Japanese Corporate Governance: Behind Legal Norms

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“All people are the same. It is only their habits that are different.”
Confucius

Introduction

Corporate governance may be analyzed from different perspectives, one of them being its legal aspect. Instead of examining legal rules governing corporate governance, this paper will analyze the relationship between non-legal norms and corporate governance focusing on the influence that non-legal norms have on the way of functioning of corporate governance in practice.

Japanese corporate governance has often been the subject of attention of foreign scholars, particularly in debates on the comparative aspects of corporate governance.¹ The main focus is usually on the rules regulating corporate governance and legal reforms affecting those rules. The main bank system, cross-shareholding and long-term employment are usually mentioned as typical features of the Japanese model of corporate governance.²

The current literature on Japanese corporate governance relies often on

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contrasting arguments. Some scholars suggest that culture is dominantly responsible for the way of functioning of corporate governance. According to culturalist view, Japanese corporate governance is fundamentally different from Western patterns and its character is determined by the unique Japanese culture. The opposite view disputes this explanation by relying mainly on an economic rationale and focusing on the economic, legal and political factors arguing that these factors are the primary force driving Japanese corporate governance. This bipolar approach is also present in discussions related to other areas of Japanese law and practice, such as various theories concerning the low litigation rate in Japan.3

This paper will analyze the influences of various factors on Japanese corporate governance in light of arguments relied on by competing theories. One of the goals of this paper is to demonstrate that these theories are often oversimplified and fail to provide a complete picture of how Japanese corporate governance works in practice. To make this point, the paper will explore the world of corporate governance that exists behind the legal norms, particularly the influence Japanese social norms have on corporate governance.

The main objective of this paper is to highlight the background of the corporate governance in Japan by taking all dominant factors into consideration. The paper will analyze economic, political and legal factors that have contributed to the development of the Japanese model of corporate governance, as well as the importance of non-legal norms in the functioning of corporate governance in Japan. An analysis of the impact of the non-legal norms on corporate governance may provide new insights into the way culture interacts with legal norms in Japan and may contribute to a better understanding of the way in which Japan is currently adapting the system of corporate governance to its evolving business

Further objective of this paper relates to a general lack of a comprehensive analysis of the effect of non-legal norms on corporate governance in the wider corporate governance literature. This paper suggests that the cultural lens should not be forgotten when attempting to correctly understand how disparate systems of corporate governance work in practice. In this sense, the goal of this paper is not just to contribute to the Japanese corporate governance literature but to the understanding of corporate governance as a whole.

The paper will firstly address the basic structure and principle of Japanese corporate governance by giving an overview of both the legal regulation and non-legal norms used in the Japanese corporate governance. The paper will then analyze the influences of both the non-legal and legal norms on corporate governance in the light of arguments relied on by competing economic and cultural theories. The last part will explore the prospects for changes in the corporate governance in Japan as a consequence of economic decline in recent years, both with respect to the legal regulations and practices based on non-legal norms. The paper will conclude by evaluating the possible directions of the evolution of Japanese corporate governance in the future.

**Legal and Non-legal Norms**

All states have a set of rules embodied in codes, statutes or court cases that represent the formal legal order. Besides this formal set of rules, in most jurisdictions there is a separate set of informal norms that also play a role in the governance of society. These non-legal norms are usually based on traditional ways of doing things in a society and rely on moral values, such as trust and reputation. These norms may play important role in determining the actual implementation of the formal legal rules. As those non-legal norms are stronger

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4 In the context of this text, the term “legal norms” is understood as legal rules and standards articulated through formal institutional processes by legislatures, courts and administrative agencies as opposed to the “non-legal norms” understood as rules that evolved through a social custom or tradition without being recognized as legal rules by formal institutions.
and more important in a society, as will be the implementation of formal legal rules be weaker and less effective.

In Japan, as well as in some other Asian nations influenced by Confucianism, there is a stronger emphasis on community interests at the expense of individual ones, and more importance is given to moral norms at the expense of legal norms. Regulations of the corporate governance represent, to certain extent, just the façade behind which there exists a world that has its own life and logic far removed from the outside appearance.

An analysis of the Japanese legal regulations of corporate governance which would be separated from the social realities is bound to fail in its attempt to understand the Japanese corporate governance system. It may only reveal the rules, but not their life in the real world of practice concerning how they are applied, and how they function and shape the Japanese corporate world. Without understanding the cultural background, the Japanese system of corporate governance cannot be properly understood, and neither can the role played by legal rules be properly appreciated.

Legal Regulation of Japanese Corporate Governance

After Japan opened its doors to the outside world in the mid-19th century, Japan embarked on a process of modernization, but with a clear strategy to preserve its own values, while importing Western technology under the slogan “Japanese spirit, Western skills” (wakon yosai). This approach was buttressed by the educational system that continued to cultivate traditional values. As result, traditional social rules and customs continue to play an important role in Japanese society. Consequently, there are two sets of rules in Japan which have co-existed

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for over a hundred years: (1) the Western legal system; and (2) traditional informal norms.

Japanese legal system is based on legal transplants imported originally from Germany. In the post-war period Japanese law moved towards the American model, particularly in the corporate law area—as the American law during the occupation period heavily influenced the revision of the “black letter” corporate law towards the US model. American influence was also dominant after the “bubble burst” in the 1990’s. In discussions surrounding a new approach to corporate governance references were often made regarding the need to adopt ‘global standards’ of governance. This idea of ‘global standards’, though, was typically understood as the American standards.6

Adoption of the American model into Japanese business culture was unsuccessful. While in the post-war period Japan adopted corporate governance structures and rules based on American corporate law, in practice, they deviated substantially from the American model.7 Dependence on banks for financing, cross-shareholding, as well as the long-term employment system, all developed in the post-war period when Japan was supposedly following the American model. One of the paradoxes of the Japanese model is that during the period when the model was presumably under the influence of American-style corporate law, it actually departed from the American model. Some commentators described this divergence from the American model as a puzzle.8

Non-legal Norms and Corporate Governance

Corporate governance may be classified by using different criteria, including the social role of corporations, ownership structure, models of monitoring, and the differing nature of legal systems. While each of these criteria is important in distinguishing various systems of corporate governance, non-legal norms have received relatively little attention.

The question which has not been sufficiently explored is: in what way do non-legal norms influence the corporate governance system of individual countries? Despite various debates on comparative corporate governance, there have been remarkably few analyses of the link between non-legal norms and the changes in corporate law and practice. Many scholars writing about the legal aspect of Japanese corporate governance are aware of the cultural aspect, but for various reasons have limited their analysis to the legal aspect only, or have only vaguely touched upon non-legal norms.9

The role of non-legal norms in corporate governance has recently attracted the attention of some legal scholars.10 Milhaupt’s paper “The Evolution of Nonlegal Rules in Japanese Corporate Governance” is one of those few attempts focusing on the non-legal rules in Japanese corporate governance.11 While Milhaupt focuses on non-legal norms - in the sense that they are features of Japanese corporate governance that are not based on law, but play a very important role in Japanese corporate governance - this paper goes further by attempting to explain the background of those non-legal norms, as well as providing a more detailed elaboration on the way they affect functioning of corporate governance in practice. This paper will look at the issues arising from

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9 For example, Puchniak mentions culture briefly in his analysis of the role of hostile takeovers in post-war Japanese corporate governance but does not undertake an in depth analysis of the historical roots of Japanese culture and how traditional culture may have prevented hostile takeovers. Dan W. Puchniak, The Efficiency of Friendliness, supra note 2, 227-28, 259-60.


