

2016

Cultural Impediments to Investments : a Case Study of Japan

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Recommended Citation

Shelby Klose, "Cultural impediments to investments : a case study of Japan," Law School International Immersion Program Papers, No. 10 (2016).

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Cultural Impediments to Investments: a case study of Japan

I. Intro

After two decades of economic deflation and declining growth, Japan is on the cusp of recovery. This is a result of many factors including a new political regime and their economic program called “Abenomics.”¹ However, Japan still has stagnated growth. One reason that persists under the current regime is the low amount of foreign direct investment (“FDI”) in Japan.²

Japan currently has “the smallest amount of inward foreign investment as a proportion of GDP of any major OECD nation.”³ This is anomalous because Japan has the third largest economy in the world and a history of robust international trade. As the economy grows, and Japan’s share of FDI stays comparatively low, experts look to many factors to explain the dissonance. The main focus is on the high cost structure and strong regulation in the economy.⁴ It is important to examine the current regulatory and structural framework to look for continued weaknesses. However, recent political initiatives focused on these factors and had reasonable success.⁵

It is equally important to look at the underlying cultural factors that impede international investment. Japan has a history of isolationism that contributed to divergent labor and business practices in the country.⁶ This is an impediment to foreign direct investment

¹ *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 4. Web.

² *Id.*

³ 4 Eckstrom's Licensing: Joint Ventures § 16:82

⁴ *Trade Policy Review: Japan*. Geneva: World Trade Organization, 2015. Web.
<https://www.wto.org/english/tratop_e/tpr_e/s310_e.pdf>

⁵ *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 3. Web.

⁶ See Haghirian, Parissa, Rudolf R. Sinkovics, and Vicky Bamiatzi. "Japan—New Business Opportunities In An Established Market." *Global Business & Organizational Excellence* 28.1 (2008): 4. *Business Source Complete*. Web. 18 Feb. 2016. (“Japan has been secluded from foreign markets for many years. This was originally initiated by the

because the largest investors in Japan are large, industrialized economies that look to Japan for a high-tech, familiar society for investment.⁷ In fact, the United States, which “[accounted] for 58.9% of inward FDI in 2013”, noted that social practice rather than regulation created many of the challenges for investors in Japan.⁸ Two of the most important factors, labor market practices and corporate governance, are examined below. After analysis, it is clear that Japan needs to update labor and corporate governance practices in order to appeal to OECD investors in conjunction with legal reforms. The reforms implemented so far are insufficient to lead to sustained growth in foreign investment.

II. Economics of Japan

Japan traditionally has a strong and stable economy based on exports of products such as automobiles, electronic equipment, metals, chemicals, and other profitable commodities.⁹ The economy’s original framework, which was created after World War II, depended on interconnected systems of manufacturers, suppliers, and distributors (“keiretsu”) and the guarantee of lifetime employment for most of the urban labor force.¹⁰ This was profitable for a long time but in an age of global competition, the country struggled to compete.¹¹ Economic growth in the country slowed around twenty years ago and a period of deflation began. This

third shogun Iemitsu, who – in an attempt to create internal peace and stability – expelled all foreigners and sealed off the country from the rest of the world for about 200 years until 1853. This period therefore became significant for the development of unique social and business practices – the legacy of which remains a strong pillar in Japanese modern life and business today.”)

⁷ Bâlgăr, Cristina, and Andreea Drăgoi. "The Role Of Fdi In Revitalizing Japan's Economy." 9.3 (2014): 161-171. *EconLit with Full Text*. Web. 2 Feb. 2016.

⁸ *Trade Policy Review: Japan*. Geneva: World Trade Organization, 2015. Web. <https://www.wto.org/english/tratop_e/tpr_e/s310_e.pdf>

⁹ “Japan.” *CIA World Factbook*. Central Intelligence Agency, 11 February 2016. Web. 18 Feb. 2016.

¹⁰ *Id.*

¹¹ *Id.*

change was compounded by the shutdown of nuclear plants in the country after a Tsunami in 2011.¹²

Shinzo Abe, the current Prime Minister of Japan, made economic revitalization a part of his platform in 2012.¹³ He pushed for an economic plan called “Abenomics” which attempted to jumpstart the economy. As a part of the plan, Japan adopted legislation to raise the consumption tax rate to 10% by 2015, beginning with a hike from 5% to 8% in 2014.¹⁴ Additionally, Japan made progress with the high deflation level as a result of monetary easing.¹⁵ Finally, Japan joined Trans-Pacific Partnership (TPP) negotiations, to open Japan's economy to increased foreign competition and create new export opportunities for Japanese businesses.¹⁶ These changes, as well as many regulatory changes explored below, led to a growth uptick in 2013.¹⁷ However, growth slowed again in the year afterwards and domestic and foreign investment grew slowly.

