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**Article**

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**ACCOUNTING, CORPORATE GOVERNANCE & BUSINESS ETHICS |  
RESEARCH ARTICLE**

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## ACCOUNTING, CORPORATE GOVERNANCE & BUSINESS ETHICS | RESEARCH ARTICLE

# Corporate Governance Reforms in Japan: Instilling the New Regime

Kostiantyn Ovsiannikov<sup>1\*</sup>

**Abstract:** This paper analyzes recent transformations in Japanese corporate governance within the context of the 2002 reform of the Japanese Commercial Code and the ensuing legislations. It is widely recognized that ongoing changes in Japanese corporate governance are aimed at incorporating key principles of Anglo-Saxon corporate law. However, this alone does not explain why, under the minimal role of market for corporate control and with predominantly insider-oriented boards, directors of Japanese stock-listed enterprises have become increasingly sensitive to indices reflecting their companies' share value. The paper argues that this shift is caused by the newly emerging regime of veridiction. The latter, as the study indicates, is the normative discourse constituted on the basis of Japanese corporate governance enactments over the last two decades.

**Subjects:** Japanese Business; Critical Management Studies; Corporate Governance; Business Ethics; Asian Business; Organizational Change

**Keywords:** corporate governance; institutions; Japan; regime of veridiction; Foucault

### 1. Introduction

During the last two decades, Japan has experienced lasting economic stagnation. It has been mainly rooted in an inadequate state response to the ever-growing influence of the market starting from



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### ABOUT THE AUTHOR

Kostiantyn Ovsiannikov is a PhD candidate enrolled in the Doctoral Program in International and Advanced Japanese Studies at the University of Tsukuba, Japan. His research mainly deals with Japan's corporate governance, as well as continuity and change in the Japanese political and economic institutions. He is a member of the Association of Japanese Business Studies (AJBS) and the World Interdisciplinary Network for Institutional Research (WINIR). He currently works on the topic of corporate governance reforms in Japan, their possible conceptualization and implications. His study aims to address the gap in business research that employs analytical framework other than the dominant agency theory. According to his opinion, Japan's moderate and fragmentary implementation of shareholder-oriented policies can provide a valuable lesson for other "coordinated market economies", such as, for example, Germany, Austria and Sweden.

### PUBLIC INTEREST STATEMENT

Due to a prolonged economic stagnation in Japan, there is a general consensus on the need to reform its inward-oriented corporate governance. Managers, board, government and investors—all of them recognize the growing role of market for corporate control. At the same time, the moderate pace of corporate reforms indicates a presence of a strong institutional resistance to outside supervision. However, as foreign investors have recently become the largest shareholder group in Japan (29.8%), they naturally claim more credentials. The tradeoff between two parties has been following. On one hand, outside investors and government have not insisted on mandatory introduction of arm's-length supervisors. On the other, board and management have started paying increased attention to share value as a tribute to shareholders' interests. This, as the paper concludes, has been a result of the acceptance of shareholder discourse as normative, although the formal transformations have been very minor.



the late 1980s (Amyx, 2004). The belated financial deregulation that occurred in the late 1990s was evidence of the eventual recognition of the market as a legitimizing factor by the Japanese Government. The subsequent reforms of Japanese corporate governance viewed as a structural component of the country's macroeconomic strategy have been aimed at transposing market competition onto the corporate level (Japan's Corporate Governance Code's, 2015).

Before 1980s, Japanese financial sector was highly regulated due to the presence of financial intermediaries that generated stable sources of indirect finance in the form of bank loans to the firms (Toya & Amyx, 2006). Until the early 1980s, close and lasting partnerships between corporate and financial institutions called the main bank system (MBS) were the major source of corporate capital. However, since 1980s, Japanese companies have been increasingly relying on equity finance. As a rule, this implies growing dependency on market monitoring as a source of corporate evaluation resulting in certain degree of "attractiveness" to investors. While raising share value is considered to be a key responsibility for the managers of listed companies (OECD, 1999) from the mainstream "agency theory" standpoint, the compliance with this requirement has to be carried out by independent directors viewed as shareholders' agents (Alchian & Demsetz, 1972; Jensen & Meckling, 1976).

During the post-war period, shareholders in Japanese public companies did not have the capacity to directly monitor their investee firms. Even with the current rise in shareholder finance, firms' boards remain predominantly inward-oriented (Japan Association of Corporate Directors, 2016b). Hence, the need for corporate management to be accountable to corporate owners for solving the "agency problem" has become a cornerstone in recent Japanese corporate governance reforms (Nakamura, 2011). The agenda for enhancing shareholders' rights in Japanese listed firms has been largely shaped by the government (Nakamura & Nakamura, 2016) and foreign institutional investors like pension, mutual, and insurance funds (Ahmadjian, 2007) that enhanced the constitution of market as a legitimizing agency for publicly traded companies. On the other hand, the implementation of corporate governance reforms has been greatly affected by the entrenched institutional legacy.

In the heyday of the Japanese economy from 1960s till 1980s, the local corporate governance model concerned with well-being of various stakeholders rather than share value alone was considered an alternative to the "Anglo-Saxon" shareholder model (Aoki, 1988). However, since early 1990s, against the background of Japan's financial bubble burst, academia has become overwhelmingly preoccupied with the "principal-agent" or "agency" theory (Dore, 2008). The hegemonic view of respective economic and business-related studies has been centered on managers acting on behalf of shareholders rather than carrying out tasks from the point of firm-specific expedience. Granting the existence of various types of managers' motivation not limited to maximization of returns to capital, according the Varieties of Capitalism theory (Hall & Soskice, 2001), authors such as Lazonick and O'Sullivan (2000), Dore (2008), van der Zwan (2014) and Mees (2015) criticize the agency theory for presenting shareholder model as "one-size-fits-all".