11 149 U. Pa. L. Rev. 2083
the link between Japanese culture and Japanese corporate governance from a perspective different from Milhaupt’s one, and will provide, in some cases, different conclusions.

**Characteristics of the Japanese Model**

The Japanese model corporate governance on its surface resembles many other models. Although there are several differences between the models of corporate governance of the United States and Japan, they still maintain the same basic structure. According to one leading Japanese legal scholar, the Japanese law resembles more the Anglo-Saxon shareholder-value model than the stakeholder model. However, this similarity is just in form, being a façade behind which a peculiar system of corporate governance operates, that is quite different from the one that can be seen from the outside. Behind the façade of legal norms that purport to regulate corporate governance, there exists the real world of corporate governance which is governed not only by legal norms, but also by non-legal norms that are rooted in the Japanese culture and are in many respects far more important than legal norms.

Japan has adopted Western legal institutions since the Meiji period, but these institutions have not operated in the same manner as in the West. The form was adopted from the West, but the way of doing things maintained a distinctive Japanese flavor. In case of corporate governance, the most typical features of the Japanese model include: the main bank system, cross-shareholding, long-term employment, and the close relationship between the business elite and the government.  

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13 There is a general consensus in the literature that the main bank, Keiretsu and lifetime employment are the three central features of Japan’s post-war system of corporate governance. However, two of the most prominent Japanese corporate governance scholars, Yoshiro Miwa and Mark Ramseyer, have recently published numerous articles and a book which suggest that all of the central features of Japanese corporate governance are “academic myths” (i.e., they do not exist). See for example, Yoshiro Miwa & J. Mark Ramseyer, THE FABLE OF KEIRETSU (U. Chi. Press, 2006); Yoshiro Miwa & J. Mark Ramseyer, The Myth of the Main
There are competing theories that attempt to explain the relevance of non-legal norms by relying on different rationale, such as economic, legal and political factors on one side, and culture on another. We shall use keiretsu and long-term employment as case studies to compare the arguments of these theories.

**Concept of Cross-shareholding**

The structure of a large publicly traded company is traditionally characterized by cross shareholding (keiretsu) which refers to mutual shareholding through which a number of companies are interconnected in a network of companies in which each of them holds shares in the other companies. In addition, the shares are held by banks, life insurance companies, individual shareholders and foreign companies. Keiretsu is a structural arrangement of Japanese firms that is characterized by close business relationships intertwined with long-term commitments among their members. Keiretsu means literally “economic line-ups”. This word includes something more than what is covered by the concept of cross-shareholding. There are various types of keiretsu (e.g. including supplier and distribution keiretsu - horizontal and vertical), but the main type are the keiretsu corporate groups (sometimes called “gurupu”), with the main bank at their center.

Normally, the shares held under these ongoing stable shareholding arrangements constitute the controlling portion of the firm’s shares. There is a

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14 Keiretsu is the term usually used in the English literature to denote cross-shareholding. In Japanese, cross-shareholding is usually called “mochiai” or “kabushiki mochiai”, while the term “keiretsu” usually refers to the network of companies.

15 Six major keiretsu groups are Mitsui, Mitsubishi, Sumitomo, Fuyo, Dai Ichi Kingyo and Sanwa.

mutual understanding between the companies that these shares are not to be traded but to be kept as safety mechanism. Member companies within a *keiretsu* offer each other preferential treatment in commercial and financial transactions. Through the main bank, they may exchange information and in time of crisis they are expected to help each other.

*Concept of Long-term Employment*

Long-term employment is another typical feature of the Japanese model. Under this system, which is not regulated by any particular law, but is based on informal norms and practice, an employee is recruited directly from school or university and is expected to remain in the company for the length of his or her career. In return, he or she can expect not to be fired or discharged, except under some extraordinary circumstances. The basis of this agreement is the commitment of employers to provide secure employment to their employees in return for loyalty and “lifetime” service. The employer can rely on loyal employees and their dedication to work hard, in exchange for the investment in their training. As a part of this system, the promotion of employees within the hierarchy of the company and the wages are based on the principle of seniority.

Mandatory retirement (*teinen*) system is an essential element of long-term employment which allows the employer to do away with employees automatically at the end. Historically, in the post-war period, the retirement age has been 55

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17 In Japan a distinction is made between investment shareholding and mutual shareholding. First one involves trading on the stock market, while second means that shares are not traded but are used to cement the relationship and prevent takeovers.


19 John Haley, a leading Japanese law scholar, has recently expressed the view that Japan’s lifetime employment system is the critical feature that defines Japanese corporate governance and makes it unique from other systems of corporate governance around the world. He also suggests that Japanese lifetime employment is largely a cultural phenomenon. John O. Haley, *Career Employment, Corporate Governance and Japanese Exceptionalism*, (Faculty Working Paper Series, Paper No. 04-04-01, 2004).
years old. However, recent amendments to Japan’s labor law mandate that it now must be 60 or higher. Presently most companies fix the age of retirement between 60 and 65. This system typically applies to workers in major Japanese companies, but is far less present in small companies.

Long-term employment does not mean a formal obligation of the company not to dismiss its employees, nor does it mean that the company does not dismiss employees, as this happens in practice. Rather, long-term employment should be understood in the sense that the company will not resort to layoffs unless the company is in deep economic crisis and layoff is the only possible way to keep the company afloat and prevent its bankruptcy. Even in time of crises, such as the oil shock crises, or more recently in the time of “lost decade”, instead of layoffs companies used other mechanisms aimed at avoiding layoffs, such as the reduction of overtime and assigning employees to affiliated companies.

Long-term employment is not really unique to Japan, since similar systems exist in many other countries. However, there are some elements of the long-term employment system that are typical for Japan and will be discussed in greater detail bellow, such as seniority based wages, on-the-job training and internal transfers based on rotation system.

Economic Theories

*Keiretsu*

Economic theories emphasize economic rationale, as well as legal and political factors as being the key factors in establishing *keiretsu*. They point out the fact

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20 Article 8 of the Act Concerning Stabilization of Employment of Older Persons [Law No. 103 of 2004]. This Act entered into force on April 1, 2006.
23 “Economic theories” is not really appropriate term, since in this text the theories covered by this term also include theories that emphasize legal, and political factors. This term is chosen as a matter of convenience to distinguish all other theories from the theories that
that individual shareholding decreased while the shareholding of financial institutions and corporations increased after the 1950’s, and particularly in the 1960’s and 1970’s. In the post-war period, individual shareholding fell from 69.1% in 1949 to 23.9% in 1986, while the ratio of shareholding by financial institutions increased from 9.9% in 1949 to 41.7% in 1986 and the ratio of shareholding by corporations increased from 5.6% in 1949 to 24.5% in 1986.\textsuperscript{24} This was a result of the easing of restrictions on ownership of shares by financial institutions and corporations due to the revision of the Anti-Monopoly Law. After the initial period in the 1950’s, when the Anti-Monopoly Act prohibited stockholding by companies, in the 1960’s, things radically changed. Japan became a member of the OECD in 1964 and one of the conditions for membership was the deregulation of its financial market. As the government relaxed the entry of foreign capital, there was a growing concern about possible takeovers of Japanese companies by foreign companies.