Japan’s Gross Domestic Product (“GDP”) growth stayed below that of South Korea, the OECD country with the most comparable economy in southeastern Asia.¹⁸ The percentage stayed consistently below that of the other country and stayed put as South Korea’s economy grew in the last few years.¹⁹ This is likely a result of slow implementation of reform; however a contributing factor is the low rate of foreign direct investment in the country. In an era of

¹² *Id.*

¹³ *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 3. Web.

¹⁴ *Id.* at 5.

¹⁵ *Id.* at 4.

¹⁶ *Id.* at 5.

¹⁷ Japan.” *CIA World Factbook*. Central Intelligence Agency, 11 February 2016. Web. 18 Feb. 2016.

¹⁸ See Appendix A.

¹⁹ See Appendix A.

globalization, foreign involvement in the economy is necessary for sustained growth. Until the 1980s, studies of growth focused on physical capital.²⁰ Japan has large stores of cash on its shores. However, research has found that capital buildup at a faster rate than population growth is likely to have diminishing returns. Many researchers instead focus on the accumulation of knowledge, both human capital and technology, which researchers can strongly link to international market growth.²¹ It is here that Japan is lagging behind. In a technology and service based economy like Japan's this is a very important consideration.

One aim of "Abenomics" was to double "Japan's inward FDI stock to 35 trillion yen (JPY) by 2020."²² This is not a realistic goal in the country's current situation. As seen below, foreign inflows totaled around nine trillion in 2014 which is a modest increase from the year before.²³ Additionally, like GDP growth, foreign direct investment as compared to GDP lags behind similarly situated OECD countries.²⁴ Sections below detail how labor and corporate governance practices are a large part of this shortfall. Changes in these areas will hopefully lead to increased FDI as well as growth overall.

Figure 1:²⁵ GDP growth (annual %): Annual percentage growth rate of GDP at market prices based on constant local currency. Aggregates are based on constant 2005 U.S. dollars.

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
1.3	1.7	2.2	-1.0	-5.5	4.7	-0.5	1.8	1.6	-0.1

²⁰ Grossman, Gene M., and Elhanan Helpman. "Globalization And Growth." *American Economic Review* 105.5 (2015): 100-104. *EconLit with Full Text*. Web. 29 Mar. 2016.

²¹ *Id.*

²² *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 3. Web.

²³ The World Bank, World Development Indicators (2015). *Foreign direct investment, net inflows (BoP, current US\$), Atlas method*. <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD/countries/JP-KY?page=2&display=default>

²⁴ See Appendix B.

²⁵ The World Bank, World Development Indicators (2015). *GDP Growth (Annual %) Atlas method*: <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>

Foreign direct investment, net inflows (BoP, current US\$):²⁶ Foreign direct investment refers to direct investment equity flows in the reporting economy. It is the sum of equity capital, reinvestment of earnings, and other capital. Data are in current U.S. dollars.

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
5,459,6 18,343	2,396,9 09,736	21,631, 204,436	24,624, 845,330	12,226, 471,579	7,440,9 79,284	- 850,71 7,035	546,9 62,69 2	7,412,0 10,906	9,069,8 45,069

III. Labor Practices:

One impediment for growth in Japan is the aging and declining population. This leads to a problem for investors who need to hire domestic workers for their Japanese operations. Two labor practices contribute to the shortage of skilled labor available in the country and need to be counteracted in order to incentivize purchases of domestic companies and the creation of foreign branches. First, the country has a tradition of using “non-traditional” workers who have less status, skill, and motivation. Second, women are assumed to be temporary employees because of future family obligations. This means that they rarely get sufficient training or management experience. Combined, these two factors lead to a shortage of skilled labor in the country for interested foreign investors.

A. Labor Dualism

A modern trend in Japanese employment is the prevalence of non-traditional workers. Employers use an increasing amount of temporary and part-time workers to keep costs down

²⁶ The World Bank, World Development Indicators (2015). *Foreign direct investment, net inflows (BoP, current US\$), Atlas method*. <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD/countries/JP->

and fill short-term labor requirements.²⁷ The people in these roles are rarely unskilled, but instead are recent graduates. “Companies recruit regular employees directly from schools or universities and provide an employment contract with no fixed duration.”²⁸ The Japanese government itself is concerned about the amount of young workers in non-traditional roles and knows that their future prospects are weakening.²⁹ A recent trend is also to re-hire people on non-regular status after retirement.³⁰

This system creates a distinct professional and social gap between the two types of employees. Permanent employees enjoy “high levels of job protection and extensive training...while having all others—including part-time and temporary workers hired either directly or through agencies—[are] on short-term contracts that do not guarantee renewal, promotion, or adequate benefits and pay.”³¹ Because Japan’s business environment emphasizes long-term employment and firm-specific training, management preserves job security and training for those seen as worthy of investment, while depriving others of perks and benefits.³²

As noted above, one reason for this trend is the lasting emphasis on life-long employment and seniority based wages.³³ These are values that are less important in modern

²⁷ *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 20. Web.