According to Lazonick and O'Sullivan (2000, p. 14): "as a precondition for considering the arguments for 'maximizing shareholder value' in those nations in which it is not yet an entrenched principle of corporate governance, it is imperative that we understand the evolution and impact of the quest for shareholder value in the United States over the past two decades." From the critical perspective, the Japanese policy-makers seem to have made a choice in favor of shareholder model due to lost trust in local institutions against sluggish economic growth, as well as a growing proportion of foreign shareholding leading to inevitable promotion of shareholder-value discourse (Dore, 2007). Japan's corporate governance reforms were largely tailored after the 2002 Sarbanes-Oxley act, designed to ensure managers' accountability toward shareholders within the "Anglo-Saxon" environment. However, by and large, conversion remained minimal due to institutional resistance of Japan's business against direct outside interference with firm's monitoring (Ahmadjian, 2007). On the other hand, because of the initial weakening of the post-war firm-finance nexus, corporate board and management have become increasingly sensitive to equity-market demands.

### 1.1. Research question

How is it possible to conceptualize the role of Japan's corporate governance reforms, given that enhancement of share-value at Japanese joint-stock companies has been promoted under a minimal role of arm's-length monitoring?

### 1.2. Contextual insights

The kind of change the government and foreign shareholders have argued for, had to be promoted within an adverse environment. Namely, execution and monitoring have mostly been unseparated under Japan's stakeholder model. Unlike the "Anglo-Saxon" disciplining by market evolving through a possibility of hostile takeover, monitoring of Japanese firms is known to be relational and trust-based (Buchanan & Deakin, 2007). Therefore, in order to subject managerial behavior to outside instance, such as institutional investors, policy-makers had to ensure managers that the drift toward market-based discipline is, firstly, inevitable, and, secondly, evolves as a non-compulsory initiative. Although, formally, only a handful of Japanese listed firms made their boards outsider-dominated (Japan Association of Corporate Directors, 2016b), the shareholder discourse has become essential in formulating their agenda. Thus, Japan's example can prove instrumental for other "coordinated market economies" in exploring possibilities of shareholder rights' enhancement without abandoning stakeholder foundations.

### 1.3. Research gap

Granting the discrepancy between the legally promoted corporate governance reforms and the Japanese institutional peculiarities, authors such as Senechal (2003) consider an American-based model a treatment for the malfunctioning Japanese system. Itami (2005) presents an argument that the revision of the Commercial Code is likely to introduce US-like shareholder principles into Japanese corporate governance, and the two systems would partially converge. Komiyama and Masaoka (2002) underline the normative character of the stakeholder model. Others ground their analyses in legal drawings of the respective Japanese decrees from analogous American and British regulations, from the Organisation for Economic Co-operation and Development (OECD) corporate governance principles (1999, 2004) and International Monetary Fund (IMF) recommendations (Aoyagi & Ganelli, 2014).

In turn, Jacoby (2007) points at the shortcomings of convergence hypothesis. Firstly, he argues that the choice of a dominant model is often shaped by admiration of a present-day economic success that might well be transient. Secondly, as regards to Japan, instead of stylized homogeneity possibly converging toward dominant model, one rather sees at least two different institutional setups for large export-oriented enterprises and SMEs (Jacoby, 2007). Miyajima (1998) also presents arguments against convergence theory, suggesting that in spite of the irreversible character of corporate deregulation, an emerging market-based discipline will be affected by the legacy of the Japanese stakeholder model. This view stresses the necessity of institutional transformations for the legal changes to take place.

Epstein (2005) and Dore (2008) list a number of institutional requirements for the transition to a stakeholder model of corporate governance. Notably, such necessary attributes as "growing dominance of capital market financial systems over bank-based financial systems" (Epstein, 2005) and "growth in and increasing complexity of intermediating activities, very largely of a speculative kind, between savers and the users of capital in the real economy" (Dore, 2008) are not characteristic to Japan (Froud, Haslam, Johal, & Williams, 2000).

Granting the absence of the required institutional framework for the emergence of a stakeholder model in Japan, it is necessary to consider how we can conceptualize the ongoing corporate governance reforms. This paper aims to offer a solution by referring to the statement of Morgan and Takahashi (2002, p. 170): "The institutional context for stakeholder value discourse has to be created and in some cases engineered into existence." The last two decades have reflected continuous efforts on the part of the Japanese government and institutional (mainly—foreign) investors to

orchestrate a new shareholder value discourse. Dore (2008, p. 1098) indicated that transition from an inward-oriented to a market-based model implies “increasing efforts on the part of government to promote an ‘equity culture’ in the belief that it will enhance the ability of its own nationals to compete internationally,” which resembles the message of Japan’s Revitalization Strategy (2014, p. 6). This study argues that the “regime of veridiction” theory of Michel Foucault is appropriate for conceptualizing the shareholder model that has so far been primarily evident in Japan as the discourse articulated from above.

Only few authors have approached Japanese corporate governance from this angle. In addition to a valuable contribution by Morgan and Takahashi (2002), Chikudate (2000) has applied Foucauldian methodology in relation to Japanese corporate governance. He analyzed corporate frauds by the Japanese security brokerage houses during 1997 and 1998 by investigating the epistemology of their normative control. Instead of juxtaposing corporate culture as an unchallengeable code of a firm’s conduct, he offered to look at the interplay between formal organizational rules and tacit corporate practices. In addition, Fu (2013; 2015) has studied the discursive justification for the spread of *haken*—“dispatched workers”—as part of ongoing neoliberal reforms.