As a response to the liberalization of markets, large Japanese corporations created a defense mechanism by establishing a stable shareholding system with the participation of “friendly companies”. The process of concentration of shares in the hands of banks and corporations led to grouping corporations into the \textit{keiretsu}. Logically, this resulted in a substantial reduction of individual shareholdings. The shares became concentrated in a small group of financial organizations and corporations.

In response to these changes, the Commercial Code was revised and it allowed for the issuance of new shares to companies. This led to the concentration of shareholdings and the creation of \textit{keiretsu} which contributed to the relatively stable and concentrated ownership structure of Japanese companies. Hence, the \textit{keiretsu} was made possible by the government action which was behind the regulations allowing shareholdings by companies.

\textit{Long-term Employment} \\
Economic theories dispute the cultural roots of long-term employment by pointing out the fact that long-term employment did not exist as a firmly established system between the two World Wars. The origins of the long-term employment concept date from the early part of 20th century, when it gradually developed as a business strategy to avoid high fluctuation of workers that created difficulties for companies, particularly in key industries, such as iron and steel. To solve that problem, companies started to offer incentives designed to encourage experienced workers to stay, such as increased wages based on seniority and hefty retirement allowances for long-term workers. An ideological justification for the long-term employment relationship developed afterwards, tying it to Confucian notions of reciprocal obligations. At the start, however, the long-term employment was, in fact, a new strategy based on rational economic choice by employers. Long-term employment was firstly institutionalized only in the 1950s and became popular in the 1970s. The modern long-term employment system was allegedly designed as a result of compromise entered into between management and unions aimed at overcoming existing labor problems, being a mutually beneficial bargain rather than as a solution imposed by social norms.

Long-term employment in its present form developed due to economic factors, because it contributed to a greater productivity that benefited both the shareholders and management through higher profits on one hand, and labor through greater employment security on the other. It has also been argued that since long-term employment affects only a portion of employees, and is not universal, it cannot be based on culture, because culture assumes a set of norms and practices that are universal.

The legal framework that developed during the same period and supported long-term employment was arguably based on a government policy that

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26 Id. at 159-60.
27 Id at153-160.
28 Aoki, supra note 24 at 3-43.
encouraged the long-term employment practice. Political factors also played a role. The government supported the lifetime employment because it contributed to reducing the tensions between employers and employees that in case of escalation could have caused problems to the peace and stability of the State. This government policy was expressed through the legal framework which was aimed at supporting the lifetime employment system.

In parallel with this development, at about the same time, despite statutory provisions that permit dismissal, the Japanese courts have developed the doctrine of abusive dismissal in a number of cases starting in 1950’s, restricting in that way the employer’s power to dismiss employees.\textsuperscript{30} This led legal scholars to emphasize the importance of restrictions on termination of employment contracts under Japanese labor law as the factor that contributed to long-term employment.\textsuperscript{31}

\textbf{Cultural Theories}

\textit{Keiretsu}

According to the cultural explanation, stable shareholding is related to the Japanese group mentality. The cross-shareholding system is deeply rooted in the Japanese group mentality, since Japanese feel more confident in dealing with the people belonging to the same group, where trust serves as a bond which is considered as more important than any legally binding obligation. As result the Japanese firms have a tendency to “cluster themselves into groupings of affiliated companies that extend a broad spectrum of markets.”\textsuperscript{32}

\begin{footnotes}
\item[29] Wolf, \textit{supra} note 22, at 63.
\item[31] Miwa, Ramseyer, \textit{supra} note 13, at 159.
\end{footnotes}
Cultural theories point out the parallel between the traditional village and the grouping of companies into larger groups of *keiretsu* with the appropriate subordinate system in which all companies are subordinated to their respective presidents (*shacho*). The analogy with the *keiretsu* - traditional village, *kaisha* - home, *shacho* - family-head naturally flows from the cultural identification of the company as a substitute family in modern Japanese culture.  

The traditional village represents the paradigm. In a traditional Japanese village, there was a strong bond connecting all the people from the village and they maintained long-term mutual relationships. For those people, it was inconceivable to live outside their village. The sense of depending on each other as members of the community ensures mutual loyalty and provides a sense of security to the members.

If one company has difficulties, it is likely to be assisted by other companies from the same *keiretsu* (same as the villagers would help each other in case of calamities). More powerful companies are expected to support smaller ones. The sense of obligation towards the company may be linked with the sense of belonging to a family and the responsibility towards one’s own family. In the same sense, *keiretsu* also represents a kind of family with members that feel close to each other. In this sense, *keiretsu* is not purely an economic concept.

*Long-term Employment*

Cultural theories argue that social norms played a far more important role in creating the long-term employment system than the formal legal rules that regulate the conduct of employees. In contradiction to economic theories which

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deny the existence of long-term employment in Japanese tradition, cultural theories rely on the argument that long-term employment, in fact, has its roots in Japanese history. The kinship-based economic unit was established in the Tokugawa period and provided the basis for the long-term employment system, seniority-based status, which became the basis of the modern system of employment in Japan. In the Tokugawa period, Japanese business entities functioned like family businesses even when the employer would hire outsiders to manage the business. The employees were expected to show loyalty and dedication to the ie so that its name is preserved. “...the employees were trained from their boyhood to serve the ie (meaning “home”), and were expected to climb up the ladder beginning from detchi (丁稚 – apprentice), through tedai (手代 – assistant manager), to banto (番頭 - manager).” This represented the foundation of long-term employment based on seniority and loyalty to the company.

Japanese corporate culture is often described as a family system, in the sense that the Japanese company is based on the principles of a traditional family. The seeds of this family concept of companies are deeply rooted in Japanese culture, based on obedience, hierarchy and loyalty which all make up important elements of Japanese culture. Originally, the Confucian ethic of the group was typically applied to relationships in a family, which are traditionally lifetime relationships. The group concept was extended to the traditional ie and later on to the firm. ie was abolished as a legal unit by revisions of the Civil Code made after WWII. Nevertheless, the concept of ie still exists as an informal norm of the social structure in Japan. Japanese employees often refer to their companies as

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“uchi” (my house), to describe the company where they work.