²⁸ "Japan." *Political Risk Yearbook: Japan Country Report (2015)*: U-1-14. *Political Science Complete*. Web. 12 Feb. 2016. (11)

²⁹ "Japan." *Political Risk Yearbook: Japan Country Report (2015)*: 11. *Political Science Complete*. Web. 12 Feb. 2016.

³⁰ *Id.*

³¹ Yu, Wei-hsin. "It's Who You Work With: Effects Of Workplace Shares Of Nonstandard Employees And Women In Japan." *Social Forces* 92.1 (2013): 3. *SocINDEX with Full Text*. Web. 22 Jan. 2016.

³² *Id.* at 6.

³³ *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 20. Web.

economies such as the United States and Germany but stayed vital in Japan until recently.³⁴ The country was under increasing pressure to adopt an American-style management system with less importance placed on seniority and the single life employer.³⁵ If the country hoped to compete on cost in a global economy, the story went, Japan needed to reform labor practices. This led to changes such as “turning away from lifelong employment, flexibility of recruitment, release of personnel and change of employer, recruitment of experienced specialists for specifically advertised positions, increased formation of specialists and turning away from the formation of generalists.”³⁶ Experts believed this was “part of a wider development; moving from long-term relationships towards a greater marketization and internationalization of the Japanese economy set against the backdrop of the prevailing conditions in the global economy. The introduction of performance-related pay means that the basis for remuneration has shifted away from the long-term development of skills towards short-term results.”³⁷

This change, while arguably better for global competition, likely led to current labor trends. Companies needed to adapt quickly to a new set of core business values and many companies stopped halfway. Regular employees often still enjoy full benefits and training while part-time and temporary employees fill the gaps at low cost. This is a temporary solution for Japanese companies but creates a long-term issue for both domestic and global employers. The young workers employed in these roles rarely get sufficient training on the job or leadership

³⁴ Krawczyk, Mariusz K. "Between The Stability Of Employment And Market Flexibility: Employment Relations In The Post-Bubble Japanese Economy." *Homo Oeconomicus* 31.1/2 (2014): 45. *Business Source Complete*. Web. 18 Feb. 2016.

³⁵ Blahová, Michaela, Přemysl Pálka, and Milan Zelený. "Contemporary Trends In Japanese Business Environment: A Review Of Existing Empirical Evidence." *Human Systems Management* 33.3 (2014): 62. *Business Source Complete*. Web. 19 Jan. 2016.

³⁶ *Id.*

³⁷ *Id.*

opportunities. This fact, combined with a lasting commitment to lifetime employment for permanent employees, leads to a “lack of mid-career mobility [which] makes it difficult for foreign firms in Japan to secure experienced workers.”³⁸ This is obviously a deterrent to foreign investment.

Additionally, there is research that suggests the use of part-time and temporary employees in the workplace lowers morale and productivity for all employees.³⁹ For instance, employees of companies with modest proportions of nonstandard workers have higher perceived likelihoods of promotion and wages than employees of companies with predominantly nonstandard workers.⁴⁰ Companies with predominantly nonstandard workers also tend to fare badly economically. Next, the share of nonstandard employees in the workplace is negatively correlated with psychological well-being. “Not only do those working with proportionately more nonstandard employees tend to report lower life satisfaction, but they are also more likely to suffer from work-related distress.”⁴¹ Employees with temporary contracts are less motivated because they have no long term prospects at their company. Employees with part-time contracts often struggle to maintain their lifestyle and feel less valued than full-time employees. Both are constantly worried about losing their job.

Lastly, the use of non-standard employees exacerbates the barriers in place for women in the workplace. Experts find that “the potential consequences associated with the share of nonstandard employees at work are not only important in their own right, but also increasingly

³⁸ "OECD Economic Surveys: Japan 2015." *OECD Economic Surveys: Japan 2015.4* (2015): 18. *Business Source Complete*. Web. 18 Feb. 2016.

³⁹ Yu, Wei-hsin. "It's Who You Work With: Effects Of Workplace Shares Of Nonstandard Employees And Women In Japan." *Social Forces* 92.1 (2013): 25-57. *SocINDEX with Full Text*. Web. 22 Jan. 2016. (53-54).