#### **1.4. Research motivation and contribution**

For international business and management studies, Japan presents a valuable case of corporate governance reforms being promoted from within, due to a very limited acceptance of outsider supervision (Inagami & Whittaker, 2005). This study contributes to the critique of convergence hypothesis, which is closely linked to agency theory. As argued by the Varieties of Capitalism literature (Hall & Soskice, 2001) as well as other critical management scholars (Mees, 2015), agency theory does not adequately capture regional institutional differences. Thus, the study suggests the ways to conceptualize corporate governance deregulation that follows institutional patterns rather than adopted legal blueprints. In particular, this article argues for the relevance of the “regime” theory that can prove instrumental in accessing government- and foreign-initiated discursive pressure to promote market-oriented model amid the crisis of the insider model.

#### **1.5. Theory**

Michel Foucault gives definition to the “*Regime of Veridiction*” in his 1978–1979 lectures “The Birth of Biopolitics.” This concept consists in “the constitution of a particular right of truth on the basis of a legal situation, the law and truth relationship finding its privileged expression in discourse, the discourse in which law is formulated and in which what can be true or false is formulated; the regime of veridiction is not a law of truth, but the set of rules enabling one to establish which statements in a given discourse can be described as true or false” (Foucault, 2008, p. 35). The usage of a regime theory in corporate governance means that we recognize the constitution of managerial and board’s priorities through the application of political power. The latter initiates shift in corporate practices, thereby enhancing governmental goals via discursive means (Fu, 2015; Roberts, 2001).

Due to the dispersed and unpredictable nature of power enforcement stemming from the market, it is hard to identify its source in advance. In “*Discipline and Punish*”—Foucault’s central work for business historians (McKinlay, 2006)—he classifies this kind of power as “disciplinary.” Discipline is “a functional mechanism that must improve the exercise of power by making it lighter, more rapid, more effective, a design of subtle coercion for a society to come” (Foucault, 1979). Moreover, the way discipline is implemented greatly depends on institutions. Thus, in our case, the effects of legal reform of corporate governance vary according to the interaction of vested interests ranging from government to various corporate stakeholders.

#### **1.6. Objective**

This paper attempts to find out, what is called in Foucauldian terms—the intersections of jurisdiction (corporate governance enactments) and veridiction (pro-market discourse vs. institutional constraints) that are responsible for defining the normative categories of truth (Foucault, 2008) within the field of Japan’s corporate governance.

### 1.7. Methodology

Analysis is primarily based on the texts of Japanese corporate governance legislations from the 2002 Commercial Code reform till the 2015 Japan's Corporate Governance Code. Other primary sources include Japan's Revitalization Strategy, Keidanren (Japan Business Federation) discussion paper, Tokyo Stock Exchange (TSE) regulations, Japan Association of Corporate Directors (JACD) papers as well as OECD, World Bank and IMF documents that frame international corporate governance standards.

This study employs qualitative methodology. The choice is justified by the literature review of McNulty, Zattoni, and Douglas (2013) who identify a substantial lack of qualitative studies within corporate governance discipline. Qualitative methods can prove particularly useful when combined with theories other than a dominant agency theory and thereby “produce new and innovative interpretations of corporate governance phenomena” (McNulty et al., 2013, p. 195).

### 1.8. Hypotheses

- (1) Recent reforms of Japanese corporate governance have been conditioned by the imposition of market discipline. Essentially the government and the growing proportion of foreign shareholders have articulated the initiation of the market-based regime through discursive shaping.
- (2) Introduction of market discipline has been affected by the legacy of Japanese institutions that play key regulatory roles in maintaining the principles of stakeholders' treatment. Their main difference from a utilitarian shareholder model is a presence of an ethical component of corporate governance.

### 1.9. Structure

The first part of the paper presents the outline of the institutional context that provides both incentives and constraints for the potential entrenchment of shareholder discourse in Japan. The paper identifies major parties interested in the growing participation of the listed companies in financial markets. In the following sections, I consider the “legal situation”—a foundation for an emerging regime of veridiction—as a series of legislations starting from the 2002 Japanese Commercial Code (JCC) reform. Following the methodological dichotomy offered by Yamauchi (2015), I analyze each of those enactments by presenting respective competitive and institutional rationale. I argue that the former is attributed to governmental and foreign shareholders' initiatives, the latter—to the ethical principles embodied in a stakeholder model of corporate governance.

## 2. Institutional context for corporate governance reforms

The lasting economic crisis has changed the corporate discourse in Japan, so that it started to underline the importance of global standards of corporate governance for publicly traded companies (Ahmadjian & Okumura, 2011). “Global standards” mostly consider the *shareholder* model of corporate governance as normative. It mainly consists of the enhancement of board independence and managerial accountability in front of shareholders (OECD, 1999). Approached in a stylized manner, contrary to the shareholder model prevalent in Anglo-Saxon world, the *stakeholder* model, peculiar to Japan and a number of continental European countries “provides employment at decent wages, producing safe and reliable products at reasonable prices, contributing to local communities and making economies grow by promoting innovation, increasingly in dialogue with government officials” (Dore, 2008, pp. 1102–1103).

Tracing the parallels between national and corporate governance, the stakeholder model implies the utmost importance of a “sovereign” aspect (ethical principles of social servitude) of the firm, whereas the shareholder model reflects the preoccupation with financial indices such as earnings per share and return on equity (Jackson & Carter, 1995). The 1980s' neoliberal shift in the Anglo-Saxon world induced a utilitarian transformation of the “economically inefficient” stakeholder

system into a shareholder one. Thereby, the dominant discourse of corporate governance has become centered on the agency approach. It implies an essentialist view of the *individual* as a self-interested opportunist. Foucauldian method, in turn, concentrates on a *subject* as the product of social relations (Roberts, 2001). Institutional theory of corporate governance is also centered on positing the socially constructed subject as opposed to agency theory that by and large takes individual motivations for granted (Seal, 2006).

