism. This thesis concludes that fostering U.S.-style institutional activism in Japan would likely to duplicate rather than remove the conflict of interest between corporate group members and outside shareholders. It argues rather that the development of Japan's capital market so as to generates more new market participants is necessary for the effective institutional reform of Japanese corporate governance. It proposes that in order to establish a viable capital market, reform efforts should be focused on deregulation aimed at removing the constraints that have discouraged potential outside investors from entering the Japanese capital market. It propose the reform should also be directed toward tightening loose corporate financial disclosure requirements and toward establishing the rigorous and formal enforcement of such requirements so as to provide a transparent, increasingly fair and, to outside or new investors, attractive capital market.
Table of Contents

I. Introduction
   A. Corporate Governance Debate in Japan
      1. Domestic Factors
      2. International Factors
   B. Trends in Recent Corporate Governance Discussion
   C. Research Objectives

II. Corporate Monitoring Mechanisms in Japan
   A. Development of Corporate Groups
   B. Problem with Corporate Groups as a Monitoring Mechanism
      1. Main Banks
         i. Monitoring by Main Banks
         ii. Problems of Main Banks' Monitoring
      2. Corporate Groups
         i. Monitoring by Corporate Shareholders
         ii. Problems of Cross Ownership
   C. Need for Corporate Governance Reform
      1. Changes in Japanese Economy
      2. International Pressure

III. Development of the Capital Market in the U.S. and in Japan
   A. Laws and regulations concerning Corporate Finance
      1. Japan
      2. U.S.
   B. Disclosure Laws and Regulations
      1. Japan
      2. U.S.

IV. Introducing U.S.-style Institutional Investor Activism in Japan
   A. Institutional Investor Activism in the U.S.
      1. Development of U.S. Institutional Investor Activism
      2. Current Trends and Arguments of U.S. Institutional Investor Activism
         i. Coordinated Activism
ii. Shareholders' Advisory Committee
iii. Influence on Composition of the Board

3. Arguments on desirability of U.S. Institutional Investor Activism

4. Institutional Investor Conflicts of Interests
   i. Conflict of Interest with Other Shareholders
      a. Private institutions
      b. Public pension fund
   ii. Conflict of Interests with Beneficiaries
      a. Private institutions
      b. Public pension funds

5. Summary

B. Arguments by Japanese Scholars

C. Comments

1. Comments on introducing each type of activism
   i. Coordinated Activism
   ii. Shareholders' Advisory Committee
   iii. Outside-director or Outside-auditor Solution

2. Comments on Introducing U.S.-Style Institutional Investors Activism in Japan

V. Policy Proposal

A. Focus of Reform Efforts

B. Development of the Capital Market

   1. Deregulation

   2. Disclosure
      i. Accounting Standard
      ii. Regulatory Agency

VI. Conclusion