⁴⁰ *Id.*

⁴¹ *Id.*

critical for our understanding of the effects of workplace gender composition. Because women constitute the majority of the nonstandard workforce globally...the rapidly rising shares of nonstandard employees in organizations inevitably affect[s] the gender composition in many workplaces."⁴² As detailed below, the country already has a comparatively small number of skilled female employees in the work force. The use of non-standard contracts for this part of the population further limits their opportunities.

The lack of income for non-traditional workers many also affect population growth directly. The lower income of non-regular workers discourages marriage and hence reduces the fertility rate."⁴³ Studies show, after adjusting for type of job and educational attainment, that the wage gap between full and part-time workers is 45% for men and 31% for women.⁴⁴ The income of a household supported by a regular worker in the 45-49 age range was more than four times that of a household supported by a non-regular worker.⁴⁵ These nonstandard employee households cannot support a wedding or larger family.

These findings show that the use of non-standard employees is a drag on productivity and globalization. Companies looking to invest in Japan know that there is already a shortage of skilled labor because of the declining population. The addition of having a class of young workers without experience or training makes an investment in Japan less attractive.⁴⁶

⁴² *Id.*

⁴³ *Id.*

⁴⁴ "OECD Economic Surveys: Japan 2015." *OECD Economic Surveys: Japan 2015.4* (2015): 33. *Business Source Complete*. Web. 18 Feb. 2016.

⁴⁵ *Id.*

⁴⁶ Local practitioners believe an overhaul of lifetime employment is also necessary to match western standards of employment. Koji, Tsurumi. Personal interview. 22 March 2016.

In order to fix this problem the government should intervene to either limit the use of non-standard contracts or help train young employees without long-term employment benefits. The current change, which would require full-time employment after five years, simply incentivizes employers to increase turnover. It is also not enough to wait for western business practices to catch on because the country has a long history of isolationism and values like lifetime employment are imbedded in society.

B. Female Participation

Cultural norms impede the use of female employees in the workplace. This is another reason that foreign and domestic employers have trouble finding enough employees in the country to meet their labor needs.

One trend of western countries in the last fifty years is the increasing number of females participating in the workforce. In fact, 48.6% of the labor force in the United States was female in 2014.⁴⁷ This trend was mirrored in Japan but at a much slower rate because of social complications. "The participation rate of prime-age women (between 25 and 54) rose from 65% in 1994 to 72% in 2010. Nevertheless, it was still the fifth lowest in the OECD area."⁴⁸ Japan's comparatively low female participation is a product of cultural norms that result in unequal trends and labor policies. However, better gender equality is needed to mitigate declines in population. The male labor participation rate is twenty percentage points above that of women

⁴⁷ See U.S. Bureau of Labor Statistics, Current Population Survey, 2014 annual averages. <http://www.bls.gov/cps/cpsaat03.htm>; and the Employment Projections Program, 2022 projections http://www.bls.gov/emp/ep_table_301.htm.

⁴⁸ Blahová, Michaela, Přemysl Pálka, and Milan Zelený. "Contemporary Trends In Japanese Business Environment: A Review Of Existing Empirical Evidence." *Human Systems Management* 33.3 (2014): 62. *Business Source Complete*. Web. 19 Jan. 2016.

at 85%.⁴⁹ If the female participation rates converged then the labor supply would decline by only 5% by 2030.⁵⁰ This would increase GDP by almost 20% compared with unchanged participation rates.⁵¹ This is an obvious reason to focus on this cultural norm because the lack of available labor is a major reason foreign companies worry about investing directly in the country.

There are many impediments for working women. First, most females leave their jobs when they have children. Researchers found that about 60% of female workers still leave the labor force when their first child is born.⁵² This not only eliminates a portion of the population eligible for employment, it likely stops foreign investors from hiring females in the first place. A reason for this is that once women have children they have difficulty finding affordable childcare.⁵³ There is also a stigma against men taking paternity leave when it is available.⁵⁴

The assumption of motherhood also leads to less employment mobility for women whether or not they plan to have a family. "Because women's primary roles are assumed to be caregivers of their families, and because standard work arrangements in Japan are likely to conflict greatly with individuals' family responsibilities, many Japanese employers consider women as secondary workers, regardless of their employment status. Thus, even when women work as standard employees, they tend to receive little on-the-job training and few promotion

⁴⁹ "OECD Economic Surveys: Japan 2015." *OECD Economic Surveys: Japan 2015.4* (2015): 15. *Business Source Complete*. Web. 18 Feb. 2016.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ International lawyers in Japan expressed this issue when explaining the differences with western practices. Stoupe, Louise. Personal Interview. 15 March 2016.