This plays an even more significant role due to the fundamental differences in the structure of social relations within a Japanese company. They would not satisfy the basic assumption of agency theory about the self-maximizing nature of managers and respective firm units that should therefore be checked by means of coercion and compete with each other (Alchian & Demsetz, 1972). Though generally lacking outsider supervision, Japanese directors are known for their empathy toward employees and dedication to long-term corporate goals (Ahmadjian & Okumura, 2011). The resulting cultivation of corporate family values often means lower returns to shareholders (Miyajima, 2014).

The above approaches correspond to two types of supervision required by shareholders to ensure the accountability of the investee-firms' managers. Under the stakeholder model, accountability can be ensured through relational monitoring. Hence, internal context is formed by ethical principles of the lasting coexistence that ensures mutual *trust*. On the other hand, the shareholder model implies arm's-length supervision by outside directors. Those directors should normally represent corporate shareholders interested in raising firm's share value, thus being agents of the "market's invisible hand." Contrary to the stakeholder model, shareholder governance is preoccupied with short-term returns, with ends justifying means under the "downsize and distribute" regime (Lazonick & O'Sullivan, 2000). Potentially seen as lacking social dimension by such firm's stakeholders as employees, this model legitimizes itself through a codified "technique of governance" thereby substituting the system of moral values peculiar to stakeholder model (Gomez & Korine, 2005). It also implies the separation of powers—with executive directors (managers) being monitored by non-executives (outside directors)—as well as corporate transparency for the sake of public control (Jensen & Meckling, 1976).

Resonating with the agency approach, the shareholder model considers managers as interest-seekers who cannot be trusted and thus need close outside supervision ideally carried out by market forces (Lazonick & O'Sullivan, 2000). At the end, as in the case of Bentham's ideal prison—"panopticon" (Foucault, 2008, p. 67)—CEOs learn to discipline themselves even in the absence of the eye of the beholder, however, under a constant fear of a hostile takeover (Roberts, 2001). Hence, the type of corporate governance where dispersed shareholders advocate their policies via outside directors roughly corresponds to the above-mentioned "disciplinary power" (Foucault, 1979). Alchian and Demsetz (1972) describe the effects of market control in the following way: "Teams of productive units, like business units, would evolve in apparent spontaneity in the market—without any central organizing agent, team manager, or boss."

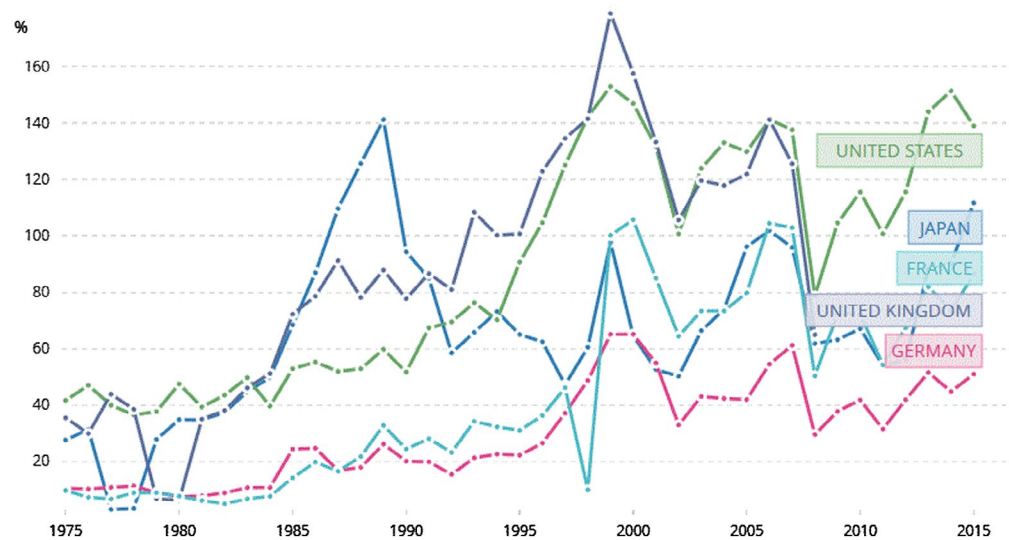
The drift toward the shareholder model is possible under certain institutional conditions that include individual participation in the stock market as well as the dominant role of equity funding for the national economy (Jürgens, Naumann, & Rupp, 2000). According to the The World Bank (2016), the market capitalization of Japanese listed companies is one of the highest among developed countries, accounting for 118.7% of GDP (Figure 1). On the other hand, as shown in Figure 2, according to the Tokyo Stock Exchange Shareownership Survey (2016), individual stock holding in Japan has been consistently decreasing since the 1970s, currently accounting for 17.5%. In contrast, nowadays, the largest portion of stock is held by foreign investors (29.8%).

Following the direction of Miyajima (2014), the survey infers that stock-market activity in Japan is spurred on by "outsiders" represented by "foreigners." On the other hand, high rates of stock-holding by such "insiders" as trust banks (18.8%—included in the "financial institutions" category) and business corporations (22.6%) illustrate the lasting legacy of cross-shareholding and adherence to bank finance.