According to cultural theories, kaisha (company) symbolizes the organization where people are not united by contractual relationships, but includes this element of association resembling that of a family. Of course, the kaisha provides the income that enables the employees to support themselves and their families, but it also involves an emotional linkage, which may also exist in the West, but usually not so deeply as in Japan. “The company is the people” is a common saying.40 By characterizing the company as a family unit, the company has achieved a greater level of loyalty between the management and the employees, because there is no conflict of interests between them. Each employee has an attachment to the company as “my company” (uchi no kaisha), so that all of the employees, in a sense, represent the company. If someone does something wrong, there will normally be solidarity between the employees who will try to protect him/her, because what was done was done for the company.41

The relationship between an employer and an employee is based on the hierarchical order in the line with Confucian teachings. In return for the employees’ loyalty and devotion to their duties, the employer is expected to treat them with benevolence.42 It has been recognized by Japanese scholars that devotion to the community plays a key role in suppressing individual desires for the common welfare of the group.43

40 Chie Nakane, JAPANESE SOCIETY (Pelican, 1970) 3.
41 There is a substantial number of cover ups by Japanese companies aimed at protecting their employees. Mitsubishi cover-up affair was one of the largest corporate scandals in Japanese history. In 2000 it was revealed that one of the Japanese giants, Mitsubishi Motors Corp. had suppressed complaints made by consumers to avoid massive and expensive recalls. Mitsubishi was forced to admit a systematic cover up of defect problems in its vehicles. In 1995 one of Daiwa Bank's bond traders, Toshihide Iguchi, in New York lost $1.1 billion speculating in the bond market. The company was later indicted for not reporting crimes by Iguchi including unauthorized sales of client's securities to cover losses.
42 Yoshikawa supra note 36 at 61.
One of the main features of Japanese industrial relations is the identification of employees with the company, which is related to a group mentality and the need of employees for a sense of belonging to a peer group. Working in a company is considered to be a part of one’s identity, and by moving to another company a person feels deprived of an important part of his/her identity. It is often said in Japan that an employee chooses a company, not a profession. Entry into the company is viewed as “being born again into another family.” Personal interrelationships give a feeling of belonging to a group (nakama ishiki) and security to the individual, but it may also result in a feeling of dependence. Community in Japan may be best understood in terms of mutual interdependency and a shared sense of belonging to a community, or group. The Japanese people even evaluate each other on the basis of the group they are affiliated with, making them very sensitive about the reputation and prestige of their group.

**Discrepancy between Legal and Non-Legal Norms**

The formal legal structure governing Japanese corporate governance is similar to the formal legal structure in many other jurisdictions. In Japan, however, there is a substantial gap between the legal norms and actual practice. This is a constant in Japan – the formal structure is adopted and then adjusted to the Japanese way of doing things, which continues to function in parallel with the formal system.

Examples of this discrepancy between form and practice can be seen in the way of functioning of the general shareholders meetings and the board of directors (BOD) – both of which demonstrate some idiosyncratic culturally based features of Japanese corporate governance. The way the BOD and general

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44 Nakane, *supra* note 40 at 11.
45 Abegglen, Stalk, *supra* note 18, at 200.
46 Sankei Shimada, the executive director of Nissho Iwai Trading Company who committed suicide following Douglas-Graman affair wrote the famous note before leaping from the building to his death: “The life of the company is eternal. For that immortality we must sacrifice ourselves.”
shareholders meetings function deviates significantly from the formal rules that regulate them. Under the law, the BOD is charged with monitoring corporate activities and is vested with the authority to make important managerial decisions.\(^{48}\) In practice, however, the BOD has not played this role, particularly with regard to the monitoring function. One of the key features (and problems) of corporate governance in Japan is that the BOD is dominated by the very same executives who are in charge of day-to-day operations of the company. Obviously, this kind of supervision has a flaw as it makes no sense if the monitors are those same persons that are to be monitored. Similarly, despite formally being a supreme organ of the company, shareholders meetings have been relegated in practice to merely formal rituals. Very few shareholders actually attend the meeting. Many shareholders meetings in Japan typically take only a few minutes to present business and financial reports, approve the distribution of profits and elect new directors and auditors. Such general meetings of shareholders where decisions are formally made represent just ceremonies of formality and public approval of decisions that have already been made in informal forums.

In order to understand the way of functioning of the company management, it is necessary to understand the process of making decisions and the role of informal ways of making decisions. In Japan the formal processes are rigid top-down involving a kind of ritual formality with importance given to seals and do not allow much deviation from the established rules. On the other hand, the informal processes are far more flexible and have a very different logic with great importance given to consensus and collective participation in making a decision. This informal way of making decisions through various forms of meetings and communications is based on personal relations rather than on formal ways of communication. The efforts made to achieve consensus and avoid disputes are incorporated in the way decisions are made. The decisions are often not made at the general meetings of shareholders or the BOD, but at informal places such as shacho-kai and jomukai.

Within the keiretsu system there is usually a group of presidents of

\(^{48}\) Article 362 of the Corporation Law (会社法), Law No.86/2005.
corporations who make up the so-called “shacho-kai” (Presidents Club), an informal organ which meets regularly.\textsuperscript{49} Shacho-kai is an important venue for fostering ties among the companies belonging to the same keiretsu. These meetings have, to a certain extent, a mysterious character, since the outsiders do not know what goes on at these meetings, no notes are taken, and no statements are made officially after those meetings. Due to the lack of information, there can be various speculations about the importance of those meetings.

\textit{Jomukai} can be translated as a “meeting of managing directors” and is aimed at supporting the BOD. A few senior directors acting as \textit{jomukai} or a similar informal management committee actually have the ultimate decision-making power. Decisions made by such bodies are usually final and the confirmation of such decisions at the meetings of the BOD is purely a formality to satisfy formal requirements. Although these meetings are not a part of Japan's formal corporate governance structure, they serve in practice as an important informal body that discusses the general corporate policy and strategy of the corporation.

This contradiction between legal and non-legal norms in practice reduces, to certain extent, the power of the formal organs of the company, since the real power is exercised in informal ways, largely outside those organs. It is well known that, while there are laws that exist on paper, the law in action often substantially deviates from these legal norms. If the general meetings of shareholders and the BOD are formally in charge of making key decisions for a company, but decisions are, in fact, being made by the \textit{jomukai} or President’s Club and only formally approved by the general meetings of shareholders, then the \textit{jomukai} and President’s Club actually represent institutions that are in many respects more relevant than the BOD and the general meetings of shareholders.

The contradiction between legal and non-legal norms should be taken into account when the issue of convergence is discussed. Gilson makes a distinction between a convergence in form and a functional convergence of

According to Gilson, each system of corporate governance is able to find functional equivalence without formal convergence. Gilson argues that corporate governance will be subject to functional convergence even without a formal convergence of legal rules. This can be seen from a completely opposite perspective, that there can be a formal convergence without a functional convergence. Japan is a good example. The choice of an American model does not mean functional convergence, but only a formal one. The law reforms brought about a formal convergence of rules, although the practices have remained basically the same. Those practices are determined dominantly by the non-legal norms in a clear contrast to the legal norms thereby demonstrating a functional divergence.