⁵⁴ Tsunoda, Yukiko. Personal interview. 21 March 2016.

opportunities.”⁵⁵ This means that foreign employers once again have an impediment to finding mid-career employees with sufficient training and leadership experience.

Another impediment is the country’s low level of female participation in management. It is much lower in Japan than in other industrialized nations even though the female workforce in Japan is among the most educated in the world.⁵⁶ The lack of women in key roles is also self-perpetuating because studies of workplace gender composition find greater discrimination and less mobility for women in workplaces with lower female representation.⁵⁷

One could argue that foreign employers could hire females out of school and provide this training. Also, one could argue that that foreign firm’s practices will eventually spread to domestic ones. Unfortunately, researchers believe that foreign company’s practices’ “overall impact will remain limited if the sorts of practices that make them desirable do not spread to their domestic counterparts and business partners. Not only is it questionable whether foreign employers’ practices remain distinct from domestic ones in the long run, but it is further doubtful that Japanese corporations would turn to foreign multinationals in any large scale in search of examples of ‘best practice’ in an area where local practices remain so entrenched.”⁵⁸

⁵⁵ Yu, Wei-hsin. "It's Who You Work With: Effects Of Workplace Shares Of Nonstandard Employees And Women In Japan." *Social Forces* 92.1 (2013): 27. *SocINDEX with Full Text*. Web. 22 Jan. 2016.

⁵⁶ Blahová, Michaela, Přemysl Pálka, and Milan Zelený. "Contemporary Trends In Japanese Business Environment: A Review Of Existing Empirical Evidence." *Human Systems Management* 33.3 (2014): 62. *Business Source Complete*. Web. 19 Jan. 2016.

⁵⁷ Yu, Wei-hsin. "It's Who You Work With: Effects Of Workplace Shares Of Nonstandard Employees And Women In Japan." *Social Forces* 92.1 (2013): 27. *SocINDEX with Full Text*. Web. 22 Jan. 2016.

⁵⁸ Bozkurt, Ödül. "Foreign Employers As Relief Routes: Women, Multinational Corporations And Managerial Careers In Japan." *Gender, Work & Organization* 19.3 (2012): 21. *SocINDEX with Full Text*. Web. 22 Jan. 2016.

Clearly something needs to change in order to truly boost participation and opportunity for women.

Overall, the cultural trend of men in the workplace and women in the home is unworkable in a global economy. As evidence, most OECD nations are moving towards higher female participation and publicly tout the goal of gender equality.⁵⁹ The situation is not perfect in any country; however Japan's situation is dire enough that it likely affects foreign investment. Not only does the lack of women affect the number of people available to work, it also speaks of outdated social practices. A strong effort in this area will benefit employers that are facing a work shortage as well as the country's international reputation.

The current government put policies in place to address this problem. For instance, in June 2013, "the government named women's increased economic participation as a policy priority. Goals include reducing the number of women who quit their jobs due to pregnancy, childbirth or child-rearing; reducing childcare center waitlists through increased capacity; increasing the number of women in management positions; and increasing the number of female national civil servants."⁶⁰ Further, a bill was submitted to the Diet that "would require larger companies to disclose statistics about the hiring and promotion of women, and adopt action plans to improve the numbers."⁶¹ This shows progress in this space but it is not enough to truly counteract cultural norms and practices. The country exhibits a remarkable resistance to outside influence and prizes tradition. As seen in many western countries, public statements

⁵⁹ Olivier, Thévenon. "Drivers Of Female Labour Force Participation In The OECD." *OECD Social, Employment And Migration Working Papers (2013): OECD iLibrary*. Web. 18 Feb. 2016.

⁶⁰ *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 20. Web.

⁶¹ *Id.*

about gender equality and disclosure requirements can only do so much. Additionally, Yukiko Tsunoda, a prominent proponent of female rights, believes the planned measures only target upper-class women.⁶² A large portion of the population will see no change.

A company has no incentive to change their practices unless the public reacts negatively to low levels of reported female participation. This means that perception needs to change with the law. For example, the government could implement programs for women that help them set career goals at a young age. They could also set an example by setting quotas on the number of women required in government leadership roles. Lastly, the government could work on improving conditions for all workers by pushing for a less demanding hour schedule. This would specifically help working mothers. These changes would fit within the deferential, inclusive culture and work for sustained change in the public perception.

IV. Corporate Governance Practices

Japan's history of isolationism did not only lead to country-specific labor practices, it also led to an insular business culture. The country's economy was built on a system that encouraged close ties between people on the vertical chain and discouraged the inclusion of "outsiders."⁶³ Additionally, after World War II, the Japanese government resisted efforts by the American government to implement antitrust reform. Huge conglomerates remained that resembled the American oil and railroad monopolies of the early twentieth century.⁶⁴ This

⁶² Tsunoda, Yukiko. Personal interview. 21 March 2016.