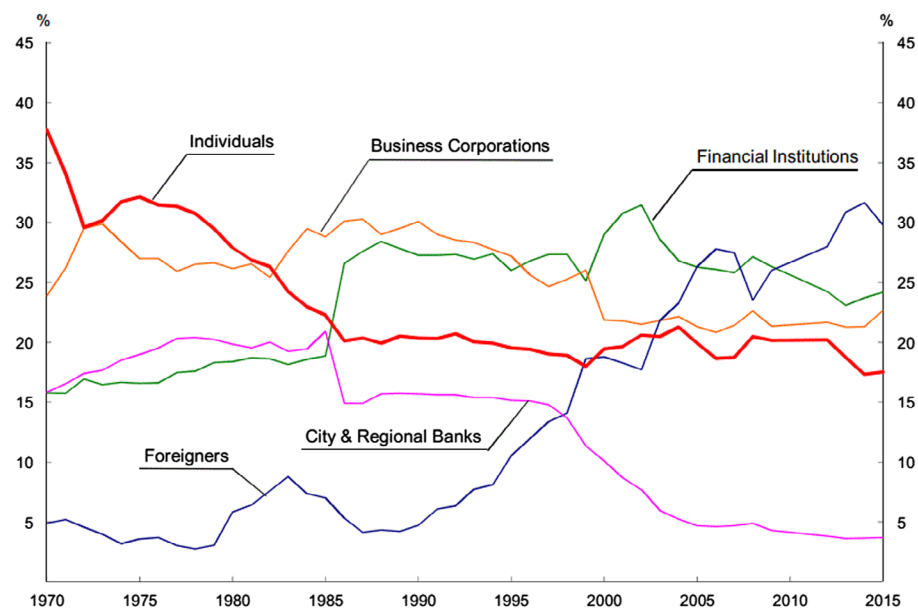
**Figure 1. Market capitalization of listed domestic companies (% of GDP).**

Source: The World Bank (2016).



**Figure 2. Distribution percent of market value owned by type of shareholder.**

Note: The market value of Financial Institutions excludes that of City & Regional Banks.  
 Source: TSE (2016).



Thus, applying the criteria of Jürgens et al. (2000), we are able to conclude that the role of equity finance for the Japanese economy is growing, which is largely due to the activity of foreign investors. On the other hand, Japanese households are quite unwilling to entrust their savings to financial markets.

In Japan, the shareholder value discourse is relatively new. It echoed the Anglo-Saxon departure from the view of managers as public servants bearing social responsibilities (Dore, 2008). Berle and Means (1932) offered a famous hypothesis that, with the growing number of shareholders and the resulting stockholding dispersion, managers would gradually become autonomous corporate rulers. This corresponds to the principal-agent vision of the relationship between shareholder and manager. The fact that since the 1980s, corporate managers in the Anglo-Saxon world have viewed their alignment with shareholders as a key, not obstacle, to strengthening their own corporate influence (Lazonick & O’Sullivan, 2000), can serve as an argument for viewing “principle-agent” interaction as reciprocal rather than one-sided. According to Müller, Zhai, Wang, and Shao (2016), voluntary

alliance of managers with shareholders is better captured by the “stewardship theory.” Moreover, it gives further reason for considering managers’ subjective formation as a dependent of the emerging regime of veridiction, whose main agency is the market.

In Japan, the legal approval of accord between shareholders and managers was the introduction of stock options in 1997 and continued with “the recognition of share buy-backs in 1998, stock swaps in 1999 and transfers of undertakings in 2001, as well as removal of the prohibition of owning own-company stocks” (Inagami & Whittaker, 2005, p. 73). However, in spite of the legal protection of minority shareholders as well as the increasing recognition of market for corporate control by the Japanese Government, the local institutions so far show little compatibility with the shareholder model.

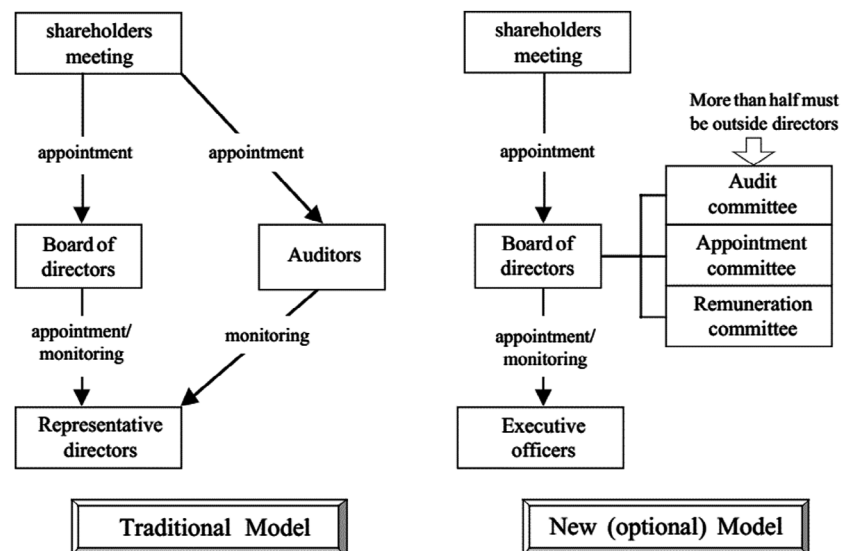
### 3. Statutory auditor (“Kansayaku”) system

The traditional Japanese corporate governance model called “statutory auditor” (*kansayaku*) originated in the first JCC that was drafted in 1899 in general accordance with German corporate law. *Kansayaku* was initially a shareholder (requirement lifted by the 1938 Commercial Code reform) called to monitor board of directors’ and managers’ activity, not however being a part of an executive board (Benes, 2013). During the US occupation in the post-war period, the JCC was amended in a way that transformed *kansayaku* into a merely symbolical body, whereby Japanese firms’ management was monitored by the board of directors after adoption of the Commercial Code in 1950. This was in line with the separation of management from shareholding and, respectively, holding companies’ prohibition. The parallel audit was undertaken by partner banks, which were embedded in the MBS and connected with corporations by cross-shareholding ties. The latter were relational, since both corporations and banks were linked by long-term mutual commitments as members of *keiretsu*<sup>1</sup> unions. From 1974 on the *kansayaku* function has been re-established. Eventually, the 1993 JCC amendment mandated a separate *kansayaku* board (“Audit and Supervisory Board”) and made it obligatory to have at least one outside statutory auditor (Lee & Allen, 2013). Finally, under the 2001 Commercial Code revision, more than a half of the *kansayaku* board are required to be outsiders.