Role of Legal Norms

The way corporate governance functions in Japan raises the issue of the role of law in Japan, specifically, corporate law. Cultural theories downplay the importance of law by giving dominant importance to the role of social norms. There is a view that law is largely irrelevant to the social and economic organization in Japan.51 Some scholars doubt that legal reforms can be effective due to social and cultural constraints.52

On the other hand, probably majority of scholars attach much greater importance to the role of law. The increase of derivative suits in Japan has been used as illustration of the relevance of law in Japan.53 The sudden increase in shareholder derivative suits almost immediately after a reduction in the filing fees

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50 Ronald Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 Am. J. Comp. L. 329, 338 (2001).
52 Curtis J. Milhaupt and Mark D. West, Id. 198 (quoting Philip Lochner, Corporate Japan: Beginning of a New Era, Columbia Conference held on March 23 2001).
53 Between 1950 and 1990 there were fewer than twenty derivative suits. After the fee for filing derivative suit was reduced by law to modest amount of 8,000 yen, there has been a huge increase of derivative suits and by the end of 1999, there were 286 derivative suits,
in the early 1990s, as noted by Mark West, illustrates the importance of legal rules.

The argument that the number of derivative suits has substantially increased after lowering the court fees have strong persuasive force. However, this argument should be taken with some reservations. A logical question that may be asked is: Would the number of derivative suits would be equally high if the court fees were equally low from the very beginning when the law on derivative suits was enacted? My guess is that the answer would be “no”, because the issue of litigation rate is too complex to be explained by relying only on the amount of court fees.

In any case, the increase in derivative suits can be at least an illustration of a possible change in traditional attitudes towards law. This example, which is emphasized as evidence that the law matters, can be seen from the opposite perspective—that the law does not play a very important role and that the rise of derivative suits has received so much scholarly attention because it is a deviation from the norm where legal reforms normally had merely a marginal effect.

Role of law in Japan was not so visible during a long period, despite its existence on the books. For several decades after being introduced into Japanese corporate law, derivative suits remained dormant, despite the fact that many opportunities for such suits existed in response to various managerial abuses. Similarly, securities laws existed, but were not used in practice, despite widespread insider trading practices and market abuses. Anti-trust laws existed, but did little to prevent widespread bid rigging and cartels. The legal infrastructure for hostile takeovers existed, although not well developed, but Japan has remained largely free of hostile takeovers. These examples of extended stagnation illustrate the fact that legal transplants need certain time to

ninety-nine of which were filed in 1999 alone.


55 Puchniak claims that there has not been a single successful hostile takeover bid in the post-war period. Dan W. Puchniak, The Efficiency of Friendliness, supra note 2 at 195.
Role of law is becoming more prominent in parallel with the process of globalization and modernization of Japanese society. At this stage it might be difficult to accurately assess the role of law and there are still divergent views on that. Cultural theories that minimize the role of law gradually lose the ground and this process may accelerate in the coming years. On the other hand, theories that give excessive importance to the role of law and legal reforms, and underestimate the parallel systems and networks based on informal rules and norms, have a similar flaw. Nevertheless, the process of change in coming years will increasingly move in direction suggested by the latter theories.

The time will tell whether the present law reforms will end up in failure and just a “formal convergence”, without substantially changing the way of doing things, or they would bring substantial changes. The experience with law reforms in Japan has shown that even if the law reforms do not bring immediate results, they may still bring results at a later stage. Law often serves as a complement rather than a substitute for non-legal norms. That is a sign of a gradual process of reform of a society, which enables a smooth transition from a society governed by social norms towards society governed by legal norms.

**Role of Non-Legal Norms**

To understand accurately Japanese corporate governance it is critical to understand the way in which non-legal norms impact upon the practice of corporate governance. Reasons rooted in the Japanese culture lie behind the way Japan has integrated foreign legal concepts, including those related to corporate governance, such as the separation between ownership and management, the organization of the firm and the way in which management functions. These concepts cannot be fully understood if observed in isolation from the larger context of the Japanese social norms.

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Long-term employment may be used as illustration. One of the explanations for the development of long-term employment is that it is based on economic efficiency. Puchniak in his unpublished doctoral dissertation argued that “(D)espite a myriad of partial explanations for lifetime employment, the most powerful and straightforward explanation for its emergence and longevity has largely been overlooked: lifetime simply makes economic sense.”\(^{57}\) However, if this is the case, why do we not find such a system in any other country in the West? After all, economic efficiency theory is normally presumed to be universally applicable.

According to Milhaupt, “corporate norms may be the product of interest group dynamics”.\(^{58}\) This is one possible explanation which has some explanatory weight. However, Milhaupt’s explanation is incomplete as it fails to address why such norms arise in Japan, and whether the emergence of norms such as those related to long-term employment would be possible, for example, in the United States? If yes, then why is there a lack of such norms in the United States, at least in comparison to their prominence in Japan? If not, then why do such norms exist in Japan and not in the United States? The most persuasive answer to these questions can be found in a theory based on Japan’s social norms. The fact that similar patterns of long-term employment have developed in different situations and under different circumstances indicates to the existence of some integrating factor that played a role in the structuring of this system in Japan. Such patterns have not developed in most other parts of the world, at least not in the form this system existed and exists in Japan.

Social values may influence the choice of particular corporate structures and legal rules out of a larger menu.\(^{59}\) Those values are deeply embedded in people's minds and social institutions. As a result, practices that are compatible with social preferences in other areas are more likely to work smoothly in a


particular society.

Non-legal norms often play a more significant role in Japanese corporate governance than formal legal rules. Even though the non-legal norms did not play a direct role in the process of creation of cross-shareholding and long-term employment, they certainly had influence in the process of their acceptance and integration in the Japanese economic model, as well as in their functioning. The nature of cross-shareholding and the long-term employment system are perfectly congruent with Japanese cultural values, even if concepts were adopted on account of other considerations. The concept of long-term employment and the way it operates are familiar to employees based on their experiences and education outside the company. So, they tend to easily adjust to their new environment due to the well known patterns of conduct that they are accustomed to. In a similar way, cross-shareholding corresponds to the traditional patterns of cooperation in Japan. The fact that the cross-shareholding and the long-term employment system solution perfectly suit the Japanese traditional social norms only enhanced their successful implementation and functioning in practice.

Cultural theories discussing the influence of non-legal norms usually emphasize the importance of Confucianism. This argument should be taken with some reservation. Some scholars argue that Confucianism in Japan was used by the Japanese elite as a kind of “cultural engineering” for the manipulation and social control to promote the goals of the elite. According to this view, the metaphor of kaisha as a family may have been used to create a sense of family relationship among employees, while the actual reason for this “familistic rhetoric”, used in a wider context of “family state”, was to enhance managerial power. The use of the concept of ie was aimed at creating an image of culture based on relationships and to conceal the real reasons. Though, this kind of argument is more relevant for determining how the culture can be influenced, then how culture actually affects the business environment. Even if these patterns

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62 Van Wolferen, supra note 38, at 16.
developed as result of a cultural engineering, cultural explanation still has some weight. The question that can be asked is why such cultural engineering was not successful, or attempted in Western countries, but was successful in S. Korea, which shares similar culture with Japan?63

The role of non-legal norms in shaping the Japanese economic model should not be overestimated. While the factor of culture is certainly important in explaining different patterns of behavior, it is also critical not to overstate its importance and to avoid stereotypes.

Present Tendencies

In the present Japanese corporate governance some trends can be identified as result number of factors, such social changes, economic recession, and legislative actions. They are visible in all areas related to corporate governance.

Keiretsu

The decline of cross-shareholding seems to have stopped and its demise will probably not happen anytime soon. The keiretsu system may not change significantly, though some changes have occurred therein. While banks have reduced their shareholdings in the companies, the keiretsu will probably retain its "safety level" that makes hostile takeovers difficult. Although banks may not be able to re-establish their participation in cross-shareholding, such obstacles do not exist in case of firms and they have been active in re-establishing “stable shareholdings”. These new trends, however, are mainly result of the interests of certain actors, rather than being influenced by the social norms. The main reason for this revival is the fear of hostile takeovers that increased after the deregulation of mergers and acquisitions.

With respect to ownership structure, probably there have been the most

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visible changes. The shareholdings of banks and insurance companies, that have been traditionally management-friendly, have substantially declined. At the same time, the foreign shareholdings have increased radically.

Long-term Employment

In recent years, particularly since 1990’s, the long-term employment seems to be under pressure as a result of economic recession, as well as the globalization which has brought about various changes in the Japanese business and social environment.

There are several signs indicating the weakening of the long-term employment system in Japan, particularly after the collapse of the bubble economy in 1990’s. Economic decline required Japanese companies to be more flexible in hiring and firing employees than the traditional system has allowed. The companies have decided to lay off a substantial number of employees in the process of restructuring companies, while in the same period the number of part-time employees has been substantially increased. The largest difference in long-term employment in the last 10 years has been the increase in part-time employees. Since Japan has always had part-time employees in large companies, this is a change in scale not in form.

It has been repeatedly claimed that long-term employment is disappearing, or even that it does not exist anymore. The fact is, however, that many employees still believe today that they are employed for the rest of their working life at their company, unless something goes very wrong. Although employment customs are said to be changing, there is still a pervasive belief in Japan that it is only really morally acceptable to resort to layoff when the

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64 According to the Ministry of Health, Labour and Welfare Organisation (MHLW) figures, there were 34.18 million regular employees in Japan at the end of 2007 (average for October–December), while non-regular employees numbered 17.38 million, or 33.7% of the total. See, www.mhlw.go.jp
company faces bankruptcy. This informal understanding has been supported in a number of court cases.\textsuperscript{65} 

Although the economy will probably further suffer as a consequence of the global financial crisis that started in 2008, it is not likely that the long-term system will be abandoned, though it may be further modified. Attitude of the new Japanese Government, as well as some recent developments, such as Japan Post recently offering permanent employment to 65,000 of part-time employees, indicate that long-term employment may even have a comeback.\textsuperscript{66} Employment practices would thus remain one important segment of the Japanese model of corporate governance that has not converged with the American model, and it is not likely to converge in the foreseeable future.

\textit{Legal Reform of Corporate Governance}

A sweeping reform to Japanese corporate governance laws was introduced in 2002. Most of the debate on reforms have revolved around the clash between the American model, which is geared towards placing primary importance on shareholders and relying on external control, and the traditional Japanese model, which is primarily a stakeholder model based on internal control. Under the new law, Japanese corporations are given the option to select from two distinct corporate governance regimes – the Reformed Large Corporation based on conventional Japanese model and the New Type Company with committees based on the American model with an executive officer (CEO).\textsuperscript{67} Through these


\textsuperscript{66} \url{http://www.japantoday.com/category/business/view/japan-post-to-make-65000-nonregular-employees-into-full-time-workers}

\textsuperscript{67} Article 2 Definitions:

10. “Corporation with a Board of Auditors” shall mean a kabushiki kaisha which has established a Board of Auditors or a kabushiki kaisha in which the establishment of a Board of Auditors is required based on the provisions of this Law.

12. “Corporation with Committees” shall mean a kabushiki kaisha which has established a nomination committee, an audit committee and a compensation committee (hereinafter “the
reforms, the Japanese corporate governance has formally moved towards shareholders model.

There are several important changes that have been introduced in the existing corporate management structure. The biggest news was the establishment of a totally new governance structure known as the “Committee System”, which was viewed by some scholars as a sign of the Americanization of Japanese corporate governance.\(^{68}\) The companies are also given the possibility to retain the old model, as a Reformed Type Corporation. Puchniak’s article contains a useful chart which provides information on the available corporate governance structures for large Japanese companies before and after the reform.\(^{69}\) On 1 May 2006, the Corporation Law entered into force taking the Company Law outside the Commercial Code.\(^{70}\)

Outside directors have been in the centre of discussion and legal reforms as an attempt aimed at improvement of monitoring. However, this might have been a wrong decision, because the effectiveness of outside directors is highly questionable. Some companies may decide to incorporate outside directors precisely because they do not consider them as a threat to the management power. On the other hand, having outside directors may be useful to attract institutional shareholders from the US or the UK, as they feel more comfortable to invest in the companies that have outside directors.

Analysis of the law reforms made in Japan indicates that despite adopting some elements of the American corporate governance system, Japan, in fact, has retained the most important features of its traditional model. Factor that contributed to preserving the traditional way of doing things is that the structure of control of Japanese corporations, including the position of shareholders, has not been changed substantially. There has been much talk on the need to give greater protection to shareholders, but this has not been much more than “lip committees”\(^{68}\)


\(^{69}\) Puchniak, *The 2002 Reform, supra* note 2 at 50.
service”. The firm continues to be controlled by its top management, while shareholders are still prevented from exercising effective control over the corporation. Most shareholders still do not interfere much in the management of the companies and not many things have really changed in corporate governance.

For the moment, the corporate governance reforms have not led to radical changes in the board, the presence of outside directors has not been adopted as a standard, and stock-options and hostile takeovers are still a rarity in Japan.71 Meetings of shareholders have become, however, more serious indicating a greater readiness to accommodate the interests of shareholders. There is a growing tendency of individual shareholders attending the annual meetings and becoming more active at those meetings, often asking questions. As result, the duration of the meetings have become longer and in June 2006, the average duration of annual meetings was 52 minutes, four minutes longer than the previous year.72

Factors of Change

When discussing reasons that lie behind the changes in the Japanese corporate governance system, several challenging questions may be raised. Why did Japanese corporate governance remain stagnant in the postwar period until the 1980s, and why have legal norms that have been dormant for about forty years suddenly started to be applied? Have the Japanese courts and judges suddenly become aware of the tools they have had in their hands for almost forty years, but never resorting to using them? What is the impact of economic decline on the legal reforms? To answer these questions it is necessary to identify the relevant social, economic and legal factors that play a role in these changes.

Social factors
In recent years, the informal practices of corporate governance based on non-legal

70 Corporation Law (会社法), Law No.86/2005.
71 Puchniak,: The Efficiency of Friendliness, supra note 2 at 195.
norms and tradition seem to be under pressure as a result of globalization which has brought about various changes in the Japanese business and social environment. Japan has been gradually transformed, especially in the urban part and among the younger generation which is naturally more inclined to accepting changes and foreign influences. Younger Japanese have ideas about their careers that are different from those of their parents. They are less committed to long-term employment and are more likely to change companies if other companies offer better conditions. This also indicates the gradual modernization of Japanese society from being family and group-oriented towards an individual-oriented society that gradually adopts Western standards.\footnote{Masako Ishii-Kuntz, \textit{Collectivism or Individualism? Changing Patterns of Japanese Attitudes}, Sociology and Social Research, vol.73, 174-179 (1989).}

The attitude of Japanese towards law has also been changing for the past forty years. At the time many law reforms were being introduced, the readiness to use those legal norms for various reasons was still lacking. Over time, though, things have changed as a result of the globalization process at the international level, and the urbanization of Japan at the national level, which resulted in the weakening of social ties in society and a more open attitude to the changes that were coming from the outside world. In particular, after the 1970s the Japanese became increasingly ready and willing to resort to law as instrument for dispute resolution. This can be seen from the increase in the number of litigation cases.\footnote{See the statistics in, Tom Ginsburg, Glen Hoetker, \textit{The Unreluctant Litigant? An Empirical}
promoting reforms of corporate governance. One such organization is the Kabunushi (Shareholders) Ombudsman (KO) which comprises lawyers, accountants, academics and shareholders. It aims to reform Japanese management practices to incorporate the views of all shareholders in Japanese companies.\textsuperscript{75} In addition, one part of large business also showed readiness to embrace new ways of doing things. Notable example is Sony which introduced its \textit{Shikkoyakuin} (Executive Officer) system in 1997, that served as a model for the New Type Company.

\textit{Economic factors}

There have been also important changes in some economic factors, mainly as result of economic decline. The traditional features of the Japanese corporate model, the \textit{keiretsu}, the main bank system and long-term employment all suffered setbacks as a result of the prolonged economic crisis. The shareholdings of stable shareholders significantly declined in the 1990’s, while the shares of foreign shareholders increased. Faced by the problem of bad debts a number of banks had to dispose of substantial part of their shareholdings. There have been also a number of large mergers, particularly in the banking sector. Employees and managers have gradually adjusted to the previously painful experiences brought about by mergers.\textsuperscript{76} The crisis has also affected the long-term employment system, so now the Japanese people have learned to live with the new reality where there is no strong guarantee of long-term employment. Economic decline was one of key factors that pushed legal reforms since 1990’s and is very likely to continue to do so.

\textit{Legal factors}

\textit{Analysis of Japan’s Turn to Litigation, Journal of Legal Studies, 31, 37 (2006).}
\textsuperscript{75} \texttt{http://kabuombu.sakura.ne.jp/}
\textsuperscript{76} The identification with the company was one of causes for problems with mergers in Japan, and difficulties in full integration between two companies. Dai-Ichi Bank and Nihon Kangyo Bank which formed Dai-Ichi Kangyo Bank is often quoted as an illustration of those difficulties, since employees of these two banks continued to identify themselves with their original banks long after the merger and the banks continued to have two separate branches.
Despite the view of cultural theories that puts in doubt the relevance of law, there should be no doubt that law plays a very important role in modern Japan. Otherwise, why would the corporate legislation be revised so many times? If the law did not matter, why would Japanese legislators spend so much time and energy in revising something that was not relevant? Law reforms relating to the Japanese corporate governance have been numerous and often comprehensive affecting many aspects of corporate governance. Most reforms in Japan have been motivated by needs to change the existing practices. The main factor in the recent reforms was the need for overcoming the economic decline which continued for over a decade.

Changes in the Japanese society have impact on the attitudes towards law and its role. Even if not vigorously enforced in all situations, the law has an important persuasive effect. The law itself cannot change things immediately, but its existence is still important for creating a legal framework that will legitimize one kind of behavior and prohibit other kinds. The law will probably play an increasingly important role in Japan, as an instrument of driving change in the desired direction.

**Limitation Factors**

Some of legal reforms in Japan had only a symbolical effect, while some reforms brought changes only many years after they were introduced. Cultural barriers often posed obstacle or delayed the actual changes, particularly when cultural factors were aligned with the interests of business elite. In Japan it is often heard an opinion that there is much reform, but not much transformation. The impression is that Japanese legislators have undertaken reforms as a kind of fashion in order to show that they make efforts to restructure the existing system and to make it more efficient. The extent and effect of reforms seems to be designed in a way to adjust the existing model in order to preserve it rather than to subject it to a substantial change.

operating side-by-side under the same roof.
Despite comprehensive law reforms, traditional patterns endure and the fundamental elements of Japanese corporate governance have not changed.\textsuperscript{77} It is very difficult to implement reform that would transform the stakeholder model into shareholders model. Large corporations continue to be controlled by the managers who view themselves as the stakeholders and effectively prevent shareholders from exercising control over them. On the other hand, the shareholders traditionally do not show much ambition to interfere in the job of managers, as the profit is often not the main motive for their shareholding status.

One of the key elements of the Japanese corporate governance reforms is the introduction of outside directors. Outside directors, however, failed to play a substantial role in monitoring. While outside directors are seen as a potentially powerful new element of monitoring, such expectations may prove to be too optimistic. Japanese companies may find it difficult to include outside directors due to social norms, at least in the initial period. It is unlikely that Japanese companies will adopt a system in which outside directors will represent the majority. This would be contrary to Japanese corporate culture, which is inherently biased against the presence of outside directors, given the tradition of board members having longstanding and close personal relationships. The importance of this aspect of Japanese business culture may prove to be a stumbling block for a system of external control based on outside directors.\textsuperscript{78}

The opposition to comprehensive reforms that would impose a stricter control over management was obvious during recent legal reforms. The logical question is why Japanese companies were given an option to adopt New Type Company, rather than being imposed as a mandatory requirement? The flexibility offered by Japanese reforms can be attributed to powerful industry groups led by Keidanren, which supported greater discretion of the management and opposed the initiative for stricter monitoring of management. During the process of

\textsuperscript{77} Haley, \textit{supra} note 34.

\textsuperscript{78} This is illustrated by the extremely small percentage of Japanese companies that have adopted the US-style board structure—which requires a minimum of two outside directors, Puchniak, \textit{The Efficiency of Friendliness}, \textit{supra} note 2 256-57. Peter Lawley, \textit{Panacea or Placebo? An Empirical Analysis of the Effect of the Japanese Committee System Corporate Governance Law Reform}, 9 Asian-Pac. L. & Pol'y J. 105, 112 (2007).
adoption of the new Corporation Law, Hiroshi Okuda, the Chairman of Toyota, who also served as the Chairman of Keidanren, expressed a view that reforms in Toyota should go in the direction of strengthening internal control, rather than introducing outside control. 79 Fujio Mitarai, the President of Canon, who replaced Okuda as the Chairman of Keidanren, held identical views taking the stance that Canon does not need outside directors to achieve more efficient management. 80

The opposition to outside directors is, in fact, motivated by the interests of the business elite rather than being determined by cultural factors, even though such attitude fits cultural patterns towards outsiders. Why would powerful senior managers adopt a system that would reduce their power by placing some key decisions under the authority of outside directors? The importance of this attitude of the major part of business elite should not be underestimated and it may pose serious obstacle to more comprehensive changes. Additionally, the harsh court sentences handed to T. Horie and Y. Murakami in 2007 raised the questions about reasons for such attitude of Japanese courts, which are usually lenient in case of corporate crimes. 81 These sentences might be interpreted as a warning for those who consider challenging the traditional ways of doing things.

Legal reforms have had a limited impact so far and have not substantially changed existing business practices. No law reform can easily change the traditional ways of doing things, such as nemawashi. These informal ways are deeply rooted in the Japanese way of doing things and cannot be changed overnight through legislation or other formal ways. Then, how can the Japanese model converge with the American one, when the process of making decisions remains quite divergent?

In the societies where the social norms are strong, the top-down legal reforms must be done very carefully in order not to cause damage to the well

80 “In order to realize a more streamlined and efficient management decision-making process, Canon has not adopted an outside director system” (Canon Annual Report, 2004, p.6).
81 Horie was found guilty of falsifying the company's accounts and misleading investors and was sentenced to a 2 year and 6 months sentence, while Murakami, was sentenced to 2 years in prison for insider stock trading.
functioning markets. The social role of corporations is too deeply rooted to be easily changed. In order for real change in those social norms to occur, there should be a consensus in the society that would consider those informal ways outdated and agree on the need to start a new way of doing things.

A note of caution is needed when legal norms and principles as applied in one country are transplanted into legal system of another country. People often wrongly assume that “if rules are made to resemble each other something significant by way of rapprochement has been accomplished”. \(^8^2\) In order to have an effective legal transplant, the law has to fit well in the new environment, so that it can be absorbed by society and implemented in practice. Otherwise, so-called “transplant effect” may be expected, which means that the law transplanted in this way would not be widely used, at least in the initial period.

**Possible Future Directions**

Japanese society and attitudes of the people are likely to change as society becomes increasingly commercialized and exposed to the globalization process. Although the significant changes in values and attitudes are likely to happen slowly, they carry a potential for change which may undermine the traditional Japanese ways of doing things.

The family-like company will probably continue to exist, but this kind of concept of company will most likely become weaker as a result of new trends, including the changing social values and attitudes of the Japanese people. Social changes do not necessarily mean that the informal norms and structures will disappear. In reality they persist and no substantial changes have occurred so far.

Companies may become increasingly exposed to the impact of the market and may not afford to keep excess employees. As result, instead of long-term profit-oriented governance, the short-term governance aimed at improving value of shares may become more important.

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As consequence of the crisis in the banking business, a large number of shares held by many banks have been sold. This has affected the monitoring process in the companies, so that monitoring function of shareholders may become stronger as a replacement for the reduced role of the banks as monitors.

Increased foreign shareholding needs careful consideration. Will increased foreign shareholding lead to more control over management? While this development may contain a potential for change, it is premature to make predictions. Substantial part of foreign shareholdings is, in fact, in the hands of institutional shareholders who do not show much interest for active participation in the management. They would have to join hands with local Japanese shareholders in order to be able to have an impact. This may not be easy task.

Probably no substantial change in the direction of the American model will happen as long as the main features of the Japanese business culture remain unchanged. It is unlikely that majority of the Japanese companies will adopt the American model-company, and even those companies that have adopted it may soon realize that such a model may not be effective when operating within the traditional Japanese business environment. There will be some adjustments in the Japanese model, but probably those will be more “cosmetic” rather than radical changes.

Despite the persistence being demonstrated by the traditional and informal ways of doing things in Japan, it would be misleading to believe that the Japanese corporate culture remains static and inflexible. Over the years, there have been gradual changes aimed at meeting the new trends and challenges brought about by the globalization process and the rapidly changing environment. Japanese corporate governance is changing in a significant and often unpredictable way. Uncertainty is more about the extent and pace of changes, rather than whether the changes are necessary and in what direction the changes will lead the Japanese corporate model. There is little doubt that in the coming years the non-legal norms will gradually weaken at the expense of the increased importance that will be given to the formal legal norms.

Conclusion
Legal regulation of corporate governance in the postwar period in Japan has been continuously influenced by the American model. In the same period, the way of its actual functioning in practice significantly deviated from the American model. This divergence between the legal norms and their implementation in practice has been result of discrepancy between legal norms on one side, and non-legal norms on the other. This divergence often remained outside debate on the Japanese corporate governance. Discussions typically emphasized importance of certain type of factors often relying on contrasting arguments. While cultural theories overestimate the importance of the cultural influence on corporate governance and fail to recognize the importance of economic and other factors, theories that suggest the dominant influence of economic, legal or political factors have a similar flaw as they fail to recognize the influence of culture on corporate governance.

Developments in corporate governance in Japan are too complex to be explained by a single factor and they cannot be explained exclusively by cultural, legal or economic factors. This author takes a middle way by recognizing the relevance of cultural, economic, legal and political factors as major determinants that have shaped the Japanese corporate governance. While economic interests may have been the driving force behind the adoption of some of the key features of Japanese corporate governance, such as cross-shareholding and lifetime employment, they were accepted by all relevant actors and integrated well in the Japanese corporate world because those features were well suited for the Japanese ways of doing things.

Japanese corporate governance can be properly understood only by giving adequate attention to all relevant factors. Discussions on both divergence and convergence usually focus on the legal rules. But such focus is often misplaced, because legal rules are only one segment of a legal system. The law plays a crucial law in designing the Japanese corporate governance system, but the role of law cannot be fully understood without considering the social and institutional aspect of a national legal system, particularly the role of non-legal norms.
When discussing the relationship between legal and non-legal norms in the context of changes, one of key questions is how to measure changes in law and practice? The assumption that legal model is identical with the actual model used in practice might be wrong. There is a contrast between law-driven Western model and the relationship-driven Japanese model. Instead of focusing on changes in law, it might be more important to consider the changes in the actual practice. But this kind of changes may also be more difficult to evaluate. Another difficult task would be to evaluate the link between the changes in law and the changes in practice. So, it is not surprising that there are substantial differences in opinion about the actual effect of legal reforms on Japanese corporate governance.

Reforms in corporate structures, such as the *keiretsu* and lifetime employment, will probably be accompanied by adjustments in social attitudes. In order for real change to occur, there should be a consensus in society that those informal ways are considered outdated and an agreement on the need to start a new way of doing things. So far, no such consensus and agreement have been achieved. This has been demonstrated by the contents of the New Company Act which allowed two models of company to exist in parallel; when a consensus cannot be achieved, the compromise is used.

The corporate model before the newest reforms looked like many western models; but behind that façade, the actual way of functioning of that model was very much based on the Japanese way of doing things. While the globalization process has an impact on Japanese society and the attitudes of Japanese people, some distinctly different Japanese attitudes will continue to exist. Even if made under the same recipe, the use of local ingredients and spices normally has as result dishes of different taste and flavor. Now Japanese corporate governance has a new façade. Time will show whether behind the new façade there is also a more efficient mechanism, or if it is just a new façade covering the traditional way of doing things.