⁶³ Toru, Y., Tsui-Auch, L S., & Jean, M. (2007). Corporate governance reform as institutional innovation: The case of Japan. *Organization Science*, 18(6), 973-988. ("While ownership and board structure certainly converge toward Anglo-American style through the reform, the influence of the reforms on corporate governance is still limited or varies by firms, due to the high cohesiveness and conformity of Japanese companies derived from strong ties among their constituencies.")

⁶⁴ Even today the Japan Fair Trade Commission brings less than 150 enforcement actions per year. Japan Fair Trade Commission. Personal Interview. 24 March 2016.

means that there was little government control of collusion and exclusion.⁶⁵ This is still an issue today and according to foreign firms in Japan, Japan's governance framework lags behind global standards.⁶⁶

The country uses the stakeholder-oriented model where "corporate boards [balance] the interests of corporate stakeholders, such as employees, business groups, banks and shareholders."⁶⁷ This is a problem for profit-minded foreign investors because weak corporate governance is linked to a number of issues, including a low rate of return on assets and the large cash holdings of Japanese firms which are seen as inefficient and wasteful.⁶⁸ Additionally, foreign firms are likely wary of fraud and their disadvantage in the face of domestic competitors. One could argue that an Anglo-American system of corporate governance is not objectively the best for every country.⁶⁹ However, the nationalities of large, foreign investors in Japan suggest that reform is necessary for increased foreign investment. One example of weak corporate governance is described below and demonstrates the effects of the inclusive corporate culture on business practices and investment.

One example of insular business behavior involves board participation. Boards of directors in Japan are dominated by insiders, usually long-term employees with intimate

⁶⁵ Eleanor M., Hadley. *Antitrust In Japan*. Princeton: Princeton University Press, 2015. *Project MUSE*. Web. 30 Mar. 2016.

⁶⁶ "OECD Economic Surveys: Japan 2015." *OECD Economic Surveys: Japan 2015.4* (2015): 19. *Business Source Complete*. Web. 18 Feb. 2016.

⁶⁷ Mizuki, Hayashi. "Corporate Ownership And Governance Reforms In Japan: Influence Of Globalization And U.S. Practice." *Columbia Journal Of Asian Law* 26.2 (2013): 315-345. *Business Source Complete*. Web. 16 Feb. 2016.

⁶⁸ *Id.*

⁶⁹ Mizuki, Hayashi. "Corporate Ownership And Governance Reforms In Japan: Influence Of Globalization And U.S. Practice." *Columbia Journal Of Asian Law* 26.2 (2013): 343. *Business Source Complete*. Web. 16 Feb. 2016. ("The critical point is that there is no consensus on the ideal corporate governance form. The interests of shareholders and stakeholders are both valued under the OECD principle.")

knowledge of the business.⁷⁰ This increases the risk of fraud and mismanagement because the people overseeing business leaders likely have personal ties and may have trouble staying objective. Their major role in decision-making also contributes to the lack of transparency in corporate governance.⁷¹ This system is likely a result of the county's emphasis on cohesiveness and loyalty which creates the tie of employee and management under lifetime employment.⁷² Directors are rewarded at the end of a long career with this prestigious position and the public generally regards their company knowledge as an asset.⁷³

As a result, Japan's progress in corporate governance reform has been slow. While the average number of outside directors in Japan rose from 0.9 per company in 2008 to 1.3 in 2014 for the nearly 1,800 companies listed on the TSE's first section, 39% of these companies did not have any outside directors at all.⁷⁴ In contrast, outside directors are legally mandatory in the United States (a majority) and Korea (one quarter). "Only 0.2% of Japanese listed companies had a majority of outside directors, compared to 50% in the United Kingdom and 90% in the United States."⁷⁵ The stock exchange requires at least one outside director. However, a member of the *Council of Experts Concerning the Corporate Governance Code* expressed

⁷⁰ "OECD Economic Surveys: Japan 2015." *OECD Economic Surveys: Japan 2015.4* (2015): 16. *Business Source Complete*. Web. 18 Feb. 2016.

⁷¹ *Id.*

⁷² Mizuki, Hayashi. "Corporate Ownership And Governance Reforms In Japan: Influence Of Globalization And U.S. Practice." *Columbia Journal Of Asian Law* 26.2 (2013): 342. *Business Source Complete*. Web. 16 Feb. 2016.

⁷³ *Id.* at 331. ("During the debate over the exclusion of these affiliates from the definition of "outside" directors, some members of the business world opposed the exclusion based on the argument that these affiliates are suitable for directors because they have "interests" in the company through capital or business transactions and thus have incentive to raise the corporate value.")