The emerged model is described as a “unique dual monitoring system” (Araki, 2005, p. 30), since it allows for the existence of both supervisory board and statutory auditor (Figure 3). Although this system has been formally based on German civil law, the major difference between two models is that the Japanese auditor bears consulting functions, and thus does not challenge board’s decisions. The German analog, on contrary, has to represent the employees’ position, whose voice is also present within the board of directors.<sup>2</sup>

Figure 3. Two competing governance models.

Source: Araki (2005, p. 31).



The corporate governance reforms starting from 2002 were explicitly based on the “statutory auditor” (*kansayaku*) system. In spite of a mandatory outsiders’ majority at *kansayaku* board, the latter is highly dependable upon internal corporate policies. Thus, so far, the emerging regime, promoted from above, has had effects different from those expected by the government due to the entrenched nature of Japanese institutions known as “community firm” (Inagami & Whittaker, 2005).<sup>3</sup> Furthermore, *Keidanren*—the Japan Business Federation—has stressed the foundational role of corporate ethics that can preserve an existing corporate order (Nippon Keidanren, 2009, p. 13).

At the end, a contradiction arose between the governmentally declared aims to promote shareholder-oriented corporate governance, and the views of conservative Japanese business actors. Internal reports on corporate governance mention that, “Japanese firms have hitherto tended to have other objectives than the simple maximization of shareholder value, but by and large they start from the assumption that the *raison d’être* of business firms is much the same the world over” (Dore, 2000, p. 71).

On one hand, the growing emphasis on the *kansayaku* as outside agents of change showed the consensus over reforming the malfunctioning inward-oriented system (Waldenberger, 2015). On the other, the fact that the reforms’ seed was planted into the old soil demonstrated the longevity of the dual monitoring system. Thus, existent institutional checks induced managers and shareholders to search for a new regime of coexistence that would account both for the growing role of outsiders’ expertise and for the common interests of managers and employees in the Japanese “community company”.

#### 4. 2002 JCC reform

The 2002 JCC reform, brought into effect in April 2003, recommended large public companies “to allow outside directors to gain control of the board of directors through committees” (Itami, 2005, p. 4) in a US-like manner known as a three-committees’ system. Moreover, contrary to the pre-1990s’ restrictions for corporate stockholding by foreigners, the new legislation aimed at paving a more open way of governance. One of the reasons for the pressure extended to local listed firms, particularly from 1990s onwards has been an ever-growing proportion of foreign stockholding in Japan. It reached a record 31.7% at the end of 2014, surpassing the holding ratio of 27.4% by domestic financial institutions (TSE, 2015). Concurrently, the accounting standards for listed companies have been strengthened. In particular, firms are required to produce quarterly detailed reports about parent as well as subsidiary entities (Nakamura & Nakamura, 2016). Thereby, increase in foreign ownership has been going hand in hand with increased transparency.

The very idea of outside directors holding a majority in the committees originated from Anglo-Saxon corporate governance practices that underline the importance of corporate disclosure and the leading informational role of market indices. The reforms of Japanese corporate governance have been promoted under the supervision of the American Chamber of Commerce in Japan (Poe, Shimizu, & Simpson, 2002). Initiatives such as the committees’ introduction have been directly influenced by the US legislature like 2002 Sarbanes-Oxley Act. According to foreign investors’ view, “supervision should be separated from execution to promote objectivity’ in assessing managers’ performance” (Buchanan, 2007, p. 29). In contrast, the Japanese institutional logic has enhanced a “community firm” that implies primacy of contingent governance or internalism (Aoki, 1994), meaning the non-separation of monitoring from execution.

From 2003—the year of Commercial Code reform coming to effect—until December 2016, the number of companies that applied US-like committee system only increased from 44 to 70 (Japan Association of Corporate Directors, 2016b). Most of the reformist companies (60) belong to the TSE 1st section, constituting however only 3% of it. In general, the US-based model was applied in a highly selective way, with stock-prices not being significantly affected by the committees’ introduction (Gilson and Milhaupt, 2005). Even in those companies that agreed to adopt the committee system, outside directors are often appointed by the firm’s CEOs. As a result, while being formally an

independent auditor, an outside non-executive director is likely to feel obliged to the company that hired him for the expressed trust (Buchanan, 2007).

The moderate pace of the 2002 Commercial Code Reform implementation within Japanese corporate milieu can also be viewed as a process of a starting institutional transformation. It is reflected in high numbers of firms that chose a path of a gradual change—to appoint outsiders to the board of auditors. By August 2016, 97.2% of TSE 1st section companies elected independent directors (Japan Association of Corporate Directors, 2016a, p. 4). In the case of companies with a traditional statutory auditor system, this action was voluntary, and mostly caused by market reputational concerns (Shishido, 2007).

The governmental and foreign-investors' push toward the shareholder model has been motivated by the claimed lack of managerial responsiveness toward investors' demands. From the institutional point of view, the automatic transformation in favor of the outside "committee system" would bear obvious risks. These are due to the fact that outside observers by definition lack information concerning corporate affairs. Therefore, their disciplinary action could interfere with firm's ethical context and thus impede its proper functioning. However, in spite of the low proportion of the firms that switched to the committee system, the numbers of outside directors were growing. Even though non-executives did not form a majority in their committees, the mere reputational role of their presence marked the growing institutional recognition of the market for corporate control.

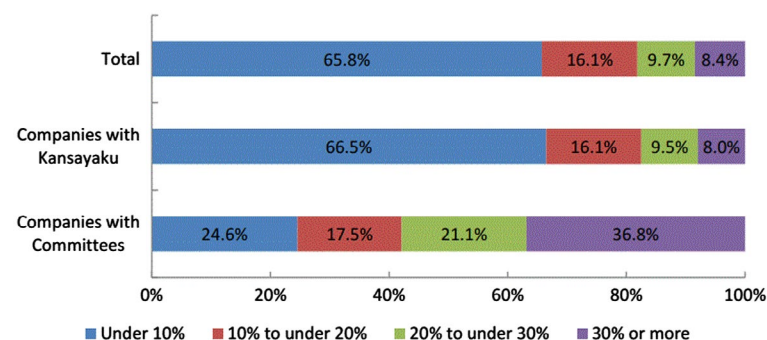
### 5. "Comply or explain" principle

Institutional flexibility inscribed into the 2002 Commercial Code has allowed for a choice between statutory auditor and committee system. Throughout early 2000s, the government allowed the decision of whether to adopt the new scheme of corporate governance to be made by the listed companies. It was reflected in the implementation of the "comply or explain [the non-compliance]" principle by the largest stock exchange in Japan, Tokyo Stock Exchange (2004, p. 23). The policy of underlying shareholders' interests, present in the "Principles of Corporate Governance for Listed Firms" formulated by the TSE in 2004 (TSE, 2004, p. 7), was kept in the analogous 2009 document (TSE, 2009, p. 5). At the same time, the moderate pace of corporate reform implementation left the "comply or explain" principle intact (TSE, 2009, p. 12).

The reason why the introduction of the committee system has remained voluntary until nowadays is the recognition of time needed for a potential adoption of shareholder principles within institutionally adverse environment. However, as presented in the TSE white paper (2013), the compatibility is likely to grow with the increasing proportion of foreign stockholding (Figure 4). The reverse tendency also holds true. Under reputational pressure for disclosing corporate affairs, some firms with low foreign shareholding, like Daiwa Securities and Ito-Yokado, chose to terminate their listed status (Jackson & Miyajima, 2007).

**Figure 4. Foreign shareholding ratio.**

Source: TSE (2015, p. 6).





For the companies that opted to continue their listing at the TSE, there have been no binding sanctions for the non-compliance with the 2002 Commercial Code requirements, mainly, the appointment of non-executives' majority to the board. The requirements have been somehow severed recently, with the 2015 Japan's Corporate Governance Code (JCGC) adding mandatory presence of at least two independent directors, in addition to previously mandated appointment of the outsiders' majority to the *kansayaku* board (Japan's Corporate Governance Code, 2015).

While legal provisions do not effectively stimulate the departure from relational monitoring, the ever growing disciplinary role is being played by market evaluation (Goto, 2013). With market authority becoming ever more apparent, even those managers less eager to implement corporate governance reforms have been increasingly associating their own performance with stock indices, paying more attention to share value and return on equity (Jacoby, 2007). Thereby, the "power of numbers" exercises reputational pressure on corporate managers, inducing them to impose discipline over themselves in order to reward shareholders. However, contrary to the US, this does not indicate the departure from stakeholder model. On the financial side, firms have retained most of their main-bank connections (TSE, 2015), and on the human resource side, the traditional lifetime-employment system was preserved for the core workers, being one of the top managerial priorities (Jacoby, 2007; JILPT, 2009).

#### **6. 2013 Japan revitalization strategy: promoting entrepreneurship**

Based on the presented evidence, one can presume that by giving evaluation authority to market, the reforms of Japanese corporate governance have aimed at empowering managers-entrepreneurs. In this regard, "the regulatory principle should not be so much the exchange of commodities as the mechanisms of competition" (Foucault, 2008, p. 147). In order to enhance such framework, it is necessary for government to turn competitive motivation into institutional rationale for listed companies. This is not only due to shareholders' demand, but also because of Japan's government macroeconomic strategy aimed at seizing equity-market opportunities in order to regain international competitiveness.

This has become an explicit case of the 2013 (revised in 2014) Japan Revitalization Strategy (JRS) implemented as part of Abenomics policies under the "structural reforms" (so-called "third arrow") title. As Kojima (2014) notes, the rationale of these reforms is to encourage corporate managers to take risky steps as a response to immediate market demands. The shareholder-based view on a firm's main task as profit-maximization has also been set by the JRS calling for "implementing specific measures to improve companies' earning power" (JRS, 2014, p. 6). Nakamura and Nakamura (2016) admits that the direction of Japan's corporate governance reforms has been primarily caused by the governmental adherence to the task of the shareholder value maximization.

Japanese structural reforms reverberate in the 2014 IMF working paper "Unstash the Cash! Corporate Governance Reform in Japan" (Aoyagi & Ganelli, 2014). It is noted there that Japanese companies prefer hoarding cash over investment. Such situation can be explained by still relatively high amounts of cross-shareholdings, accounting for about 10% of corporate stock-ownership against 15% in early 1990s (Lewis, 2015), as well as continuing importance of bank finance (TSE, 2015, p. 2). Due to this fact, the IMF emphasizes the role of outside directors that can contribute to corporate management's dialog with shareholders. Unlike CEOs promoted to board members, outside directors might not possess thorough firm-based knowledge. However, they are likely to take risks more frequently and to enhance control based on stochastic market discipline (Ahmadjian & Okumura, 2011).

The introduction of the JPX-Nikkei 400 index in 2014 was expected to foster the alignment of shareholders' and managers' interests. The constituencies of the newly created index are companies that relatively succeeded in enhancing their shareholder value through introduction of outside directors (Japan's Corporate Governance Code, 2015; Miyajima, 2014).

Thus, listed firms are likely to view other companies as rivals and strive to raise their share value by inclining toward riskier behavior. At the same time, the “downsize and redistribute” strategy peculiar to shareholder-oriented Anglo-Saxon companies, is not usually followed by Japanese CEOs, who do not view shareholder-oriented and employee-oriented policies as conflicting (Ahmadjian, 2007). This is due to a small number of outside directors, who, contrary to IMF and outside investors’ requirements, do not have substantial formal rights at the annual general meetings. This lack of formal leverages is, however, compensated through reputational pressure that increased foreign stockholding exercises over CEOs (Ahmadjian, 2007; Dore, 2007). In a nutshell, despite formal adherence to trust-based monitoring, listed-companies’ managers increasingly apply market-based criteria for self-evaluation. In this way market becomes a veridiction agency, gradually altering insider-oriented regime of corporate governance.

## 7. Discussion and conclusions

This study aimed to answer the question of how it is possible to conceptualize the role of the ongoing reforms of corporate governance in Japan. The problem of conceptualization results from the fact that, on one hand, only few Japanese joint-stock companies have followed legal recommendations to implement “Anglo-Saxon” committee system with independent directors’ majority, as it appeared in the text of 2002 Commercial Code reform. On the other hand, the crisis of the traditional inward-oriented regime coerced corporate managers and board to adopt other elements of a shareholder model (Nakamura & Nakamura, 2016). Amid the resistance to shareholder rights’ enhancement, the tradeoff between conservative directors/managers and outside investors took a shape of a compulsory nomination of at least two independent directors plus kansayaku-board’s majority. Although, according to convergence hypothesis, the above-mentioned formal transformations have not been significant, the Foucauldian regime theory offers to look not only at the legal side, but also at the formulation of the corporate agenda—i.e. veridiction.

The paper presented evidence of corporate governance discourse of Japanese stock-listed companies being increasingly influenced by the demands of government and foreign institutional investors to raise share-value returns. Importantly, companies were not forced to comply with new requirements. In turn, the “comply or explain” principle gave CEOs and board a freedom of choice on whether to adopt an American-like system. Although not coerced directly to alter their policies, executive directors have been increasingly linking own performance to indices reflecting shareholder orientation of their companies.

At the same time, the adoption of shareholder principles has not implied the departure from stakeholder foundations. Firstly, listed companies are still dependent on bank finance, although equity funding increases. Secondly, weakened but still continuing legacy of cross-shareholding provides companies with poison pills against hostile takeovers and thereby discourages CEOs to take risks, which impedes the implementation of Japan’s Revitalization Strategy. Lastly, Keidanren—Japan Business Federation—as well as overwhelming majority of Japanese managers consider long-term commitments to partner banks, customers, suppliers and employees as important as capital returns to shareholders.

In a nutshell, the combination of voluntary managerial and board’s subjection to market discipline with the retention of stakeholder principles make Japan a promising case for further critical business research.

### 7.1. Theoretical implications and limitations

Nakamura and Nakamura (2016) admits that it is difficult in economic terms to measure the impact of independent directors on board unless they constitute a majority. According to the hypothesis of this study, managers’ reorientation toward financial indices such as earnings per share and return on equity is largely conditioned by the governmentally instilled shareholder value discourse as well as pressure from foreign investors. However, it is problematic to isolate the reputational motivation of CEOs to present their companies as “attractive” to investors, from firms’ economic rationale to improve their financial accounts by utilizing equity-market opportunities.

Since the mandatory introduction of independent directors to boards is a very recent development, it is so far hardly possible to measure its impact on companies' economic performance. However, alone the fact that since 2002 Commercial Code reform, listed companies have been steadily uneager to introduce outsiders' majority, leads us to a conclusion that independent monitors have carried advisory and symbolic function rather than being arm's-length whistleblowers. This shows the merits of qualitative method that is able to capture shareholder-management relations outside the mainstream "principle-agent" framework, turning a closer look to what is known in Foucauldian terms as "subjugated knowledges" (Mees, 2015, p. 195).

Thus, current study contributes to the literature on stakeholder corporate governance peculiar to coordinated market economies such as Japan, Germany, Sweden, and Austria. The companies with pronounced internal hierarchical structure pertaining to these states are also inevitably influenced by the neoliberal-promoted market-based contractual obligations between shareholders and managers (Birch, 2016). The novelty of this study lies in the application of Foucauldian regime theory to Japan's joint-stock companies in order to show, how market can become a major disciplinary agency for corporate managers even in the absence of formal arm's-length enforcement mechanisms.

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#### Notes

1. Large enterprises peculiar for their cross-shareholding with subcontractors and links with partner-banks coordinated by the Bank of Japan (Westra, 2003, p. 365).
2. Taking employees' interests into account according to industry-based regulations in German case is referred to as "labor-management codetermination" (*Mitbestimmung*) (Whittaker & Deakin, 2009, p. 4).
3. The segment of Japanese labor market represented by large corporations is constituted by three pillars described in the OECD report (1973). These major organizational standpoints are: lifetime employment (*shūshin koyō*), seniority wage system (*nenkō joretsu*) and enterprise unions (*kigyō-betsu kumiai*). Such favorable policies toward permanent employees are related to stable shareholding: "The J-firm is a coalition of the body of stockholders and the body of employees, integrated and mediated by management, which acts to strike a balance between the interests of both sides" (Aoki, 1988, p. 101).

#### Cover image

Source: [http://patterncooler.com/gen/index/w/classic\\_japanese\\_wave\\_pattern-1069.jpg](http://patterncooler.com/gen/index/w/classic_japanese_wave_pattern-1069.jpg)

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