⁷⁴ "OECD Economic Surveys: Japan 2015." *OECD Economic Surveys: Japan 2015.4* (2015): 72-73. *Business Source Complete*. Web. 18 Feb. 2016.

⁷⁵ *Id.*

concern that the current criteria for independent directors established by securities exchanges are “abstract and they allow considerable room for interpretation.”⁷⁶

This deficiency may lead to less direct investment in foreign subsidiaries or joint ventures. Alternatively, large investors such as the United States and the United Kingdom may decide to invest in countries with more stringent standards such as Korea. This may explain the higher amount of internal foreign investment as a percentage of GDP in the country.⁷⁷

New legislation in the country focuses on this issue. The revised Companies Act, which becomes effective in 2015, encourages the appointment of an outside director.⁷⁸ However, if a company does not appoint one they can simply explain why they did not comply in their annual report and at their shareholder meeting. Also, the Company Act only blocks current and past executive directors, managers, or employees of the company and its subsidiaries.⁷⁹ It does not acknowledge family members or other close relationships. This new legislation is similar to that aimed at increasing female participation. It shows progress but may not be enough to counteract a cultural resistance to outside influence. There are too many loopholes that allow for manipulation. Companies have little incentive to add more than one outside director and the success of the legislation depends on public disapproval to resistance. Additionally, the amendments created an alternative structure where companies may add an audit and

⁷⁶ *Id.* at 70.

⁷⁷ See Appendix A.

⁷⁸ *Id.* at 321. (“In 2009, the Tokyo Stock Exchange (TSE) revised its Securities Listing Regulations and required a listed company, for the purposes of protecting general shareholders, to secure at least one independent director/auditor, meaning an outside director/auditor who is unlikely to have a conflict of interest with the general shareholders.”)

⁷⁹ Mizuki, Hayashi. “Corporate Ownership And Governance Reforms In Japan: Influence Of Globalization And U.S. Practice.” *Columbia Journal Of Asian Law* 26.2 (2013): 331. *Business Source Complete*. Web. 16 Feb. 2016.

supervisory committee whose members do not serve as directors.⁸⁰ If companies choose to take this route then only the fraud problem has a solution while the inclusive business decision problem remains.

The Financial Services Agency and Tokyo Stock Exchange recently drafted the first corporate governance 'Code of Conduct.' It is modeled on OECD and United Kingdom corporate governance principles and aims to increase corporate transparency and management accountability through five broad areas, including the appointment of outside directors to company boards and a requirement that companies provide a public explanation for cross-holding company shares.⁸¹ This shows Japan's motivation to appease foreign investors. But the code has little enforcement power.

The country must undertake further reform to truly change practices. This must be done carefully, however because "bringing many outside directors without the appropriate knowledge of the specific businesses into the board could drive up the cost of decision making enormously, which would probably outweigh the benefit."⁸² Outside of requiring a higher number of outside directors, the country could require other procedures to manage the directors already in place. The OECD report on Japan in 2015 recommended that the country change their policies to make sure "compensation of outside directors [is] more strongly linked to shareholders' dividends."⁸³ Also, the report recommends that directors receive training from

⁸⁰ *Id.*

⁸¹ *Japan Investment Climate Statement*. Washington, D.C.: U.S. Dept. of State, Bureau of Economic, Energy, and Business Affairs, International Finance and Development, Office of Investment Affairs, 2015. Page 17. Web.

⁸² Mizuki, Hayashi. "Corporate Ownership And Governance Reforms In Japan: Influence Of Globalization And U.S. Practice." *Columbia Journal Of Asian Law* 26.2 (2013): 343. *Business Source Complete*. Web. 16 Feb. 2016.

⁸³ "OECD Economic Surveys: Japan 2015." *OECD Economic Surveys: Japan 2015.4* (2015): 70. *Business Source Complete*. Web. 18 Feb. 2016.

independent sources on their fiduciary responsibilities and have access to information that does not come directly from management. Unlike other countries in the OECD, Japan has no rules requiring director training or disclosure.⁸⁴ This would result in less resistance from a culture that expects a board of lifetime employees. However, could lead to improved oversight and decision making by the board.

These suggested changes reflect the idea that the best way to improve corporate governance in the country is to work within the current framework. Change requires both legal and cultural shifts. As noted in a recent study by Hayashi Mazuki, the current stakeholder model in the country, which involves the inside board, is not defined by law but instead by custom.⁸⁵ The government will likely meet steep resistance to externally imposed quotas of external directors. But training and incentives for current directors may successfully lessen fraud and mismanagement without ostracizing citizens. As the country gets used to objective management the government can implement stronger standards.

V. Conclusion

In the next few years, Japan has the chance to jumpstart growth and increase foreign participation in the economy. The current political regime showed a commitment to policy change and economic reform. There are also signs of cultural shifts towards a profit-focused mindset in the business community. However, real change is not realistic without more

⁸⁴ *Id.* at 72.

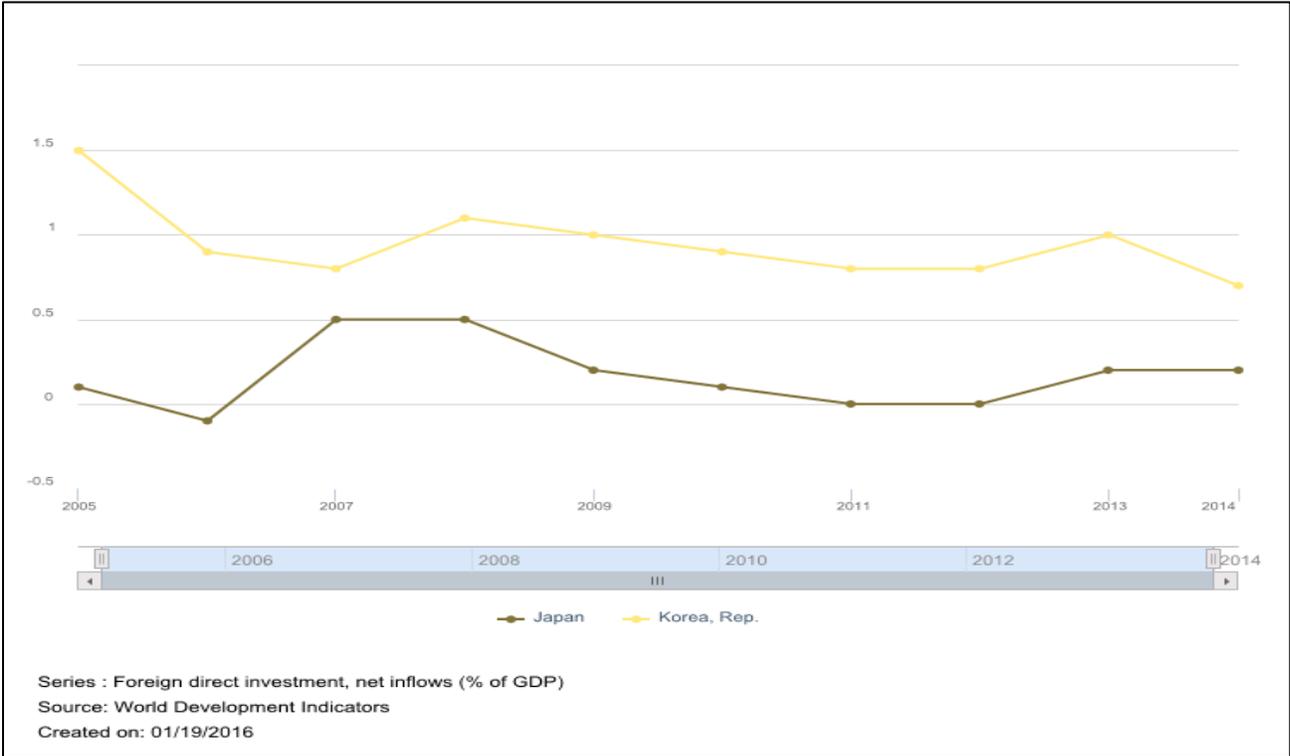
⁸⁵ Mizuki, Hayashi. "Corporate Ownership And Governance Reforms In Japan: Influence Of Globalization And U.S. Practice." *Columbia Journal Of Asian Law* 26.2 (2013): 332. *Business Source Complete*. Web. 16 Feb. 2016.

intervention by the government or other actors to push this process. Significant improvements require both investment law and cultural norm reforms.

As detailed above, Japan has labor and corporate governance practices that make the country less attractive to the western countries who are their largest investors. This is a result of a strong tie to tradition and years of isolationism. It is vital for the country to put standards in place to help counteract these principles and norms. However, one must take this cultural tradition into account when hoping to implement long-term changes. Reporting requirements and resolutions for change are not enough. Also, enforced quotas may lead to political controversy and symbolic resistance. The country needs to change the business mindset with training, education, and example setting. This way the new generation will grow up in a changed environment. Additionally, current practitioners will resist less to what they see at outwardly-imposed standards.

It will not take a complete cultural overhaul to increase foreign investment. A commitment to increased education and training will signal change to foreign investors. They will likely move in to take advantage of predicted increases in future profits.

Appendix A:



Appendix B:

