

2010

Hostile Takeover Bids In Japan? Understanding Convergence Using The Layered Approach

Michael Cody

University of British Columbia

Follow this and additional works at: <http://scholarship.richmond.edu/global>

 Part of the [Comparative and Foreign Law Commons](#), and the [International Trade Law Commons](#)

Recommended Citation

Michael Cody, *Hostile Takeover Bids In Japan? Understanding Convergence Using The Layered Approach*, 9 Rich. J. Global L. & Bus. 1 (2010).

Available at: <http://scholarship.richmond.edu/global/vol9/iss1/2>

This Article is brought to you for free and open access by the Law School Journals at UR Scholarship Repository. It has been accepted for inclusion in Richmond Journal of Global Law & Business by an authorized administrator of UR Scholarship Repository. For more information, please contact scholarshiprepository@richmond.edu.

HOSTILE TAKEOVER BIDS IN JAPAN? UNDERSTANDING CONVERGENCE USING THE LAYERED APPROACH

*Michael Cody**

ABSTRACT

Hostile takeover bids arrived in Japan in 2005 and U.S. legal scholars announced that their arrival offered strong evidence in support of corporate governance convergence to the U.S. shareholder-oriented model. Now, four years later, there has still not been a successful hostile takeover bid and the practice has seemingly fallen out of favor. The Japanese experience with hostile takeover bids suggests a much more complicated process is occurring than the one suggested by the traditional convergence theories.

This article uses the arrival of hostile takeover bids in Japan to explore a number of convergence theories, including: traditional theories, the economic version of selective adaptation, other theories of selective adaptation, and a new theory—the “Layered Approach.”

The Layered Approach is based on previous selective adaptation theories of Pitman Potter and Tom Ginsburg combined with insights from institutional analysis from sociology. It argues corporate governance convergence happens in the following way: 1) economic events trigger convergence, 2) corporate governance convergence is more likely to occur among firms that operate in the same field (i.e. global companies listed on public exchanges), 3) the speed and direction of convergence is affected by local social institutions, and 4) government and market participants play a significant and active role in “selecting” which foreign corporate governance rules will be “adapted” into the local corporate governance regime.

The conclusion of the article is that the Layered Approach better explains the arrival and effect of hostile takeover bids in Japan because it acknowledges that both economic and social factors had roles to play. In particular, the evidence shows local social institutions, with local market participants, play an active role in determin-

* The author is a Ph.D. student at the University of British Columbia in Vancouver, Canada. This article was presented at the Pan-Pacific Business Law Conference in Vancouver, BC, September 29–30, 2006. Special thanks to Masafumi Nakahigashi, Yoshihiro Yamada, Julian Dierkes, Christie Ford, Liljana Buckovic and Maclean Brodie for their insightful comments on previous drafts of this paper. Extra special thanks to Yoshihiro Yamada for providing me with translations of some sources. Any errors or omissions in the paper remain my own.

ing the speed and direction of the changes to the Japanese corporate governance system.

INTRODUCTION

In 2005, hostile takeover bids arrived in Japan in dramatic fashion. To date, there have been fifteen hostile takeover bid attempts.¹ At the time of their arrival, these attempts surprised many Japanese scholars who believed that hostile bids would never be culturally acceptable.²

Many legal scholars, favoring corporate governance convergence theories akin to the U.S. shareholder-centric model, trumpeted the arrival of hostile takeover bids in Japan.³ For example, in 2005, U.S. legal scholar, Curtis Milhaupt, speculated that the arrival of hostile takeover bids in Japan was the beginning of a developing market for corporate control and that U.S. corporate law (particularly Delaware corporate law) would make a strong contribution to its development:

If, as now seems distinctly possible, the world's second largest economy is in the process of embracing hostile M&A (however reluctantly), and along with it the core of Delaware takeover jurisprudence, this development may represent an epochal moment for Japan and for the global standards movement in corporate governance.⁴

Some scholars even proposed these changes in Japan were part of a larger process of bringing about the "Americanization" of Japanese law.⁵

There is no doubt that the arrival of hostile takeover bids in Japan took centre stage in a broad social and political debate about the future of Japan. After a fifteen year recession, Japanese society was looking for something to waken its slumbering economy.⁶ Change was coming. The only question was: What type of change? The debate

¹ Each bid is summarized in the Appendix. *See infra* pp. 47–51.

² *See* NEIL FLIGSTEIN, *THE ARCHITECTURE OF MARKETS* 187 (2001).

³ *See* Cristina Alger, Note, *The Livedoor Looking Glass: Examining the Limits of Hostile Takeover Bids in Japan*, 3 N.Y.U. J. L. & BUS. 309, 317–18 (2006).

⁴ Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2173–74 (2005).

⁵ *See generally* R. Daniel Kelemen & Eric C. Sibbitt, *The Americanization of Japanese Law*, 23 U. PA. J. INT'L ECON. L. 269.

⁶ Current Japanese corporations are characterized by high levels of liquid assets and management that is not accountable for financial performance. Some view hostile takeovers as a potential solution to both problems. *See* Symposium, *The Poison Pill in Japan: The Missing Infrastructure*, 2004 COLUM. BUS. L. REV. 21, 21–22 (2004).

raged between supporters of the “old” Japan who wanted to maintain the useful and unique portions of the existing Japanese corporate governance system, and advocates for a “new” Japan who supported an aggressive Westernized economy.⁷ In this larger societal context, hostile takeover bids dominated the media, captivated Japanese society, and became a microcosm of the larger debate between the “old” and “new” Japan.

A small group of younger businessmen, dubbed the “Hills Tribe” by the Japanese press because their companies were located in the posh Roppongi Hills commercial complex in Tokyo,⁸ led the hostile takeover movement in Japan. The two most prominent members of the “Hills Tribe” were Yoshiaki Murakami, the founder of M&A Consulting⁹—a U.S. style aggressive investment fund—and Takafumi Horie, the Chief Executive Officer of internet company Livedoor Co. (“Livedoor”).¹⁰ These “mavericks” represented the new breed of Japa-

⁷ See Milhaupt, *supra* note 4, at 2181. Examples of organizations that support the “old” Japan viewpoint are Toyota Corp. and Canon Inc., who are known for wanting to maintain the good points of Japanese-style corporate management. See Hisane Masaki, *Japan: Another “Hills Tribesman” Brought Down*, ASIA TIMES ONLINE, June 10, 2006, <http://www.atimes.com/atimes/Japan/HF10Dh03.html>. Examples of individuals who support the “new” Japan are Yoshiaki Murakami and Takafumi Horie. See *infra* notes 9–10 and accompanying text.

⁸ The Roppongi Hills commercial complex was built in 2003. Many successful IT industry firms have moved to the complex, “making it a symbol of success.” Masaki, *supra* note 7.

⁹ Yoshiaki Murakami is a graduate of Tokyo University, the most prestigious university in Japan. Andrew Morse, *Maverick’s Fall Portends Change*, WALL ST. J., June 6, 2006, at C1. He is a former government official, having worked at the Ministry of International Trade and Industry (MITI, now called METI) for sixteen years. *Id.* For a description of the importance of this agency to Japan, see generally JOHNSON *infra* note 42. When he left the ministry in 1999, Murakami founded M&A Consulting, a U.S. style aggressive investment fund. M&A Consulting launched one of the first hostile takeover bids in Japan in 2000, when it made a bid for Shoei Co. See Masaki, *supra* note 7. For a description of this bid, see Appendix, *infra* pp. 47–51. Murakami is the key individual supporting the hostile takeover bid movement in Japan. Murakami and M&A Consulting were involved in four of the eleven hostile takeover bids in Japan.

¹⁰ Takafumi Horie also attended Tokyo University but did not graduate. Yuka Hayashi, Andrew Morse & Sebastian Moffett, *Raw Deals: In Clubby Japan, A Brash Raider Takes a Big Fall*, WALL ST. J., Feb. 3, 2006, at A1. He expanded his Japanese internet company, Livedoor, by using a Western style growth-through-acquisition strategy. At its peak, Livedoor was worth over \$8 billion. See Jim Frederick, *Feeding Frenzy: Livedoor May Be in Ruins, but Its Acquisition Hungry Approach Lives On*, TIME ASIA, Feb. 6, 2006, at 41, available at <http://www.time.com/time/asia/magazine/article/0,13673,501060206-1154258,00.html>.

nese entrepreneurs who supported an aggressive style of business that primarily focused on profits.¹¹

The highpoint of the hostile takeover movement came in dramatic fashion on February 8, 2005, when Horie's upstart internet company, Livedoor, announced a hostile bid for Nippon Broadcasting System Inc. ("Nippon Broadcasting"), a radio-broadcasting firm affiliated with Japan's largest media conglomerate, the Fuji Sankei Media Group.¹² On January 17, 2005, Fuji TV, the parent company, made an offer for all of the shares of Nippon Broadcasting.¹³ In the midst of that bid, Livedoor made the surprising announcement that it had acquired thirty-eight percent of the Nippon Broadcasting shares, and that it intended to make an offer for the remainder of the shares.¹⁴ Livedoor's share purchases were financed by an issuance of \$750 million "death spiral" convertible bonds underwritten by Lehman Brothers, a United States investment bank.¹⁵

On February 23, 2005, the board of Nippon Broadcasting responded to Livedoor's bid by issuing a substantial number of warrants (*shin kabu yoyaku ken*) to Fuji TV to dilute Livedoor's stock ownership below twenty-percent.¹⁶ Nippon Broadcasting maintained that remaining part of the Fuji Sankei group would provide long-term benefits to shareholders.¹⁷ Livedoor successfully sued to enjoin the issuance of the warrants.¹⁸ The situation was eventually resolved amicably in a familiar Japanese fashion through a cross-shareholding arrangement on April 18, 2005, when Livedoor sold all of its Nippon shares to Fuji TV.¹⁹ Fuji TV purchased a reciprocal two and a half

¹¹ See Kanako Takahara, *JAPAN: Murakami Arrested Over Insider Trading*, JAPAN TIMES, June 6, 2006, available at <http://www.asiamedia.ucla.edu/article.asp?parentid=47220>.

¹² *Japan: Livedoor ups Broadcaster State*, THE JAPAN TIMES, Feb. 22, 2005, available at <http://www.asiamedia.ucla.edu/article-eastasia.asp?parentid=21060>.

¹³ The bid was necessary to cure an anomalous shareholding situation because Nippon owned 22.5% of the shares of its parent, Fuji TV, but Fuji TV owned only 12.5% of Nippon shares. Fuji Television Network, Inc., SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 78,921 (Jan. 18, 2005), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/sullivan010605.htm>.

¹⁴ See *Japan: Livedoor ups Broadcaster State*, *supra* note 12.

¹⁵ *Hostile Takeovers: Shaking up Corporate Japan*, ECONOMIST, Mar. 23, 2005 at 61, available at http://www.economist.com/businessfinance/PrinterFriendly.cfm?story_id=3793297 (explaining the death spiral bonds gave Lehman the right to convert the bonds into shares at a constant discount to the share price).

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Milhaupt, *supra* note 4, at 2179–80 (explaining how Livedoor sold its shares for a value roughly equal to its cost and therefore did not profit from the transaction).

percent stake in Livedoor, and the three companies established a joint committee to explore related ventures.²⁰

With this bid, the Japanese hostile takeover movement started with great promise, accompanied by predictions of a wave of hostile bids sweeping across Japan which would aid in jumpstarting the economy.²¹ Less than four years later, the movement appears to have stalled, if not ended, since there have been no successful hostile bids.²² The expected wave of takeovers never materialized, and the two most prominent leaders of the new aggressive style of business in Japan have both been jailed.²³ Takafumi Horie was sentenced to two and a half years for fraudulently manipulating the financial statements of Livedoor.²⁴ Yoshiaki Murakami was arrested for insider trading in relation to Livedoor's bid for Nippon Broadcasting and has been sentenced to two years in jail and fined 1.15 billion yen.²⁵ Murakami was found guilty of persuading Horie to make the bid for Nippon Broadcasting after buying Nippon Broadcasting shares in his Murakami Fund,²⁶ and then selling his position on the rise in share price after the bid was launched.²⁷

²⁰ See generally, Alger *supra* note 3.

²¹ See *Hostile Takeovers: Shaking up Corporate Japan*, *supra* note 15, at 61 (although, many of the articles with these predictions originated in western countries).

²² For a discussion on how bids end in the typical Japanese fashion of cross-shareholding, see Alger, *supra* note 3, at 315.

²³ Hostile takeovers continue to happen at the pace of 2–3 a year. *Id.*

²⁴ On January 18, 2006, Japanese officers raided Livedoor's offices and Horie's home on suspicion of securities fraud. On January 23, 2006 Takafumi Horie and three other Livedoor executives were arrested on suspicion of fraudulently manipulating the financial statements of Livedoor so that the share price would rise. Horie resigned as the CEO of Livedoor the next day and Livedoor's stock plummeted 80%. See Frederick, *supra* note 10; see also *Murakami's Arrest Comes as a Sober Reminder of Need for Discipline on Markets in Japan*, FOREIGN PRESS CENTER JAPAN, June 14, 2006, available at http://www.fpcj.jp/old/e/mres/japan/brief/jb_634.html.

²⁵ Murakami was accused of making somewhere between three and ten billion yen from the sale of Nippon Broadcasting shares based on insider knowledge that Livedoor was going to launch a bid. See Masaki, *supra* note 7; see also Takahara, *supra* note 11.

²⁶ Takahara, *supra* note 11 (discussing how Murakami's fund had 400 billion yen in assets, and that the fund made most of its capital from overseas, particularly United States, investors).

²⁷ Murakami admitted he met with Horie and Livedoor executives in September and urged them to buy Nippon Broadcasting shares. Murakami's fund eventually ended holding almost 20% of Nippon Broadcasting shares. See Takahara, *supra* note 11; Masaki, *supra* note 7.

At the time of the arrests, it was not clear whether the new aggressive style of business in Japan, including hostile takeover bids, would survive or simply become a part of Japanese business history. The following quotes from the Japanese press illustrate the importance of these events to the future of Japanese corporate governance:

The question now: Will the rough-and-tumble style of capitalism that Horie pioneered be another, more far-reaching casualty of this debacle?²⁸

Horie and Murakami, who became champions of the times and drew praise for their seemingly commendable acts to shake up the self-complacency of corporate governance in Japan, are now being condemned for “betraying the market and investing public” with their illegal practices. The public’s anger and feeling of being betrayed by the two men appears to be all the stronger because they managed to make themselves heroes by speaking of respectable causes. There is a persistent undercurrent of opinions that values the two men’s conduct in that they had made a considerable impact on the tepid traditional corporate governance. . . .²⁹

In its lengthy editorial on June 12 titled “Toward a Market Society with Discipline”, the *Asahi Shimbun* commented on Murakami’s wrongdoing: “It carries a grave meaning which is not limited to mere economic crime, since this could determine the direction in which Japanese society will head in the future.”³⁰

Since the arrests, there have been a small number of hostile takeover bid attempts, mostly by U.S. investment fund Steel Partners.³¹ None have been successful.

From a North American perspective, the arrival of hostile takeover bids in Japan is interesting because it offers insight into the debate about worldwide corporate governance convergence. Corporate governance convergence theories have traditionally associated themselves with one of two opposing positions, convergence or divergence. The convergence theories contend that due to the competitive forces of economic efficiency there will be a global convergence in corporate gov-

²⁸ Frederick, *supra* note 24, at 1.

²⁹ FOREIGN PRESS CENTER JAPAN, *supra* note 24, at 2.

³⁰ *Id.* at 3.

³¹ The bids include: Oiji Paper’s bid for Hokuetsu Paper Mills, Aoki Holdings Bid for Futata, Steel Partners bid for Myojo Foods, Steel Partners Bid for Bulldog Sauce, Davinci Advisors bid for TOC Co. and Steel Partners bid for Sapporo. See *infra* Appendix pp. 47–51.

ernance rules towards the Anglo-American shareholder oriented model.³² Divergence theories generally argue that local institutions or culture will cause divergence as opposed to convergence; or, alternatively, at least make convergence unlikely.³³

The arrival of hostile takeover bids in Japan initially seemed to provide evidence in support of the convergence theories because nothing could be more consistent with the U.S. shareholder form of corporate governance than hostile takeover bids. However, the latest developments seem to provide evidence against convergence. More importantly, the set of events that led to the arrival of hostile takeover bids in Japan suggest something more complicated than convergence or divergence is going on. Some corporate governance convergence is happening in Japan but Japanese society is blending foreign corporate governance institutions with its own domestic institutions to develop something uniquely Japanese. In short, takeover bids have arrived in Japan, but they do not look or work the same way as North American hostile takeovers. Recently, a few scholars have used the concept of “selective adaptation” to explain this more complicated process, and

³² See discussion of convergence theories *infra* Part 1.

³³ The most well known theory is Lucian Bebchuk and Mark Roe’s theory of path dependence which argues that political forces and the historical path of development in a society will limit the ability of the competitive forces to cause corporate convergence and that the “corporate structures that an economy has at any point in time are likely to depend on those that it had at earlier times.” Lucian Bebchuk & Mark Roe, *A Theory of Path Dependency in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 169 (1999); see also Sanford M. Jacoby, *Corporate Governance in Comparative Perspective: Prospects for Convergence*, 22 COMP. LAB. L. & POL’Y J. 5, 16–17 (2000) (examining a theory of path dependence as applied to the Japanese economy). Mark West performed an empirical study on Japanese and U.S. corporate laws and found that the two corporate laws are actually diverging and not converging. This study was only made possible because of the odd historical fact that the Japanese Commercial Code was based on the Illinois Business Corporation Act of 1933. West argued that the divergence was likely caused by a difference in the institutions in Japan – primarily the lack of competition among domestic firms and the reliance on exogenous shocks to stimulate regulatory change. See Mark D. West, *The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States*, U. PA. L. R. 527, 601 (2001). The criticism of divergence theories is that they appear to argue that convergence of corporate governance regimes is not possible or that changes are possible only within a narrow band. However, history has shown this is clearly not the case because there is some convergence happening, at least among global publicly traded companies. The arrival of hostile takeover bids in Japan is a perfect example of this.

one theory attempts to combine all of these insights into a “Layered Approach.”³⁴

This article explores the ability of the three different theoretical frameworks from the corporate governance convergence literature to explain the arrival of hostile takeover bids in Japan. The frameworks are: The traditional economic convergence theories, the more recent selective adaptation theories, and the Layered Approach.³⁵

The analysis in this article is organized into six sections. First, the traditional convergence theories are discussed. Second, the economic theory of selective adaptation is discussed. Third, the alternate version of selective adaptation based on sociology and cultural analysis is discussed. Fourth, the Layered Approach to convergence is discussed. Fifth, a historical and institutional account of the arrival of hostile takeovers in Japan is provided. Sixth, the different theories are compared to determine which theory better explains the Japanese experience. Finally, the article concludes by suggesting the Layered Approach is preferred, and predicts where the Japanese corporate governance system is likely to go in the future and whether the expected wave of hostile takeover bids will materialize.

PART 1 – CONVERGENCE THEORIES

A. *The Theories*

Corporate governance convergence theories contend that due to the competitive forces of economic efficiency there will be a global convergence in corporate governance rules towards the Anglo-American shareholder oriented model. The strong-form of convergence theory was argued by Henry Hansmann and Reinier Kraakman in 2001.³⁶ They predicted “the end of history” for corporate law because, in their view, global ideological convergence on the U.S. shareholder oriented corporate governance model had already occurred. They went so far as to say:

There is no longer any serious competitor to the view that corporate law should principally strive to increase

³⁴ See Michael Cody, *Corporate Governance Reform in the People’s Republic of China: the Layered Approach to Convergence*, 3 CORP. GOV. L. R. No. 4, 366 (2007) (describing the layered approach).

³⁵ The divergence theories will not be discussed in this paper because the arrival of hostile takeover bids in Japan suggest that some level of convergence is occurring. Two different versions of selective adaptation are discussed in this article: one based on economic analysis; the other based on cultural and sociological analysis. See discussion of convergence theories *infra* Part 1.

³⁶ Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 455 (2001).

long-term shareholder value. This emergent consensus has already profoundly affected corporate governance practices throughout the world. It is only a matter of time before its influence is felt in the reform of corporate law as well.³⁷

The softer version of the convergence theory is offered by John Coffee who argues that there will be some convergence in the corporate governance regulations of the largest publicly traded companies, even if corporate law convergence may not happen.³⁸

B. Critiques of Convergence Theories

The major criticism of both convergence theories is that they are very Western. In fact, the convergence theories are part of a larger set of economic based Western centric theories that assume superiority of the Anglo-American capitalist economic system. The larger set of economic theories include: the globalization theory which claims that inevitable economic forces are more powerful than nation states,³⁹ the rights hypothesis of new institutional economics (NIE) which claims that enforceability of contract rights and security of private property

³⁷ *Id.* at 439.

³⁸ John C. Coffee & Adolf A. Berle, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 140 (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 144, 1999), available at <http://ssrn.com/abstract=142833>.

³⁹ See generally MARTIN WOLF, *WHY GLOBALIZATION WORKS* (2004); JAGDISH BHAGWATI, *in DEFENSE OF GLOBALIZATION* (2004). The globalization theory is also heavily criticized by scholars. See, e.g., PITMAN B. POTTER, *THE CHINESE LEGAL SYSTEM: GLOBALIZATION AND LOCAL LEGAL CULTURE* 5 (2001) (hereinafter *CHINESE LEGAL SYSTEM*) (“While the capacity of the liberal industrial economies to promote visions of globalization derives as much from political and economic power as from the inherent wisdom of the ideas themselves, there is little doubt that the influence of liberal ideals of private property have spread dramatically in the past decade. . . . [L]iberal legal norms associated with globalization constitute a belief system driven by changing historical conditions of socio-economic and political relations in Europe and North America. The essentially one-way direction by which these norms are disseminated around the world reflects the imbalances in political and economic power between developed and developing economies that characterize the current dynamic of globalization.”); see also JOHN RALSTON SAUL, *THE COLLAPSE OF GLOBALISM AND THE REINVENTION OF THE WORLD* (2005). For an older critique of the theories of economic free trade and mercantilism see generally KARL POLANYI, *THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME* (2d ed. 2001) (arguing that when these types of economic theories are allowed to dominate society, bad consequences result; and that the consequences of 19th century mercantilism included the World War I, the Great Depression, and the rise of fascism and communism).

rights are both necessary for economic development,⁴⁰ and the law and finance literature which claims that common law legal systems are superior to civil law legal systems for supporting a market economy.⁴¹ The common theme of these theories is that global convergence on the Anglo-American economic model is inevitable because of economic competitive pressures. The convergence theories tend to ignore the fact that economies with very different institutional structures from Anglo-American economies have shown the ability to grow. In some cases, those economies have grown at a rate far exceeding the growth of Anglo-American countries. Japan is a prime example.⁴² Another criticism of the convergence theories is that they tend to ignore the role that local culture and institutions play in structuring the economy and determining corporate governance structures.⁴³

A final criticism of convergence theories is they are too simplistic because they ignore the role that individual actors (both individuals and governments) play in the convergence process—both in the selection of which foreign corporate governance institutions to adopt and the way in which those institutions are interpreted by individuals. In other words, the process of adapting foreign legal institutions into a local culture is a far more complicated process than the convergence theories present.

⁴⁰ See generally DOUGLASS NORTH, *STRUCTURE AND CHANGE IN ECONOMIC HISTORY* 20–21 (1981) (hereinafter *STRUCTURE AND CHANGE*) (describing the NIE); DOUGLASS NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE* (1990) (hereinafter *INSTITUTIONS*); Donald Clarke, *Economic Development and the Rights Hypothesis: The China Problem*, 51 *AM. J. COMP. L.* 89 (2003) (criticizing the Rights Hypothesis).

⁴¹ See generally Rafael La Porta et al., *Legal Determinants of External Finance*, 52 *J. FIN.* 1131 (1997); Rafael La Porta et al., *Law and Finance*, 106 *J. POL. ECON.* 1113 (1998).

⁴² For examples of studies highlighting the different institutional structures of these economies and the way those institutional structures contributed to hyper-economic growth, see generally, DOUG GUTHRIE, *DRAGON IN A THREE PIECE SUIT* (1999); CHALMERS JOHNSON, *MITI AND THE JAPANESE MIRACLE* (1982); EUN MEE KIM, *BIG BUSINESS, STRONG STATE* (1997); Gary Hamilton, *Organization and Market Process in Taiwan's Capitalist Economy*, in *THE ECONOMIC ORGANIZATION OF EAST ASIAN CAPITALISM* 237, 237–93 (Marco Orrú, Nicole W. Biggart, & Gary G. Hamilton eds., 1997).

⁴³ See Donald Clarke, *Puzzling Observations in Chinese Law: When is a Riddle just a Mistake?* in *UNDERSTANDING CHINA'S LEGAL SYSTEM: ESSAYS IN HONOR OF JEROME A. COHEN* (C. Stephen Hsu ed., 2003).

C. *The Evidence in Japan*

Curtis Milhaupt has recently written about how the arrival of hostile takeover bids in Japan provides evidence in support of convergence theories:

To date, developments in Japan provide powerful – even astonishing evidence in support of the strong convergence theory. One way to interpret these developments is that intellectual convergence on the shareholder-oriented model, propelled by novel transactions, driven by overriding concerns for financial returns, is gradually breaking down resistance to change, and inexorably drawing Japan’s corporate governance institutions closer to those of the United States. Indeed, the Japanese situation appears to be playing out in much the way that Professors Hansmann and Kraakman have suggested: “As shareholding patterns become more homogenous (as we expect they will), and as corporate cultures everywhere become more accommodating of takeovers (as it seems destined to do), takeovers presumably will become much more common in Europe, Japan and elsewhere.”⁴⁴

However, Milhaupt acknowledges that, at a closer look, there is something much more complicated going on than the traditional convergence theories suggest:

In all likelihood, however, the transplantation of Delaware takeover jurisprudence and the poison pill will lead to neither strong convergence nor to path-dependent blockage of further reforms. *Rather, preliminary evidence suggests that Delaware law will be adapted by the judiciary and other actors to suit local interests – indeed, a struggle for the “proper” interpretation of Delaware takeover jurisprudence in Japan is already taking shape. This struggle may well lead to a new governance regime, but its contours may look quite different from those in the United States.*⁴⁵

⁴⁴ Milhaupt, *supra* note 4, at 2203 (quoting Henry Hansmann and Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO L.J. 439, 457–58 (2001)).

⁴⁵ *Id.* at 2176 (emphasis added); *see also id.* at 2212 (explaining that, Milhaupt believes that convergence theories are not very good explanatory tools, “[y]et collectively, the convergence and law and finance literature still offer a rather anemic account of how corporate law evolves and why it matters to economic success.”); *id.* at 2209 (“Legal transplants are always tenuous experiments, and this particular transplant may be especially unpredictable. Japan has borrowed, not a single legal rule or procedural mechanism, but a complex body of common law principles and a sophisticated legal technology in the shareholder rights plan, which evolved

The remainder of this article uses the experience in Japan to explore this more complicated process of corporate convergence.

PART 2 – THE ECONOMIC VERSION OF SELECTIVE ADAPTATION THEORY

Curtis Milhaupt introduced an economic version of “selective adaptation” theory to explain the arrival of hostile takeover bids in Japan in 2005.⁴⁶ In that article, he argued the experience in Japan did not support the traditional convergence theories because the borrowing of foreign law in successful economies tends to be highly piecemeal and selective.⁴⁷ To accommodate this fact he offered a theory of selective adaptation. He summarized the theory in the following way:

The important dynamics at work in this Japanese experiment are masked by the prevailing analytical constructs in the comparative corporate governance literature. In practice, successful economies do not abandon their institutions for foreign models. Rather, foreign legal technologies are selectively adopted locally, then adapted by coalitions of market and governmental actors to suit their own interests. The potential to enhance shareholder protections is one motivation for the foreign borrowing, but many other motivations are also at work. The result is not so much a *convergence* of systems on the Anglo-American model as the unsettling *telescoping* and *stacking* of borrowed legal institutions on top of domestic governance structures.⁴⁸

Milhaupt’s selective adaptation focuses on how foreign legal institutions are *telescoped* (selected) and *stacked* (adapted) with local legal institutions:

In practice, borrowed rules (and the home country experience surrounding their formation and interpretation) are telescoped into a convenient or politically palatable package and stacked atop existing institutions in the host country. Only through repeated strategic and adaptive responses by local actors are the new rules and old institutions eventually welded together into something functionally operative. By that point, the result is inevitably distinct from both the borrowed rule as it operated

through an iterative process of strategic and adaptive responses over two decades in tandem with market developments.”).

⁴⁶ See, e.g., *id.* at 2171.

⁴⁷ *Id.*

⁴⁸ *Id.* at 2176–77.

in the home country and the pre-existing institution in the host country.⁴⁹

Milhaupt's theory of selective adaptation offered three very significant advances in convergence theory. First, he recognized that there is a very complicated process taking place where foreign institutions are combined with local institutions for new effect. Second, he recognized that the convergence process was not inevitable and that participants (both individuals and governments) have a role to play in directing the changes. Third, his use of institutional analysis offered a fuller contextual explanation of the convergence process than the more simplistic traditional convergence theories where the structural differences between two societies are assumed away so that the analysis can focus on economic efficiency.

Notwithstanding these important advances, Milhaupt's theory has a significant weakness. He uses a narrow understanding of what constitutes an institution. His definition of institution is taken from new institutional economics (NIE),⁵⁰ and, in particular, the work of Douglass North.⁵¹ NIE defines institutions in a Western way. It recognizes only the institutions that supported the *economic growth* of Anglo-American societies.⁵² North's definition of institutions is: "a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of *maximizing the wealth or utility of principals.*"⁵³

Examples of NIE institutions are enforceable contract rights and private property rights. For example, Milhaupt identified the institution of poor information disclosure in Japan.⁵⁴ The goal of NIE analysis is to argue domestic institutions that differ from Western institutions should be replaced by Western institutions to stimulate eco-

⁴⁹ *Id.* at 2213–14.

⁵⁰ CURTIS MILHAUPT & MARK D. WEST, ECONOMIC ORGANIZATIONS AND CORPORATE GOVERNANCE IN JAPAN: THE IMPACT OF FORMAL AND INFORMAL RULES 1 (2004); GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS (Curtis Milhaupt ed., 2003) (providing examples of Milhaupt's other work with NIE and comparative corporate governance).

⁵¹ See generally STRUCTURE AND CHANGE, *supra* note 40; INSTITUTIONS, *supra* note 40.

⁵² NIE is not capable of recognizing social institutions. An example in the Japanese context is the Japanese institution of "administrative guidance." A full understanding of the convergence process is not possible without taking these social institutions into account. See *infra* pp. 37–41 (describing how administrative guidance affects the convergence process).

⁵³ STRUCTURE AND CHANGE, *supra* note 40, at 201–02 (emphasis added).

⁵⁴ See MILHAUPT & WEST, *supra* note 50, at 135.

conomic growth.⁵⁵ By definition, the advantage of initially identifying the domestic institution is lost because of the theoretical framework's inability to understand the institution in its own local and cultural context.

In effect, the NIE definition of institution predetermines the outcome of any analysis that uses it. In a simplistic way, it is like conducting an analysis to determine who is more American: the Japanese, the Chinese, or the Americans? Even more to the point, after acknowledging the importance of institutional analysis or the cultural differences between the Japanese, the Chinese, and the Americans, the researcher still runs a study to determine who is most American. What if the other societies have social, instead of economic, goals that they take into account when deciding how to structure their societies, such as the preservation of social stability or specific social institutions like lifetime employment or a seniority wage system?⁵⁶ Those social goals cannot be accommodated within the NIE institutional framework. Therefore, for institutional analysis to work in an analysis of Japan, it must be used outside of the economic paradigm. When the broader sociological definition of institutions is adopted, the institutions identified by institutional analysis can be understood from the cultural perspective of the society that created them and not through the lens of Anglo-American economic analysis.⁵⁷

⁵⁵ For example, Milhaupt wrote that the role of Delaware law in global corporate governance convergence may be in its ability to help break down domestic institutions: "Thus, in both systems, corporate law has crucially served to coordinate the expectations of market participants during phases of institutional transition. This role for corporate law has been largely overlooked in the comparative corporate governance literature, which has become fixated on minority shareholder protections. *Returning to the discussion of convergence, gravitation toward Delaware corporate law may signal recognition in other countries, at least implicitly, that its main features are suited to playing this central role in efficient economic adaptation. Serving as a focal point for market and institutional change may in fact be one of the most important ways in which corporate law matters to successful economies.*" Milhaupt, *supra* note 4, at 2215 (emphasis added).

⁵⁶ These institutions are disappearing in Japan. See Christina Ahmadjian & Gregory Robbins, *A Clash of Capitalisms: Foreign Shareholders and Corporate Restructurings in 1990s Japan*, 70 AM. SOC. REV. 451 (2005).

⁵⁷ A similar argument was made with respect to the application of institutional analysis to China. See Michael Cody, *Selective Adaptation and Corporate Governance Reform in the P.R.C.* (on file with author). Institutional W. Richard Scott shares this perspective. In writing about the changes occurring to Chinese enterprises he stated: "In short, the changes underway are more profound than is suggested by a narrow focus on property rights or incentives, involving fundamental changes in the types of social actors – both individual and collective-regarded as legitimate and in the institutional logics that govern their actions. Indeed, the prevailing focus on 'property rights' seems to me to be inappropriate for the Chi-

PART 3 – OTHER THEORIES OF SELECTIVE ADAPTATION

Two theories of selective adaptation predated Milhaupt's theory. Neither was based on economic analysis. Pitman Potter offered the first of these theories in 2001, in his work on the legal reforms occurring in China.⁵⁸ The second was proposed by Tom Ginsburg in 2002 in his work comparing the current set of reforms in Japan with the reforms of the Meiji era.⁵⁹

Potter's work was motivated by the mistaken belief in Western societies that the legal reforms undertaken in China in the 1990s were the beginning of a broad movement toward the acceptance of Western institutions, and that political reforms would follow shortly thereafter. This belief was based on the fact that some of the terminology used in the reforms was familiar to Westerners, for example, "corporations." Potter argued this was a mistaken assumption that would lead to frustration for foreigners doing business in China.⁶⁰ Potter's book, *The Chinese Legal System: Globalization and Local Legal Culture*, was an attempt to explain how China adapts international norms to local conditions. In it he offered his theory of selective adaptation. He argued local legal culture⁶¹ affects the adoption of foreign legal institutions and that China was not a "blank slate upon which can be written the

nese context." See W. Richard Scott, *The Changing World of Chinese Enterprise: An Institutional Perspective*, in *THE MANAGEMENT OF ENTERPRISES IN THE PEOPLE'S REPUBLIC OF CHINA*, 59, 70 (Anne Tsui & Chang Ming Lau eds., 2002).

⁵⁸ Potter developed his theory of Selective Adaptation in the following works: *CHINESE LEGAL SYSTEM*, *supra* note 39; *Globalization and Economic Regulation in China: Selective Adaptation of Globalized Norms and Practices*, 2 *WASH. U. GLOBAL STUD. L. REV.* 119 (2003) (hereinafter *Globalization and Economic Regulation*); *LEGAL REFORM IN CHINA: INSTITUTIONS, CULTURE, AND SELECTIVE ADAPTATION*, 29 *LAW AND SOC. INQUIRY* 465 (2004) (hereinafter *LEGAL REFORM IN CHINA*).

⁵⁹ Tom Ginsburg, *Japanese Legal Reform in Historical Perspective* (on file with author).

⁶⁰ See Clarke, *supra* note 43, at 93 ("For a Western-trained lawyer encountering Chinese law for the first time, a reaction other than perplexity is a bad sign – it means that one has not really grasped the depth of the problem of understanding.").

⁶¹ Potter identifies two components of local Chinese legal culture: Official legal culture which reflects the norms of instrumentalism (laws and regulations are instruments of policy; law can be used as a tool for social change) and formalism (the content of law is assumed to represent reality or that there are no gaps between the content of the law and the operation of the law); and popular norms which reflect the preference for informal relationships and autonomy (preference for extra-legal mechanisms to accomplish goals to protect parties from state intrusion e.g. *guanxi*). See *CHINESE LEGAL SYSTEM*, *supra* note 39, at 11–15. Potter's theory relies heavily on the concept of local legal culture to explain the Chinese-specific aspects of Chinese society. For the purposes of this paper, the concept of social institutions will be preferred over the concept of local legal culture because institu-

normative preferences of the regime, imported or otherwise.”⁶² Potter’s theory of selective adaptation argued that local actors and culture select which components of foreign laws to implement:

Selective adaptation describes a process by which foreign ideas are received and assimilated into local conditions. . . societies engage in selective adaptation as a coping strategy for balancing local regulatory imperatives with requirements of compliance with foreign norms largely derived from the regimes of liberal democratic capitalism. . . This involves a complex process of selectively adapting foreign norms to local needs. In contrast to ideologies of convergence, suggesting development toward a unified system, of institutional practices, selective adaptation is a useful perspective for examining the interplay or difference and conformity in the interaction between the global and the local.⁶³

The extent of the implementation of foreign norms (or selectivity) depends on three elements: perception, complementarity and legitimacy. Perception refers to local actors understanding about the foreign institutions to be imported and their origins and implications. Complementarity refers to the process through which the foreign institution is combined with the local institution to create a new institution that remains true to local values. Legitimacy refers to the extent to which local actors support the purposes and consequences of the selective adaptation process.⁶⁴

tions are much easier to define than culture. Potter himself admits to the difficulties of trying to define culture. *See id.*

⁶² *Id.* at 6. This view is also shared by Chinese legal scholars. *See, e.g.,* Sibao Shen, *China’s New Corporate Governance Measures After its Accession into the WTO*, 17 AUSTL. J. CORP. L. 6, 6–7 (2004) (“However, people in China are likely to see issues of corporate governance in accordance with their own ways of thinking; this will be heavily influenced by traditional Chinese culture so that corporate governance, as a borrowed notion, may face many pitfalls created by such thinking and behavior. Thus, there is a clash between the original definition of corporate governance and Chinese traditional values. This is one of the root causes of the many imperfections that can be found in relation to corporate governance in China.”).

⁶³ *Globalization and Economic Regulation*, *supra* note 58, at 119–21.

⁶⁴ Potter provides the following description of the three components:

Perception determines understanding (and misunderstanding) about foreign and local regulatory norms and their origins and implications. Thus, perceptions about the purpose, content, and effect of foreign and local regulatory norms may determine the focus and parameters for selection and adaptation. Complementarity describes a circumstance by which apparently contradic-

Tom Ginsburg also described the tendency for Japanese society to selectively adapt foreign legal institutions from other countries.⁶⁵ His theory is based largely on his historical analysis comparing the reforms of the Meiji era (1868–1905) with the reforms of the current Heisei era. From his analysis he concluded, “Japan’s legal history has involved a series of adaptations of foreign institutions into domestic soil.”⁶⁶ Ginsburg argued external forces or foreign pressure may initiate reforms, but internal forces, particularly domestic business interests in the case of Japan, quickly took over direction of the reforms.⁶⁷ For Ginsburg, the existence of the internal direction of reforms is important because rather than adopting foreign legal institutions *carte blanche* in response to foreign pressure, he argues that internal forces direct changes and “[t]he emphasis on selective adaptation empowers those doing the selecting.”⁶⁸

PART 4 – THE LAYERED APPROACH

The layered approach to convergence uses the levels of analysis concept from institutional analysis in sociology to combine insights from the economic, selective adaptation, and other convergence theories for a more complete explanation of how the corporate governance convergence process works. The levels of analysis concept acknowledges that all social phenomena are complex and that no single theory is sufficiently sophisticated to explain the entirety of any social pro-

tory priorities are combined for new effect, while still preserving essential characteristics of each component. In the context of economic regulation, the effectiveness of selective adaptation may depend on the capacity to combine local and foreign regulatory norms in ways that address globally derived challenges while remaining true to established local values. Legitimacy reflects the extent to which members of local communities support the purposes and consequences of selective adaptation. While the forms and requirements of legitimacy may vary with time, space, and context, the effectiveness of selectively adapted regulatory norms depends to an important degree on legitimacy of the content and process of selection.

Id. at 119–21.

⁶⁵ See generally Ginsburg, *supra* note 59.

⁶⁶ *Id.* at 24.

⁶⁷ *Id.* at 29. Ahmadjian and Robinson reached the same result in their empirical study of the de-institutionalization of lifetime employment in Japan. See Christina L. Ahmadjian & Patricia Robinson, *Safety in Numbers: Downsizing and the Deinstitutionalization of Permanent Employment in Japan*, 46 ADMINISTRATIVE SCIENCE QUARTERLY, Dec. 2001, at 622. For further arguments that external forces or “exogenous shocks” cause changes in Japan, see generally West, *supra* note 33.

⁶⁸ Ginsburg, *supra* note 59, at 28.

cess, including corporate governance convergence. The concept acknowledges that different theories better explain different levels of analysis, and it is acceptable to combine them in a blended approach.⁶⁹

The levels of analysis that are relevant to convergence are:

1. Individual actor level
2. Social structure or institutional level
3. Societal level

The layered approach is based on a sociological definition of social institution that is broad and free from cultural centrism: "Institutions are social structures that have attained a high degree of resilience. Institutions are composed of cultural-cognitive, normative, and regulative elements that, together with associated activities and resources, *provide stability and meaning to social life.*"⁷⁰ As the italicized language indicates, the purpose of social institutions is societal stability. Society consists of sets of interrelated social institutions including: family, church, school, business enterprises, corporations, political parties, and the state. Social institutions are sets of formal stable relations. They are rules that define individual roles in specific areas of society and they normally have built-in mechanisms of enforcement. Collectively, they define "who we are and what we do."⁷¹ Gore describes the importance of social institutions in the following way:

We are born and socialized into the existing institutions, such as family, church, school, and workplace. These are the basis of our identity formation and perception of self-interests. Our rule-following or institutionalized behaviour (which represents the bulk of the routine choices we make in a day) requires a shared back-ground knowledge so taken for granted that it becomes part of our collective identity. This is the cultural reinforcement of existing institutions, which explains why even strategi-

⁶⁹ For further development of this theory, see generally Michael Cody, *Corporate Governance Reform in the People's Republic of China: the Layered Approach to Convergence*, 3 CORP. GOV. L. R. No. 4, 366 (2007).

⁷⁰ Scott, *supra* note 57, at 60 (citing W. RICHARD SCOTT, INSTITUTIONS AND ORGANIZATIONS 48 (2d ed. 2001)) (emphasis added). This view of institutions is far richer than the view adopted by economists, and it allows cultural and social variables to be included in analysis of market behavior in addition to profit maximizing behavior.

⁷¹ For a discussion of sociological institutional theory, see LANCE GORE, MARKET COMMUNISM: THE INSTITUTIONAL FOUNDATION OF CHINA'S POST-MAO HYPER-GROWTH 24 (1998). See generally INSTITUTIONAL PATTERNS AND ORGANIZATIONS: CULTURE AND ENVIRONMENT (Lynne G. Zucker ed., 1988); THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS (Paul DiMaggio & Walter W. Powell eds., 1991).

cally oriented individuals chronically reproduce or acquiesce to social structures that are not in their best interests.⁷²

The layered approach utilizes concepts from institutional analysis in sociology. First, the corporation is a social institution. Second, the institutional structure of an industrialized nation is set at the time the country emerges into industrialization.⁷³ Third, institutional structures change very slowly except in the case of social crisis. In the context of the convergence debate, it is best to think of social institutions (including the corporation) as “shock absorbers” for society. Their role is to create stability and to insulate society from dramatic or constant change. In performing this function they affect the pace and direction of change, even for corporate governance reform. The stronger a society’s existing social institutions, the longer it will take for changes to occur and the more the existing institutions will absorb the change and redirect it in a way that is complimentary to the existing institutions. Trying to bypass or speed up the process, as is often advocated by the economic theories, can have disastrous results.⁷⁴

According to the layered approach, convergence happens in the following manner:

1. Economic drivers trigger corporate governance reform.⁷⁵
2. Corporate governance convergence is more likely to occur among firms that operate in the same field (i.e. global companies listed on public exchanges).⁷⁶
3. The speed and direction of convergence is affected by local social institutions.⁷⁷

⁷² See GORE, *supra* note 71, at 24–25.

⁷³ See NEIL FLIGSTEIN, *THE ARCHITECTURE OF MARKETS: AN ECONOMIC SOCIOLOGY OF TWENTY-FIRST CENTURY CAPITALIST SOCIETIES* 36 (2001).

⁷⁴ See, e.g., Bernard Black, Reiner Kraakman & Anna Tarasova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 *STAN. L. REV.* 1731 (2000) (discussing the lessons learned from the “shock therapy” treatment undertaken in Russia).

⁷⁵ This element relates to the societal level of analysis and it preserves the insight from the economic theories that economic efficiency creates pressure for corporate governance convergence.

⁷⁶ This element relates to the institutional level of analysis and it is based on the concepts of fields and isomorphism from institutional analysis and the weak-form convergence theory offered by Professor Coffee.

⁷⁷ This element of the theory also relates to the institutional level of analysis and it preserves the insight offered by path dependence theory and utilizes the basic insight of institutional theory—that social institutions affect the process of change.

4. Government and market participants play a significant and active role in “selecting” which foreign corporate governance rules will be “adapted” into the local corporate governance regime.⁷⁸

The layered approach is an improvement over the previous convergence theories because it is able to accommodate all of their insights together with explaining how social institutions affect the convergence process.

PART 5 – ANALYSIS OF ARRIVAL OF HOSTILE TAKEOVERS IN JAPAN

The dramatic changes that occurred in Japanese corporate governance over the past fifteen years are an ideal situation to test the various corporate governance convergence theories. Since the end of World War II, one of the distinguishing features of the Japanese corporate governance system has been an extremely low degree of influence exercised by shareholders.⁷⁹ The absence of hostile takeover bids is one indicium of low shareholder influence. This low degree of influence was identified by Chalmers Johnson as one of the “improved institutional arrangements” that contributed to the “Japanese Miracle.”⁸⁰ During the 1980s, this institution was widely portrayed as

⁷⁸ This element of the theory relates to the social actor level of analysis and it includes the insights offered by the selective adaptation theories. In short, actors are able to make choices that direct change and there is nothing inevitable about corporate governance convergence.

⁷⁹ From an institutional perspective, the arrival of hostile takeover bids in Japan can be studied as a “de-institutionalization” of low shareholder influence. In the past, institutional analysis focused on the process of how new practices became institutionalized. See Paul Dimaggio & Walter Powell, *Introduction*, in Dimaggio, *THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS* (1991); W. RICHARD SCOTT, *INSTITUTIONS AND ORGANIZATIONS* (1995). Practices become institutionalized when they spread and persist for social reasons regardless of whether they are economically or technically efficient. However, recent studies in institutional analysis have begun to focus on deinstitutionalization, or how practices are eliminated across an organizational population and replaced with new practices. *Id.* See generally Christine Oliver, *The Antecedents of Deinstitutionalization*, 13 *ORGANIZATION STUDIES* 563 (1992) (theorizing that certain political, functional and social factors preceded deinstitutionalization and could be used as predictors of deinstitutionalization including: changes in government regulations, declining economic performance and changes in social values); Ahmadjian & Robinson, *supra* note 67 (suggesting an alternate theory that hypothesizes economic pressures trigger deinstitutionalization but social and institutional pressures shape the pace and process of deinstitutionalization).

⁸⁰ JOHNSON, *supra* note 42, at 12, 240 (1982).

a competitive strength of the Japanese economic system.⁸¹ However, it has come under severe criticism since the beginning of the Japanese recession in 1990. It is widely believed that the Japanese corporate governance system is incapable of disciplining ineffective managers. Under the weight of mounting criticism from international scholars, market participants, and the business press, along with continued poor economic performance, there has been a decade of remarkable change in Japan. Japan has moved away from the stakeholder based corporate governance system and its low degree of shareholder influence toward the Anglo-American shareholder based corporate governance model and its high degree of shareholder influence. This Anglo-American model is characterized by managerial policing of activist board members and the threat of hostile takeover bids.

This part will analyze the changes to the Japanese corporate governance system by looking at the state of shareholder influence in Japan at two points in time: 1990, just before the beginning of the recession, and today.

A. *The Japanese Corporate Governance System in 1990*

1. *The Stakeholder Corporate Governance System in Japan*

The Japanese corporate governance system in 1990 was characterized by concentrated shareholders, close bank centered corporate networks, debt financing from group banks, internal labor markets, and an emphasis on growth over profitability.⁸² This system has been referred to as a “stakeholder” governance system because it was based on the recognition of the interests of a number of corporate stakeholders, including employees, creditors, trading partners and lastly shareholders.⁸³

Japan created this distinct governance system after World War II based on the policies adopted by the occupation forces to eliminate

⁸¹ See, e.g., D. ELEANOR WESTNEY, *JAPANESE ENTERPRISE FACES THE TWENTY-FIRST CENTURY* 125 (Paul DiMaggio ed., 2001). See generally MICHEL ALBERT, *CAPITALISM VS. CAPITALISM: HOW AMERICA'S INDIVIDUAL ACHIEVEMENT AND SHORT-TERM PROFIT HAVE LED IT TO THE BRINK OF COLLAPSE* (Paul Haviland trans., 1993); P. Hall & D. Soskice, *An Introduction to Varieties of Capitalism*, in *VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE* 1–70 (P. Hall ed., 2001); EZRA VOGEL, *JAPAN AS NUMBER ONE: LESSONS FOR AMERICA* (1979).

⁸² Ahmadjian & Robbins, *supra* note 56, at 451–52.

⁸³ Ahmadjian & Robbins, *supra* note 56, at 454; Hugh Patrick, *Evolving Corporate Governance in Japan*, 8 (Ctr. on Japanese Econ. & Bus., Columbia Bus. Sch., Working Paper No. 220, 2004); Janis Sarra & Masafumi Nakahigashi, *Balancing Social and Corporate Culture in the Global Economy: The Evolution of Japanese Corporate Structure and Norms*, 24 *LAW & POL'Y* 299, 300 (2002).

the *zaibatsu*.⁸⁴ The occupation forces intended to set up a new competitive economic system with widely diffused share ownership (and power) so that the economic system would never again become an instrument for military designs.⁸⁵ While the policies were successful and eliminated the concentrated share ownership of the *zaibatsu* families, the system was replaced by another form of concentrated share ownership characterized by *mochiai*, or cross shareholding structures (CSSs).⁸⁶ Through these CSSs, Japanese corporations and their main financial banks transformed the traditional Japanese business groups by holding each other's shares.⁸⁷

The use of CSSs grew from the 1950s to the 1970s as companies sought to stabilize management, strengthen business ties with other companies, and protect themselves from the threat of foreign takeovers during the liberalization of the economy in the 1960s.⁸⁸ The use of CSSs expanded even further during the economic boom of the 1980s as companies purchased each other's stock offerings.⁸⁹ Estimates place the level of CSSs around twenty-five percent of total shareholdings in the 1950s, rising to forty-five percent in the 1960s, and above fifty percent in the 1970s.⁹⁰ As a result of the CSSs, shareholders exerted little influence, and the ownership structure of Japanese firms remained remarkably stable from the 1970s through to the 1990s.⁹¹

During the 1980s, the Japanese stakeholder governance system became recognized as one of the distinctive features of the Japanese economic system.⁹² This governance system allowed managers to focus on long-term growth instead of short-term profit.⁹³ It also indi-

⁸⁴ Patrick, *supra* note 83, at 5.

⁸⁵ JOHANNES HIRSCHMEIER & TSUNEHIKO YUI, *THE DEVELOPMENT OF JAPANESE BUSINESS: 1600-1973*, at 230 (1975).

⁸⁶ Katsumasa Suzuki, *Future Prospects of Takeovers in Japan Analyzed from the View of Share-ownership Structures and Laws in Comparison with the United States and the European Union*, 42 COLUM. J. OF TRANSNAT'L L. 777, 814 (2004).

⁸⁷ *Id.* at 777.

⁸⁸ Hideaki Inoue, *Companies Continue to Unwind Cross-Shareholdings: The Fiscal 1999 Cross-Shareholding Survey*, NLI Research Institute, No. 145, at 11, 15 (2000), available at <http://www.nli-research.co.jp/english/economics/2000/economy0010a.pdf>; Suzuki, *supra* note 86, at 815.

⁸⁹ *Id.* at 15.

⁹⁰ Hideaki Miyajima & Kuroki Fumiaki, *The Unwinding of Cross-Shareholding: Causes, Effects and Implications in*, CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 79, 84-85 (Masahiko Aoki et al. ed., 2007).

⁹¹ *Id.* at 85.

⁹² Patrick, *supra* note 83, at 9 (discussing the self-confidence in the system, which was reinforced in the 1980s).

⁹³ Ahmadjian & Robbins, *supra* note 56, at 455.

rectly supported several other unique Japanese institutions, including the long-term employment structure and the seniority-based wage practice.⁹⁴ Some scholars even advocate that the stakeholder model should be adopted by the United States.⁹⁵

To see the distinctive character of the Japanese governance system in 1990, on the eve of the recession, one need only read the words of Kanji Ishizumi describing the prevailing social feelings concerning companies and their stakeholders:

Undoubtedly, the majority within Japan would say without hesitation that [companies] exist ordinarily for the benefit of their employees. Correspondingly, employers and senior business executives are under an obligation to exert their best business efforts to assure the financial stability of their employees, and in turn, their dependents. A Japanese company can be compared to a ship, with the employer and senior executives as its captains and chief officers, and the employees as its crew – a community bound together by a common destiny. For any employee, the corporation for which he works is as important as his own private life, because once he has joined the company he will (under the lifetime employment practice presently prevailing in Japan) spend at least 35-40 years there, probably until he reaches retirement age. As an employee of the company, he experiences the joys and sorrows of life – through human relationships, successes and failures, and promotions and demotions – just as he does at home in his private life. For many Japanese, companies are much more than just the place of work where they are forced to contribute their labor in exchange for a salary and fringe benefits. *Therefore attempts by the owner of the company, whether its founder or chief executive officer, to sell the controlling interest to an outsider are seen as betrayal, analogous to that of a captain of a ship deserting his crew in a storm.*⁹⁶

The low degree of influence exercised by shareholders characterized the unique Japanese stakeholder governance system.⁹⁷ As late as 1990, shareholders in Japan exercised none of the activist rights that

⁹⁴ See JOHNSON, *supra* note 42, at 12. It should be noted that these two institutions are also in the process of being de-institutionalized in Japan. See, e.g., Patrick, *supra* note 83, at 23.

⁹⁵ See, e.g., ALBERT, *supra* note 81, at 75.

⁹⁶ KANJI ISHIZUMI, ACQUIRING JAPANESE COMPANIES: MERGERS AND ACQUISITIONS IN THE JAPANESE MARKET 12 (1990) (emphasis added).

⁹⁷ Patrick, *supra* note 83, at 7.

North American investors would be accustomed to, including: electing shareholder representatives to boards of directors, combating proxy fights for control of corporations, or encouraging shareholder maximization transactions in the form of takeover bids or mergers and acquisitions activity.⁹⁸

2. *Measurements of Shareholder Influence*

There are a number of ways to measure shareholder influence. In a 2005 study, Ahmadjian and Robbins measured shareholder influence indirectly by examining the relationship between foreign ownership of shares in Japan and corporate restructurings through downsizing or asset divestitures—behaviors more consistent with the shareholder governance system than the stakeholder governance system.⁹⁹ They found that companies with higher percentages of foreign ownership were more likely to engage in downsizing or asset divestiture.¹⁰⁰ However, they also made a resource dependence¹⁰¹ argument that the influence of foreigners “depended on the degree to which a firm was embedded in the Japanese system through its ties to financial institutions or business groups.”¹⁰²

Given more recent events in Japan, including increasing examples of direct pressure being exerted through shareholder activism, it may be more appropriate to start measuring shareholder influence in Japan using direct shareholder activism variables. This article measures shareholder influence using two direct shareholder activism variables: (1) the existence of shareholder representatives on the board of directors, measured by whether a company has adopted the new U.S. style corporate structure, and (2) the existence of a market for corporate control, measured by the prevalence of hostile takeover bids or proxy contests.¹⁰³ The market for corporate control will be fur-

⁹⁸ *Id.* at 20.

⁹⁹ Ahmadjian & Robbins, *supra* note 56, at 451–52.

¹⁰⁰ *Id.* at 466.

¹⁰¹ See generally W. RICHARD SCOTT, ORGANIZATIONS: RATIONAL, NATURAL AND OPEN SYSTEM (5th ed. 2003). Resource dependency is an organizational theory. This theory emphasizes organizational adaptation. It assumes that organizations and their leaders can act to improve chances of survival of the organization if it can reduce its dependency on its environment. The need for the organization to acquire resources (capital, labor, supplies, etc.) makes it dependent on its environment. The scarcity of the resources determines the dependency of the organization.

¹⁰² Ahmadjian & Robbins, *supra* note 56, at 467.

¹⁰³ Other possible measurements for shareholder influence are: (1) number of derivative actions (suits brought by shareholders on behalf of the corporation) and, (2) the number of shareholder proposals put forward at the annual meeting—which is a complicated measure to use in Japan because of the existence of

ther analyzed by tracking the dissolution of the traditional CSSs that characterized the stakeholder governance system in Japan and the corresponding increase in foreign ownership of securities. In 1989, on the eve of the Japanese Recession, the measure of these shareholder influence variables was zero.¹⁰⁴

a. The Composition of Japanese Boards of Directors in 1990

In 1990, there were no shareholder representatives on boards of directors in Japan. Boards of directors in Japan were exclusively composed of former employees.¹⁰⁵ This can be explained by the dominance of the Japanese version of the stakeholder governance system with its emphasis on the importance of the interests of employees.¹⁰⁶

b. The Absence of a Market for Corporate Control in 1990

In 1990, there was no market for corporate control in Japan. Hostile takeover bids simply did not occur. In fact, only one hostile takeover bid had been attempted in Japan in the 1980s. In 1985, two foreign firms, Trafalgar Holdings (United States) and Glen International (United Kingdom) made a bid for Minebea Company. The bid was unsuccessful, and hostile bids did not return to Japan until 1999.¹⁰⁷ The cultural explanations offered for the absence of hostile takeover bids are no longer persuasive because of their recent arrival in Japan.¹⁰⁸ Similarly, legal scholars have concluded that there were no legal barriers to a market for corporate control.¹⁰⁹ Most commentators believe that the explanation for the absence of the market for corporate control in Japan was explained largely by the existence of the CSSs.¹¹⁰

There are two significant measures for CSSs. First, is the measure of stable shareholder holdings (*antei kabunushi*)—all shares held by “long-term shareholders” including commercial banks, insurance

Sokaiya. See CURTIS MILHAUPT & MARK WEST, ECONOMIC ORGANIZATIONS AND CORPORATE GOVERNANCE IN JAPAN: THE IMPACT OF FORMAL AND INFORMAL RULES 9–35 (2004) (discussing derivative actions and *Sokaiya* in Japan).

¹⁰⁴ The data for both of these variables for the years 1989 to 2004 are contained in Table 1.

¹⁰⁵ See WESTNEY, *supra* note 81, at 124; Sarra & Nakahigashi, *supra* note 83, at 339.

¹⁰⁶ WESTNEY, *supra* note 81, at 124.

¹⁰⁷ Dai Higashino, *Corporate Restructuring Picks up Steam (Part 2): New Currents and Prospects*, 9 JAPAN ECONOMIC MONTHLY, 3 (2004).

¹⁰⁸ See generally ISHIZUMI, *supra* note 96 (characterizing cultural explanation).

¹⁰⁹ See Suzuki, *supra* note 86.

¹¹⁰ See *id.*; see also Miyajima & Fumiaki, *supra* note 90.

companies, and other firms.¹¹¹ For the purposes of this paper this broader concept will be referred to as CSSs. The second measure is the narrower measure of shares held by “friendly” financial institutions or firms in reciprocal cross shareholding relationships (“RCSs”).¹¹² In 1989, on the eve of the Japanese Recession, CSSs were 44.9%¹¹³ and foreign shareholdings were 3.9%.¹¹⁴

3. *The Shareholder Corporate Governance System in Anglo American Jurisdictions*

The Japanese stakeholder governance system should be contrasted to the shareholder corporate governance system dominant in Anglo-American countries, particularly in the United States. In dramatic contrast to the Japanese stakeholder governance system, the shareholder governance system is characterized by dispersed share ownership, strong anti-trust tendencies, equity financing, external labor markets, and an emphasis on profitability over growth.¹¹⁵ In Anglo-American countries, shareholders have a significant amount of influence, and they actively exercise it by electing representatives to boards, fighting proxy contests, and supporting shareholder maximization processes, such as takeover bids. Comparatively, in the United States in 1989, boards often contained one or more shareholder representatives or outside directors and hostile takeover bids were commonplace. In fact, 1989 saw the closing of a decade of frantic takeover activity in the United States where one-third of the Fortune 500 companies had been subject to a takeover bid during the decade, a majority of those bids being hostile.¹¹⁶

4. *The Contrasting Feature between the Two Governance Systems: The Separation of Ownership from Control*

In 1932, Adolf Berle and Gardiner Means identified the separation of ownership from control as the major problem that resulted from

¹¹¹ Fumio Kuroki, *The Relationship of Companies and Banks as Cross-Shareholdings Unwind—Fiscal 2002 Cross Shareholding Survey*, N.L.I. INSTITUTE (2003), available at <http://www.nli-research.co.jp/english/economics/2003/eeco031118.pdf>.

¹¹² *Id.* at 3–4 (describing cross-shareholding relationships and long-term shareholding relationships).

¹¹³ *Id.* at 6.

¹¹⁴ Stock Exchange, *2008 Shareownership Survey*, 10 (2008), <http://www.tse.or.jp/english/market/data/shareownership/english2008.pdf>.

¹¹⁵ Ahmadjian & Robbins, *supra* note 56, at 451–52.

¹¹⁶ Gerald Davis and Suzanne Stout, *Organization Theory and the Market for Corporate Control: A Dynamic Analysis of the Characteristics of Large Takeover Targets, 1980–1990*, 37 ADMIN. SCI. Q. 605, 605 (1992).

the development of capitalism.¹¹⁷ For the first time in history, the owners of a corporation (the shareholders) were no longer the managers of the corporation.¹¹⁸ Through the evolution of the joint stock company, with diffuse stock ownership, the control of the owners had been handed over to professional managers.¹¹⁹ This was a serious structural problem in the system. Managers were no longer accountable to a stakeholder group that could effectively discipline them for poor performance. The United States shareholder governance system came to prominence in the last half of the twentieth century in large part to address the deficiency in stakeholder oversight. In the shareholder governance system, managers are obligated to act primarily in the best interests of shareholders, as opposed to other stakeholders. If they do not, they face the possibility of having activist shareholders on their boards, proxy battles, or hostile takeover bids being launched to gain control of their companies. In theory, the threat of such actions keeps managers honest.¹²⁰

Publicly traded companies in Japan, on the other hand, represented one of the most extreme adherences to the separation of ownership from control in publicly traded companies.¹²¹ Managers controlled Japanese firms and shareholders had almost no influence. Therefore, according to the theory, it was natural, as the recession continued throughout the 1990s, for there to be pressure to change the stakeholder governance system to make corporate managers in Japan more accountable and to force managers to make the tough decisions to return Japanese companies to their growth trajectories.¹²²

PART 6 – THE JAPANESE CORPORATE GOVERNANCE SYSTEM IN 2006

A. *The Increase in Shareholder Influence*

Over the last decade, the Japanese corporate governance system has undergone a remarkable period of change. The degree of

¹¹⁷ See generally ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (William S. Hein & Company 1982) (1932).

¹¹⁸ *Id.*

¹¹⁹ See Carlo Osi, *Board Reforms With a Japanese Twist: Viewing the Japanese Board of Directors With a Delaware Lens*, 3 *BROOK J. CORP. FIN. & COM. L.* 325, 341–42 (2009).

¹²⁰ The effectiveness of the shareholder governance system for addressing the issue of separation of ownership from control is ambiguous at best, but it is outside the scope of this paper.

¹²¹ Patrick, *supra* note 83, at 7. It is a curious historical fact that the occupation forces in Japan, by carrying out their policies of disbanding the *zaibatsu*, created the very problem they were trying to avoid at home.

¹²² See Jacoby, *supra* note 33, at 14–15.

change is best illustrated by examining the two measures of shareholder activism as they exist now.

B. *The Composition of Boards of Directors in 2006*¹²³

Japanese boards of directors are no longer composed exclusively of employees. Boards now increasingly include outside directors or shareholder representatives. In 2001, amendments to the Japanese Commercial Code introduced the concept of an “outside director”¹²⁴ and, in 2002, additional amendments gave Japanese corporations the option of adopting an Anglo-American “corporation with committees” structure.¹²⁵ This structure eliminates the traditional corporate auditor and replaces the internal auditing function with a board of directors composed of independent board members who sit on committees (including an audit committee).¹²⁶

Changes in corporate board composition speak to the drastic shift in how corporate boards and corporations are viewed in Japan. It is estimated that between thirty-six and sixty companies adopted the new corporate structure at their earliest opportunity in 2003¹²⁷ and that another 10 companies had boards of directors that had at least as many outside directors as inside directors.¹²⁸ The estimates on the number of companies adopting the new structure rose to 60 in 2004 and 125 in 2005.¹²⁹ This data is summarized in Table 1. These numbers are small considering that the number of listed companies in Japan is 2500.¹³⁰ However, their significance cannot be understated because of the dramatic shift in beliefs that they represent.

C. *The Market for Corporate Control in 2006*

Hostile takeover bids have also arrived in Japan. However, they are still isolated instances that have been precipitated by a small

¹²³ For the purposes of this paper, it is assumed that any company which adopted the new corporate structure has either outside directors or shareholder representatives on its board, and therefore the measure adequately measures shareholder influence.

¹²⁴ Mark Poe, Kay Shimizu & Jeannie Simpson, *Revising the Japanese Commercial Code: A Summary and Evaluation of the Reform Effort*, 2 STAN. J. E. ASIAN AFF. 71, 72–73 (Spring 2002).

¹²⁵ Hiroyuki Itami, *Revision of the Commercial Code and Reform of the Japanese Corporate Governance*, 2 JAPAN LAB. REV. 4 (2005), available at http://www.jil.go.jp/english/JLR/documents/2005/JLR05_itami.pdf.

¹²⁶ Ronald J. Gilson & Curtis J. Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J. COMP. L. 342, 352–53 (2005).

¹²⁷ Itami, *supra* note 125, at 9.

¹²⁸ Patrick, *supra* note 83, at 25.

¹²⁹ Itami, *supra* note 125, at 4, 11; Patrick, *supra* note 83, at 25.

¹³⁰ Patrick, *supra* note 83, at 25.

group of market actors. Hostile takeovers have not yet been accepted as a legitimate business practice by the larger Japanese business community. In fact, the larger business community seems more interested in defensive measures than the actual bids themselves.

Since 1999, there have been fifteen hostile takeover bids or proxy battles attempted. The data on these bids is presented by year in Table 1, and each of the bids is summarized in the Appendix. The Hills Tribe has figured prominently in most of the bids. All of the earlier bids were made by Murakami's M&A Consulting group or foreign firms and were not considered to be an indication of a general shift in Japanese business culture. However, some of the latest bids, including the Yushemin Holdings bid for JEC, the Oiji Paper bid for Hokuetsu Paper Mills and the Aoki Holdings bid for Futata Co. involve only Japanese market participants.¹³¹ These latest bids may be watershed events that signal a change in Japanese business culture that hostile takeover bids may become an acceptable business strategy in Japan. All of this evidence suggests that the institution of low shareholder activism may have begun to de-institutionalize over the period between 2000 and 2006.

PART 7 – CONVERGENCE OR SELECTIVE ADAPTATION?

In this section, the changes to the Japanese corporate governance system will be used to evaluate the traditional convergence theories and the alternate theory of selective adaptation. The aim of the analysis is to determine which theory is better at explaining what actually occurred in Japan.

A. *Japanese Hostile Takeovers and Convergence Theories*

The analysis outlined above shows clear evidence against the corporate convergence theories based on economic efficiency arguments. First, from a societal level, the governance reforms have taken place over a very long period of time (over a decade) even though Japanese firms performed poorly on an economic basis throughout much of the 1990s. Economic efficiency arguments would have predicted the changes to happen much more quickly to return firms to profitability. The deinstitutionalization of low shareholder influence and the arrival of hostile takeover bids should have started when the recession hit in 1990, or shortly thereafter.

Second, the convergence theories would have predicted that the Japanese corporate governance system and Japanese form of hostile

¹³¹ As mentioned in the introduction, it has since come to light that Murakami and Lehman Brothers were also involved in the early planning stages of this bid. See discussion *supra* INTRODUCTION.

takeover bid would have adopted the same form that these institutions have in the United States because that form is the most efficient. However, that does not appear to have happened. From an institutional perspective, the Japanese corporate governance system is not based on the Anglo-American model, but instead it is a conscious blend of Japanese, American and other characteristics. The economic efficiency argument postulates that all governance systems will look the same. The findings in this study on the adaptation of the governance systems into something uniquely Japanese contradicts this prediction. This process of adaptation is discussed below.

B. Japanese Hostile Takeovers and Selective Adaptation Theories

The selective adaptation theories are better at explaining the arrival of hostile takeover bids in Japan than the convergence theories because they take into account the role that individual actors can play. However, the theories do not fully take into account the affect that Japanese social institutions had on the convergence process and they discount the triggering effects predicted by the economic theories.¹³²

C. The Layered Approach

The layered approach is the best approach for explaining the arrival of hostile takeover bids in Japan because it accommodates the insights from the economic theories and the selective adaptation theories together with taking into account the complexity and strength of the Japanese social institutions. The four stages of the layered approach are explored in more detail below.¹³³

1. Economic Drivers Trigger Corporate Governance Reform

Economic pressures in Japan triggered the changes to the corporate governance system by dissolving the CSSs and causing a corre-

¹³² Milhaupt's theory of selective adaptation does not take into account social institutions borrowing from foreign sources or the role of administrative guidance. See generally Milhaupt, *supra* note 4. Potter's theory of selective adaptation is able to accommodate the existence of these institutions within the concept of complementarily – the extent to which the foreign institutions are consistent with local institutions. Although, Potter's theory is not able to examine the effects of the institutions directly. See sources cited *supra* note 58.

¹³³ Because of space constraints, the author was not able to include a full empirical analysis of the significance of the relationships hypothesized in this section. However, there have been a number of studies that have done so – and to the extent that those studies support the hypotheses presented, their findings will be presented. Where no study exists, potential measures for the relationships are proposed.

sponding increase in foreign ownership by Anglo-American investors.¹³⁴

a. The Dissolution of the Cross-Shareholdings

Table 2 provides a summary of the CSSs and RCSs for the years 1989–2003.¹³⁵ By 2003, CSSs in Japan had declined to 24% from a peak of 45.2% in 1992. The causes of this decline were three economic pressures: the recession; changes to general accounting rules to value securities at market; and changes to banking regulations related to the minimum capital requirements for banks.¹³⁶

b. The Recession

The recession in Japan started in 1990. Poor economic performance of the Japanese economy was the basic trigger for the corporate governance reforms. If there had been no recession there would not have been any need for change. The relationship between the recession and the deinstitutionalization of low shareholder influence can be tested by linking firm economic performance and the dissolution of the CSSs:

Hypothesis 1: Firms with poor ROE will be more likely to reduce CSSs.

Hypothesis 2: Firms with poor sales growth will be more likely to reduce CSSs.

Studies indicate that at these hypotheses are true. For example, the NLI Institute's 1997 Cross Shareholding Study found: (1) that firms that were underperforming the market in sales growth were more likely to unwind CSSs; and (2) firms that had an ROE below the market average were more likely to unwind CSSs.¹³⁷

c. Accounting Changes

Under Japanese generally accepted accounting principles, investments in market securities could be carried at cost. This meant that underperforming investments in CSSs could be carried indefi-

¹³⁴ This part of the theory argues that the insight of the convergence theories relating to economic pressures are pressures only and that they do not explain much about the actual process of change. See Cody, *supra* note 34, at 366.

¹³⁵ Data collection on this variable ceased in 2003.

¹³⁶ Suzuki, *supra* note 86, at 816–20.

¹³⁷ Hideaki Inoue, *Recent Developments in Cross-Shareholding*, NLI RES. INST., No. 121, at 14, 20–21 (1998), available at <http://www.nli-research.co.jp/english/economics/1998/eco9812b.pdf>.

nately on balance sheets, regardless of their market value, with no financial penalty to the firm. However, an important change was made to accounting practices in 2001. It provided that for all fiscal years starting April 1, 2001, shares held, other than those held for trading purposes, had to be reported at fair value and the unrealized gains or losses reported as a component of shareholder's equity. The impact of this change in Japan was huge because CSSs fell into this category and, as a result of the recession, the market value of most CSSs was below their cost. Furthermore, for the fiscal year starting April 1, 2003, shares which values had declined more than 50% from acquisition cost had the impairment charge run through the income statement.¹³⁸ As such, Japanese firms and financial institutions were finally required to re-evaluate their CSSs because any CSS they chose to maintain could affect the firm's financial performance. Since there is evidence that many companies already adopted the mark-to-market approach in 2000 in anticipation of the adoption of the rule in April 2001,¹³⁹ this relationship can be tested in the following way:

Hypothesis 3: The dissolution of CSSs rises significantly in 2000 and 2001 before the accounting change comes into effect on April 1, 2001.

This hypothesis seems to be supported by the data presented in Table 1. CSSs stayed relatively stable from 1989 (44.9%) to 1998 (39.9%). Then there was a drastic reduction in the CSSs two years prior to the implementation of the accounting change, with CSSs dropping to 37.9% in 1999 and 33.0% in 2000.

Also, since CSSs are valued at market after 2000, the dissolution of the CSSs should increase in years when the market value of securities decreases. This could be tested in the following way:

Hypothesis 4: The dissolution of CSSs increases when the Nikkei average declines.

This hypothesis seems to be supported by a cursory glance at the Nikkei average. The Nikkei average is outlined in Table 3. The Nikkei average hit a ten-year low in 2001, and then continued to hit new lows through to 2003. The year's 2001 to 2003 are also the years in which CSSs declined the most.

¹³⁸ Suzuki, *supra* note 86, at 817.

¹³⁹ Fumiaki Kuroki, *The Present Status of Unwinding of Cross Shareholding: The Fiscal 2000 Survey of Cross Shareholding*, 157 NLI RES. INST. FIN. 24, 27 (2001), available at <http://www.nli-research.co.jp/english/economics/2001/eo0110b.pdf>.

d. *Changes to Banking Regulations*

The accounting changes discussed above had the most impact on the banks because they are subject to minimum capital standard requirements under both the Basel Capital Accord of the Bank for International Settlement and under Japanese banking regulations. Under the Basel Capital Accord, the target standard of capital to weighted risk assets that international banks are generally expected to achieve is set at 8%.¹⁴⁰ The result of these capital requirement rules for Japanese banks are that any profits from a rise in the market price of CSSs will not improve the capital ratio of the banks, but any losses from the fall in the market price of CSSs will decrease the bank's capital ratio.¹⁴¹ As such, there was increased incentive for the banks to sell their CSS positions:

Hypothesis 5: Reduction of CSSs should be higher for banks and financial institutions than for corporations.

This hypothesis is supported by Miyajima's 2005 study that found that the rate of selling of CSS shares by banks was similar to the rate of selling by corporations until 2000 and then the rate of selling by banks significantly outpaced the rate of selling by corporations by about 2.5:1.¹⁴²

2. *Corporate Governance Convergence is More Likely to Occur Among Firms That Operate in the Same Field*

In the case of Japan, this part of the theory relates to firms that have significant foreign shareholders. The inclusion of foreign shareholders in a firm's capital structure expands that firm's "field" to include other firms in which those shareholders have investments. This increases the pressure on those firms to adopt practices consistent with the firms in this now larger field (isomorphism) which now includes foreign firms. Table 2 provides a summary of foreign ownership of securities in Japan for the years 1989–2005. It shows that foreign investors were the primary purchasers of the shares of the dissolving CSSs. Foreign shareholdings increased from 3.9% in 1989 to 24.1% in 2005.¹⁴³ The evidence also points to an acceleration in the pace of foreign holding acquisitions. In 2006, foreign shareholders be-

¹⁴⁰ See BANK FOR INTERNATIONAL SETTLEMENTS, BASEL II: INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENTS AND CAPITAL STANDARDS: A REVISED FRAMEWORK ¶ 5 (June 2004), <http://www.bis.org/publ/bcbs107.htm>.

¹⁴¹ Suzuki, *supra* note 86, at 818.

¹⁴² Miyajima & Fumiaki, *supra* note 90, at 90.

¹⁴³ TOKYO STOCK EXCHANGE, 2008 SHAREOWNERSHIP SURVEY 10, <http://www.tse.or.jp/english/market/data/shareownership/english2008.pdf>.

came the largest single group of owners of Japanese shares for the first time in history. Foreign ownership of shares in 2006 (at 25.4%) was larger than the ownership by financial institutions (at 24.6%) and business corporations (at 23.6%).¹⁴⁴

While no data is available to determine the nationality of the foreign investors, a recent study indicated that most of the foreign institutional investors in Japan were from Anglo-American economies, and predominantly from the United States and the United Kingdom.¹⁴⁵

As stated previously, Ahmadjian and Robbins found that firms with a higher percentage of foreign investors were more likely to adopt practices consistent with Anglo-American investor capitalism.¹⁴⁶ Consistent with this finding, the following hypotheses can be made:

Hypothesis 6: The greater the percentage of a firm's shares held by foreign investors the more likely the company is to adopt the new corporate structure.

Hypothesis 7: The greater percentage of a firm's shares held by foreign investors the more likely it is to be subject to a hostile takeover bid or proxy battle.

Unfortunately, there is not enough data yet to conduct the analysis for either of these hypotheses.

Also, since companies with foreign ownership are probably already outside of the CSS structure:

Hypothesis 8: The greater the percentage of a firm's shares held by foreign investors the more likely the firm is to reduce CSSs.

Research shows that this last hypothesis is true. Miyajima Hideaki and Kuroki Fumiaki found that firms with high levels of foreign ownership tended to unwind cross-shareholding patterns.¹⁴⁷

Therefore, based on the data presented in this paper, a preliminary conclusion can be drawn that the deinstitutionalization of low shareholder influence was triggered by the economic pressures of the recession, changes in accounting practices and changes to banking regulations. These pressures resulted in the dissolution of the traditional CSSs and a corresponding increase in foreign ownership of shares.

¹⁴⁴ TOKYO STOCK EXCHANGE, 2008 SHAREOWNERSHIP SURVEY 10, <http://www.tse.or.jp/english/market/data/shareownership/english2008.pdf>.

¹⁴⁵ Ahmadjian & Robbins, *supra* note 56, at 456.

¹⁴⁶ *Id.* at 467.

¹⁴⁷ Miyajima & Fumiaki, *supra* note 90, at 116–17.

Unfortunately, there is not enough data yet to support the final portion of the proposed chain of events: that foreign ownership led to increased shareholder influence.

3. *The Speed and Direction of Convergence is Affected by Local Social Institutions*

The pace and direction of corporate governance convergence in Japan has been affected by at least three social and institutional factors: the strength of the existing Japanese institutions; the Japanese institutions of borrowing from foreign sources; and administrative guidance.¹⁴⁸

a. *The Pace of Change*

The pace of change in the Japanese governance system has been slow. The economic triggers for convergence started in 1990 with the onset of the recession, and significant progress on convergence was not visible until 2000. This has led some scholars, including Curtis Milhaupt, to talk about “the lost decade in Japan” of missed opportunity for reform.¹⁴⁹ However, this fact is best explained by the theory that social and institutional structures set the pace of convergence. Given the strength and homogeneity of the existing governance institutions in Japan, it is not surprising that it took a long time for these institutions to deinstitutionalize. This theory can be tested by measuring the dissolution of CSSs among corporate groups (with stronger institutional ties) when compared to the dissolution of CSS between corporate groups:

Hypothesis 9: CSSs declined less among corporate groups than between corporate groups.

The NLI Institute’s 2000 Cross Shareholdings Survey supports this finding. The study found that CSSs dissolved more rapidly between corporate groups than they did among corporate groups.¹⁵⁰

¹⁴⁸ These are the non-economic institutions that Milhaupt’s selective adaptation theory is not able to take into account. See Milhaupt, *supra* note 4.

¹⁴⁹ See MITSUHIRO FUKAO, JAPAN’S LOST DECADE AND WEAKNESS IN ITS CORPORATE GOVERNANCE STRUCTURE, in JAPAN’S ECONOMIC RECOVERY: COMMERCIAL POLICY, MONETARY POLICY, AND CORPORATE GOVERNANCE 289–327 (Edward Elgar ed., 2003); Curtis J. Milhaupt, *A Lost Decade for Japanese Corporate Governance Reform? What’s Changed, What Hasn’t, and Why* (Columbia Law Sch., The Ctr. for Law and Econ. Studies, Working Paper No. 234, 2003), available at http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID442960_code030930630.pdf?abstractid=442960.

¹⁵⁰ Kuroki, *supra* note 111, at 7–12.

b. *The Process of Change*

It is important to note that Japanese institutions are playing a significant role in directing changes to the governance system. Two unique Japanese institutions in particular are significantly influencing these changes: the institution of borrowing from foreign sources; and the institution of administrative guidance.

c. *Borrowing from Foreign Sources*

Some argue the increase in foreign ownership of Japanese securities has caused Japanese managers to accept the “American way of thinking”, that the management of corporations is for shareholders.¹⁵¹ However, to assume such a causal relationship would be a mistake. In the area of law in general and particularly corporate governance, the Japanese have a long history of borrowing from foreign sources to drive progress in domestic institutions. The first evidence of this can be seen during the early years of the Meiji Restoration (1868–1895) when there was a real enthusiasm for Western things. This enthusiasm even had its own phrase: *bummei kaika* which means “civilization and enlightenment.”¹⁵² During the Meiji Restoration, many scholars examined Western social and political institutions as possible replacements for the outdated institutions of the Tokugawa Period. Some of those Western institutions were adopted, for example: joint stock companies, a national banking system and the Japanese Commercial Code of 1899 (which was based on the German Code).¹⁵³ During the twentieth century, this practice became institutionalized as Japan looked to the West for inspiration in developing its domestic institutions each time its economy stagnated. This has occurred at least three more times in the last century and a half: the post WWII era, the 1960’s liberalization of the economy, and finally in the late 1990’s through to the present day.¹⁵⁴

What is important to note about this institution is that the Japanese do not fully adopt foreign institutions. Instead, they have a long history of adapting those institutions to blend in with their domestic institutions, to generate something that is uniquely Japanese. Hirschmeier and Yui, in the introduction to their history of Japanese business organizations, describe the institution of borrowing from foreign sources, in the following way, “Japan took over the forms, but, as we will see, very little of the spirit of capitalism. The fact that Japan

¹⁵¹ Suzuki, *supra* note 86, at 820; see Itami, *supra* note 125, at 5; Sarra & Nakahigashi, *supra* note 83, at 300.

¹⁵² Japanese 1-2-3.com, <http://www.japanese123.com/bunmeikaika.htm>.

¹⁵³ See HIRSCHMEIER & YUI, *supra* note 85, at 129.

¹⁵⁴ Tom Ginsburg has compared the latest round of reforms to the reforms of the Meiji era in his article. See Ginsburg, *supra* note 59.

could adopt Western style technology and organizational forms, and yet penetrate them with her own non-Western 'spirit,' is certainly significant."¹⁵⁵

An example of this institution at work in the current context is how the Japanese adopted hostile takeover bids. Even though Japanese market participants have started to engage in hostile takeover bids, not one of the bids has been successful. The participants, so far, have always found a way to resolve the situation in a distinctly Japanese way by coming to a friendly long-term agreement backed by mutual cross-shareholdings. In describing the cultural changes that are happening in Japan, it would not be accurate to conclude that Japanese managers have realized the superiority of the Anglo-American system and finally chosen to adopt it. Instead, it would be more accurate to describe the process as the most recent example in a repeating pattern of Japanese actors borrowing and adapting Western institutions with domestic institutions. The adaptation process will be discussed more below.

d. Administrative Guidance

Chalmers Johnson identified the industrial policy of Japanese government and in particular the policies of the Ministry of International Trade and Industry (MITI), as *the primary* cause of the "Japanese Miracle."¹⁵⁶ In particular, Johnson emphasized the importance of the institution of "administrative guidance" to Japan's economic success during the 1970s and 1980s.¹⁵⁷ Administrative guidance was a tool utilized by MITI to ensure that its policies were adopted and used by markets participants during the 1960s.¹⁵⁸ Johnson described administrative guidance in the following way:

[A] Japanese analyst writes, administrative guidance "is what makes Japan's business tick. It is what made this country the world's third industrial nation. It is one of the pillars that support Japan Incorporated." There is nothing mysterious about administrative guidance. It refers to the authority of the government, contained in the laws establishing the various ministries, to issue directives (*shiji*), requests (*yobô*), warnings (*keikoku*), suggestions (*kankoku*), and encouragements (*kanshô*) to the enterprises or clients within a particular ministry's jurisdiction. Administrative guidance is constrained only by the requirement that the "guides" must come under a

¹⁵⁵ HIRSCHMEIER & YUI, *supra* note 85, at 7.

¹⁵⁶ JOHNSON, *supra* note 42, at 74.

¹⁵⁷ *Id.* at 265–66.

¹⁵⁸ *Id.*

given governmental organ's jurisdiction, and although it is not based on any explicit law, it cannot violate the law. . . .¹⁵⁹

One of the primary tools for the issuance of administrative guidance in Japan is the issuing of policy statements:

In some of its forms administrative guidance is indistinguishable from a formal legal order by the government. An example is guidance through policy statements (*shidô yôkô*). This refers to the obligation of the public to pay attention and respond in good faith to properly drawn and published policies of the government, although penalties for non-compliance have never been specified.¹⁶⁰

Japanese market actors follow administrative guidance from government agencies even though they are not legally obligated to do so.

The administrative guidance of MITI (now METI), exercised through its ability to issue policy statements, is an example of how social and institutional factors can direct the convergence process. Since the beginning of the current recession, METI has continued its role as an active maker of industrial policy for the economy. It has done so in much the same way as it did during the 1970s and 1980s. One commentator has stated that throughout this latest period, "[c]hange has been driven significantly by government bureaucrat-led reforms of corporate and related laws and institutions."¹⁶¹ For example, during this period METI has been very active revising laws, changing the tax system, using financial stimulus to try and kick-start the economy and issuing policy statements to guide market participants. METI amended the Japanese Commercial Code in 1997, 1999, 2000 and 2002 to, among other things, introduce holdings companies, introduce the option to adopt the new United States style committee system of corporate governance, to allow stock options, and to allow for mergers to happen by way of share exchanges. Also, a new consolidated Corporate Law was enacted on June 26, 2005 that came into force in 2006.¹⁶²

One example, in particular, illustrates the administrative guidance role still played by METI: its new policy statement on takeover bid defense measures. As the CSSs dissolved, Japanese companies be-

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 266.

¹⁶¹ Patrick, *supra* note 83, at 13.

¹⁶² The most interesting provision in the Corporate Law is the one that will allow foreign investors to make bids for Japanese companies by way of share exchange although the implementation of this provision has been delayed until May 1, 2007. For a complete list of changes to the Commercial Code and other relevant Japanese Legislation, see Higashino, *supra* note 107, at 3.

came vulnerable to hostile takeover bids. As a result, they needed to adopt new defensive measures to replace the stabilizing influence provided by the traditional CSSs.¹⁶³ Japanese companies never before had to resort to takeover bid defense measures because there had been no hostile takeovers in Japan. There was real uncertainty about whether such measures were legal.¹⁶⁴ As a result, market participants were reluctant to adopt defensive measures for fear that these measures would cause declines in stock prices or would be illegal.¹⁶⁵ Some market participants looked to the courts for a solution.¹⁶⁶ But, most looked to METI to provide a framework within which they could operate, even though METI does not have the formal legal authority to provide guidelines on this matter.¹⁶⁷ As an illustration of the impor-

¹⁶³ MINISTRY OF ECONOMY, TRADE AND INDUSTRY, & MINISTRY OF JUSTICE, GUIDELINES REGARDING TAKEOVER DEFENSE FOR THE PURPOSE OF PROTECTION AND ENHANCEMENT OF CORPORATE VALUE AND SHAREHOLDERS' COMMON INTERESTS 2-3, (May 27, 2005), trans. version available at http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishin_hontai.pdf.

¹⁶⁴ See Suzuki, *supra* note 86, at 799-807. See generally Ronald Gilson, *The Poison Pill in Japan: The Missing Infrastructure*, (Columbia Univ. Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 244, 2006), available at <http://ssrn.com/abstract=509522>.

¹⁶⁵ METI: CORPORATE VALUE STUDY GROUP, SUMMARY OUTLINE OF DISCUSSION POINTS: PROPOSAL TOWARD ESTABLISHMENT OF RULES FOR A FAIR BUSINESS COMMUNITY 5 (Mar. 2005), available at <http://www.meti.go.jp/english/information/downloadfiles/Corporate%20Value.pdf>.

¹⁶⁶ For example, both Livedoor and SFP Value Realization Master Fund Ltd. went to court to obtain rulings on the legality of defensive measures. See *Livedoor v. Nippon Broadcasting*, Mar. 11 (Tokyo District Court) 1726 Commercial L. Rev. 47; *Livedoor v. Nippon Broadcasting*, Mar. 16, 2005 (Tokyo District Court) 1726 Commercial L. Rev. 59, and *Livedoor v. Nippon Broadcasting*, Mar. 23, 2005 (Tokyo High Court) 1728 Commercial L. Rev. 41; See also *SFP Value Realization Master Fund v. Nireco Corporation*, June 1, 2005 (Tokyo District Court) 1734 Commercial L. Rev. 37; *SFP Value Realization Master Fund v. Nireco Corporation*, June 9, 2005 (Tokyo District Court) 1735 Commercial L. Rev. 44 and *SFP Value Realization Master Fund v. Nireco Corporation*, June 15, 2005 (Tokyo High Court) 1735 Commercial L. Rev. 48.

¹⁶⁷ This point was recognized by Milhaupt. However, he seems to have misunderstood the practice of administrative guidance because he argues that METI was not the appropriate body to rule on this. He would have preferred the Securities Exchange Surveillance Commission to provide these guidelines (as is done by the Securities and Exchange Commission in the United States). In this regard, he was showing his Western centric bias and a misunderstanding of the importance of METI in formulating policies for the Japanese market. Milhaupt stated that "[i]n this regard, METI's role in spearheading the formulation of guidelines that led to Japan's embrace of Delaware is also noteworthy. While METI's initiative is consistent with its involvement in other corporate governance in recent years, METI is arguably not the most appropriate agency to formulate a coordinated response

tance of METI in Japan, it is possible that the Japanese courts actually *waited* for the METI guidelines to be released before issuing their decisions.¹⁶⁸

In September 2004, METI commissioned a Corporate Value Study Group to look at the arrival of hostile takeover bids in Japan and to investigate the availability of United States style defensive measures in Japan.¹⁶⁹ The Corporate Value study group issued its report in March 2005 (the “METI Interim Report”).¹⁷⁰ The report advocated the adoption of U.S. style defensive measures (including the poison pill) because “by adopting Western style defensive measures Japanese management will have more time and increased leverage to negotiate with hostile suitors.”¹⁷¹

On May 27, 2005, METI issued its final guidelines on defensive measures.¹⁷² These guidelines specifically acknowledge that takeover defenses are legal in Japan and describe the circumstances under which they will be allowed. One of the most interesting facts in the guidelines is that they acknowledge the “principle of protecting and enhancing corporate value and the interests of *shareholders* as a whole” [emphasis added].¹⁷³ Note the language used by METI in this policy when they refer to the interests of “shareholders as a whole” and not in the interests of “employees.”¹⁷⁴ The policy is the first official acknowledgment in Japan that a shift in the corporate governance system is occurring towards the shareholder model. It is also an example of the way METI melds the importation of foreign institutions with existing Japanese practices. This policy statement was a blend between the shareholder governance system of the United States and the principle of shareholder equality in the Japanese Commercial Code.

to hostile takeovers. It has no formal jurisdiction over the corporate securities laws, and other governmental actors such as the Financial Supervisory Agency and the Securities Exchange Surveillance Commission (a rough analogue to the SEC) seem more appropriately situated to formulate a governmental response to this policy issue.” Milhaupt, *supra* note 4, at 2211.

¹⁶⁸ The court referred to and endorsed the METI Guidelines in its decision in *Yushemin Holdings Co. Ltd. v. Japan Engineering Consultants*, July 29, 2005 (Tokyo District Court) 1739 Commercial L. Rev. 100.

¹⁶⁹ METI: CORPORATE VALUE STUDY GROUP, *supra* note 165, at 1.

¹⁷⁰ *Id.* at 1.

¹⁷¹ *Id.* at 5.

¹⁷² MINISTRY OF ECONOMY, TRADE AND INDUSTRY & MINISTRY OF JUSTICE, GUIDELINES REGARDING TAKEOVER DEFENSE FOR THE PURPOSE OF PROTECTION AND ENHANCEMENT OF CORPORATE VALUE AND SHAREHOLDER’S COMMON INTERESTS (SUMMARY) 1 (May 27, 2005), http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishin_youyaku.pdf.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

By promulgating this policy METI is playing the crucial role of adapting the foreign influences (shareholder influence) to fit the Japanese governance system so that they are interpreted in a way that is uniquely Japanese and also to measure the pace of the deinstitutionalization of the present system.

4. Government and Market Participants Play a Significant and Active Role in "Selecting" Which Foreign Corporate Governance Rules Will be "Adapted" into the Local Corporate Governance Regime

This component of the theory highlights the active role that individual actors play in the process of corporate governance convergence. It highlights the fact that there is nothing inevitable about corporate governance convergence and that actors (both individuals and governments) can affect the pace and direction of the change. For the purposes of this analysis, Pitman Potter's theory of selective adaptation will be used because it allows for a focus on the cultural aspects of the choices that actors make.¹⁷⁵ In that theory, whether a particular change will be adopted into a society depends on three elements: perception, complementarity, and legitimacy.¹⁷⁶

In this case, the Japanese government has been very active (primarily through METI) in directing the corporate governance reforms to increase their chances of success. The issues in the Japanese case are related to the complementarity or the vast ideological differences between the existing Japanese social institutions and the foreign institutions that are being imported.

a. Perception

The Japanese have a long history of borrowing legal institutions from foreign sources. This practice is based on the acknowledgment that their own system is not well suited to internal evolutionary growth without outside influences. This is probably due to the fact that its domestic institutions are so homogenous that there is little natural variation among institutions and organizations to allow evolution when the existing structures prove inadequate for changing circumstances.¹⁷⁷ There is also a widely held belief among Japanese market participants and government officials that the institutions of

¹⁷⁵ This analysis could also be presented in Milhaupt's paradigm of *telescoping* and *stacking*. See Milhaupt, *supra* note 4.

¹⁷⁶ It should be noted however, that each of the insights discussed below could also be framed as a Chinese social institution.

¹⁷⁷ This is an insight that is offered by population ecology theory and evolutionary economics from organizational analysis. This homogeneity is also the reason why it takes so long for changes to occur in Japan.

the shareholder corporate governance system, including hostile takeover bids, are a legitimate solution to the current issue of poor economic performance of Japanese firms. The hope is that the threat of hostile takeover bids will provide an incentive for Japanese managers to improve the financial performance of their firms.¹⁷⁸ In the context of the current corporate governance reforms, the practice of borrowing foreign legal institutions has helped mitigate any perception issues that may have been associated with the reforms. Perception in the Japanese case has also been enhanced because many Japanese lawyers, bureaucrats and judges were educated in the United States and are very familiar with the foreign legal institutions that are being adapted.¹⁷⁹

b. Complimentarity

Complimentarity is where the real problem lies in this case. There is very little that is complimentary between the traditional Japanese stakeholder corporate governance system and the new institutions of the shareholder corporate governance system. In fact, they are opposites. One is a system characterized by consensus and collectivity; the other a system characterized by conflict and individualism. This lack of complimentarity will have two likely effects on the adaptation process. First, the process will continue to be a very slow progress as market participants struggle with attempting to combine the institutions from the two vastly different systems. Second, the compromises that will be required to adapt the two systems will mean that the corporate governance system that results will not be similar to either of the existing systems – but a new system altogether. It will, however, be a system that is uniquely Japanese.

c. Legitimacy

From an official standpoint there is no barrier to adaptation in terms of legitimacy. Most, if not all, of the major constituents in the

¹⁷⁸ It is interesting to note that the goal of the reforms in Japan might be to create simply the “threat” of hostile takeovers to improve financial performance without actually instigating a wave of takeovers to sweep across the economy. At the same time that the government is making it possible to make hostile bids it is also laying out clear guidelines on the acceptable ways in which firms can protect themselves from the bids.

¹⁷⁹ See *e.g.*, Milhaupt, *supra* note 4, at 2206 (stating that “[a]s with any transplant, familiarity with the foreign law among the experts responsible for interpreting and enforcing it appears to have played a role in the adoption of the Takeover Guidelines. Delaware corporate law is familiar to many Japanese lawyers, economic bureaucrats, and judges, many of whom have studied in U.S. law schools. More specifically, at least one-third of the Corporate Value Study Group’s members have extensive exposure to Delaware corporate law.”).

Japanese economy are supportive of changes that will allow Japan to remain competitive on a global scale.¹⁸⁰ The government is supportive of the changes, METI is actively directing the process and pace of the changes, and the business elite acknowledge the need for the changes. However, the business elite may not be as supportive of the arrival of hostile takeover bids. The lobbying of the Japanese business elite delayed the effective date for the rules that would allow foreign companies to purchase Japanese companies by way of share exchange until May 1, 2007. There is widespread concern about making sure that Japan does not fall behind in global markets. The only issue for adaptation that may arise in the area of legitimacy is that informal norms (social relations) are more important than formal norms (laws) in Japan.¹⁸¹ The result of this may be that even though the government changes the laws to allow different business practices, those practices may never materialize because the informal norms of Japanese business culture remain intact. This is just another of many indicia that total convergence to the shareholder corporate governance system in Japan is unlikely.

PART 7: CONCLUSION

The layered approach is better at explaining the arrival of hostile takeover bids in Japan than the traditional corporate governance convergence theories or the selective adaptation theories used on their own. It is able to take into account the social institutions in Japanese society and not just Japan's economic institutions. Examples offered in this article of such social institutions include the practice of borrowing from foreign sources and administrative guidance.

The evidence presented in this article supports the four step convergence process hypothesized by the layered approach: (1) economic pressures triggered convergence; (2) corporate governance convergence was more likely to occur among firms that operated in the same field (the field was defined as firms with a large percentage of foreign shareholders); (3) the speed and direction of convergence is affected by the strength and existence of local social institutions including borrowing from foreign sources and administrative guidance; and (4) government and market participants and, in particular, METI are playing a significant and active role in "selecting" which foreign institutions to adapt.

While hostile takeover bids have arrived in Japan, they have not yet become a widely accepted Japanese business practice. Most of the hostile takeover bids to date were launched by a handful of

¹⁸⁰ See Milhaupt, *supra* note 4, at 2204.

¹⁸¹ See e.g., MILHAUPT & WEST, *supra* note 50 (studying informal and formal rules that shape economically integral factors).

younger aggressive businessmen and none have yet been successful. In fact, one man, Murakami, was behind or involved in many of the early takeover bids, and he, along with Takafumi Hori, were jailed for breaching securities laws.¹⁸² The fact these men have been arrested is evidence that Japanese business culture is not yet prepared to accept this kind of aggressive business practice. For example, there has been talk that Lehman, because of its role in the Livedoor bid, could have problems finding new clients in Japan.¹⁸³

This article suggests that shareholder influence will continue to grow in Japan. More companies will adopt the new corporate structure and shareholder activism will become more prevalent. However, this article also suggests that there will not be a convergence towards the Anglo-American shareholder governance system and that, because of social and institutional pressures, there will likely be a blending of the stakeholder governance system with the shareholder governance system into something uniquely Japanese.¹⁸⁴ In conclusion, it appears that sociologist Neil Fligstein's assertion may still prove to be true: "[t]here is no market for corporate control in Japan, and there is not likely to be one."¹⁸⁵

¹⁸² See Takahara, *supra* note 11. Murakami's M&A Consulting was involved in 4 of the first 9 hostile takeover bids in Japan. See the Summary of Bids provided at the end of the article.

¹⁸³ *Hostile Takeovers: Shaking up Corporate Japan*, *supra* note 15. In fact, Mr. Eisuke Sakakibara, a former top finance ministry official resigned from the Lehman advisory boards because of the controversy surrounding the bid.

¹⁸⁴ See generally Patrick, *supra* note 83; WESTNEY, *supra* note 81.

¹⁸⁵ FLIGSTEIN, *supra* note 2, at 187.

TABLE 1
DIRECT MEASURES OF SHAREHOLDER INFLUENCE

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
No. of Companies Adopting New Committee Structure ¹⁸⁶	0	0	0	0	0	0	0	0	0	0	0	0	0	0	36	60	125	NA
No. of Takeover Bids ¹⁸⁷	0	0	3	3	3	1	1	5	11	14	17	16	27	24	NA	NA	NA	NA
No. of Hostile Takeover Bids ¹⁸⁸	0	0	0	0	0	0	0	0	0	0	1	2	0	1	2	0	3	3

¹⁸⁶ Patrick, *supra* note 83; Itami, *supra* note 125 (regarding the number of companies adopting new United States style corporate structure).

¹⁸⁷ Suzuki, *supra* note 86 (research through 2003).

¹⁸⁸ Based on authors own research. The Hostile bids are as follows: Cable & Wireless/IDC (1999), Beohringer Ingelheim/SSP (2000), M&A Consulting/Shoei (2000), M&A Consulting/Tokyo Style (2002 proxy contest), Steel Partners of Japan/Sotoh (2003), Steel Partners of Japan/Yushiro Chemical Industries (2003), Livedoor /Nippon Broadcasting (2005), Yushemin Holdings/JEC (2005) and M&A Consulting/Hanshin Electric/Hankyu (2005). Japan/Yushiro Chemical Industries (2003), Livedoor /Nippon Broadcasting (2005), Yushemin Holdings/JEC (2005), M&A Consulting/Hanshin Electric/Hankyu (2005), Oiji Paper/Hokuetsu Paper Mills (2006), Aoki Holdings Inc./Futata Co. (2006), and Steel Partners/Myojo Foods (2006). There were also two hostile takeover bid attempts in 2007: Steel Partners/Sapporo and Davinci Advisors/TOC Co.

TABLE 2
 LEVELS OF CROSS SHAREHOLDINGS AND FOREIGN OWNERSHIP IN JAPAN
 (BASED ON MARKET VALUE)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Percentage of Cross Shareholdings (CSSs)	44.9	45.6	45.6	45.7	45.2	44.9	43.4	42.1	40.5	39.9	37.9	33.0	30.2	27.1	24.0* ¹⁸⁹	NA ¹⁹⁰	NA
Percentage of Reciprocal Cross-Shareholdings (RCSs)¹⁹¹	17.3	18.0	17.8	17.8	17.5	17.4	17.1	16.3	15.1	13.3	10.6	10.2	8.9	7.4	NA	NA	NA
Percentage of Foreign Ownership¹⁹²	3.9	4.2	5.4	5.5	6.7	7.4	9.4	9.8	9.8	10.0	12.4	13.2	13.7	16.5	19.7	21.9	24.1

¹⁸⁹ METI: CORPORATE VALUE STUDY GROUP, *supra* note 165 at 3.

¹⁹⁰ *Id.*

¹⁹¹ Kuroki, *supra* note 111 (providing CSS and RCS information).

¹⁹² TOKYO STOCK EXCHANGE, 2008 SHAREOWNERSHIP SURVEY 5, <http://www.tse.or.jp/english/market/data/shareownership/english/2008.pdf>.

TABLE 3
THE NIKKEI AVERAGE 1996-2006¹⁹³

NIKKEI 225 JAPAN INDEX



SUMMARY OF HOSTILE TAKEOVER BIDS IN JAPAN

No.	Year	Parties Involved	Summary
1.	1999	Cable and Wireless (U.K.) International Digital Communications	Between May 7 and June 15, 1999, Cable and Wireless made a hostile bid for International Digital Communications ("IDC"). Cable and Wireless made the bid after IDC proposed a stock swap with NTT. Cable and Wireless was able to get 97% of the shares.
2.	2000	Boehringer Ingelheim (Germany) SS Pharmaceuticals ("SSP")	Boehringer made an unsolicited offer for SSP. While the bid was unsuccessful, Boehringer was able to increase its stake from 20% to 36% giving it a blocking position and effective control.
3.	2000	M&A Consulting Shoei Corporation	M&A Consulting made a hostile bid for Shoei Corporation. It was unsuccessful because a friendly shareholder stepped in.
4.	2002	M&A Consulting Tokyo Style	In 2002, M&A waged an unsuccessful proxy battle over the dividend policy at Tokyo Style.
5.	2003	Steel Partners Japan (U.S. Investment Fund)	On December 19, 2003, Steel Partners Japan (a U.S. investment fund) ("SPJ") made a hostile takeover bid for 33% of the shares of Sotoh. Sotoh had no debt and a significant

¹⁹³ BMO Investorline, <https://www.bmoinvestorline.com/ILClientWeb/marketing/marketingChart.do>.

- Sotoh amount of liquid assets (¥20B). NIF (a company affiliated with Daiwa securities) responded by making a white knight bid. SPJ raised its bid and offered to buy 100% of the shares. NIF dropped out. Sotoh responded by raising its dividend from ¥13 to ¥200. The stock soared as a result of the dividend increase and SPJ's bid was ultimately unsuccessful. SPJ then sold its entire position for approx. ¥2B yen profit.
6. 2003 Steel Partners Japan (U.S. Investment Fund) Yushiro Chemical Industries On December 19, 2003, SPJ made a hostile takeover bid for Yushiro Chemical Industries. Yushiro had a large cash position and a history of paying low dividends. The attempt was also unsuccessful because Yushiro raised its dividend.
7. 2005 Livedoor Co. Nippon Broadcasting Company On February 8, 2005, Livedoor Co. Ltd. ("Livedoor") a small Internet service provider attempted a takeover of Nippon Broadcasting Company ("Nippon") a radio broadcasting firm affiliated with Japan's largest media conglomerate, the Fuji Sankei media group. The situation started because Nippon owned 22.5% of the shares of its parent (Fuji TV) but Fuji TV owned only 12.5% of Nippon shares. On January 17, 2005, to cure the anomalous share ownership situation, Fuji TV made an offer for 100% of the shares of Nippon. In the middle of the process Livedoor made the surprising announcement that it had acquired 38% of Nippon and that it intended to make an offer for 100% of the shares. Livedoor had made its purchases in after hours trading and was able to bypass the early warning reporting requirements.¹⁹⁴ The share purchases by Livedoor were financed by an issuance of \$750 million "death spiral" convertible bonds underwritten by U.S. investment bank Lehman Brothers. The death spiral bonds allowed Lehman the right to convert the bonds into shares at a constant discount to the share price. On February 23, 2005, the board of Nippon responded by issuing a substantial number of warrants (*shin kabu yoyaku ken*) to Fuji TV to dilute Livedoor back down below 20%. The rationale for the warrants was that they ensured that Nippon would remain with the Fuji Sankei group which would provide long-term benefits to shareholders. Livedoor then sued to enjoin

¹⁹⁴ This loop-hole has since been fixed.

- the issuance of the warrants and was successful. The situation was eventually resolved amicably on April 18, 2005 when Livedoor sold all of its Nippon shares to Fuji TV for about what it bought them for and in return Fuji TV purchased a 2.5% stake in Livedoor and the three companies established a joint committee to explore related ventures.
8. 2005 Yushemin Holdings Co. Ltd.
Japan Engineering Consultants
In July 2005, Yushemin Holdings launched a hostile takeover bid for Japan Engineering Consultants (“JEC”). The board of JEC engaged in a number of defensive measures including a stock split that were challenged in court. The court rejected the defensive measures. In doing so, it referenced the METI Takeover Guidelines. The bid was eventually unsuccessful because few shareholders tendered to the bid.
9. 2005 M&A Consulting
Hanshin Electric Railway Co. Ltd.
Hankyu Holdings, Inc.
On September 28, 2005, M&A Consulting disclosed that it had acquired a major stake in Hanshin Electric Railway and Hanshin Department Store. M&A Consulting continued to purchase shares in Hanshin Railway through May 10, 2006 when it held 46% of the shares. On May 2, 2006, it made a shareholder’s proposal to appoint its nominees at the shareholders meeting scheduled for June 29, 2006.
- In all its disclosure documents, the fund had been disclosing the purpose of the investment in Hanshin as “pure investment.” In fact, it had been proposing a management buyout accompanied by other transactions. On May 22, 2006, it corrected the disclosures to read “participation to management.”
- In order to escape M&A Consulting, Hanshin arranged a competing takeover by a competing railway company: Hankyu Holdings Inc. On April 23, 2006, Hankyu Holdings announced that it was considering purchasing all of the shares of Hanshin Electric Railway.
10. 2006 Oiji Paper Co.
Hokuetsu Paper Mills Ltd.
On August 1, 2006, Oiji Paper, Japan’s largest paper maker, announced its intention to make a hostile bid for Hokuetsu Paper. The value of the transaction was \$1.45 billion dollars (165 billion yen). This bid was the first ever hostile bid between two Japanese market participants that was not influenced by a foreign party or a member of the “Hills Gang.”
- On August 3, 2006, Hokuetsu responded by issuing a 24.4% stake of shares to friendly

Mitsubishi Corp. and Nippon Paper Group at a discount.

The bid expired unsuccessful on September 4, 2006. Oiji had acquired only 5.4% of the shares of Hokuetsu.

11. 2006 Aoki Holdings Inc. On August 7, 2006, Aoki Holdings made a hostile takeover bid for Menswear maker Futata Co. On August 19, 2006, Futata responded by being acquired by its largest shareholder Konaka Co.
12. 2006 Steel Partners In October of 2006, Steel Partners launched a tender offer for Myojo Foods.
Myojo Foods Co.
Nissin Food Products Co. In November of 2006, Nissin Foods announced that it will buy a 33.4% stake in Myojo Foods. Steel Partners tendered to Nissin's bid.
13. 2007 Davinci Advisors KK In April to May of 2007, TOC management made an unsuccessful buyout bid at a 4% premium.
TOC Co. In July of 2007, Davinci, a major shareholder, made an unsolicited bid at approx. 1,300 yen.
On July 24, 2007, Davinci abandoned the bid after only 34% of the shares were tendered.
14. 2007 Steel Partners In May of 2007, Steel Partners announced a bid for Bull-Dog Sauce, a maker of Worcester Sauce.
Bull-Dog Sauce Co. Bull-Dog responded on June 7th by announcing that it would hold a special meeting June 24th to approve the issuance of warrants that would dilute Steel Partners interest.
On June 15th, Steel Partners raised its bid to 1,700 yen per share from 1584 yen.
The warrant issued was approved by 80% of the shareholders at the meeting and the warrants were issued July 11th. The warrants diluted Steel Partner's interest down to 3% from 10% and paid Steel Partners 2.3 billion yen. It was the first time a poison pill had been triggered in Japan.
Steel Partners challenged the legality of the action by seeking an injunction on the issuance of the warrants. The legal battle went to the Supreme Court which upheld Bull-Dog's right to issue the warrants. Along the way, the High Court referred to Steel

Partners as an “abusive acquirer.”

Steel Partners admitted defeat after only acquiring 4.4% stake.

15. 2007 Steel Partners
Sapporo

Steel Partners had been a shareholder of Sapporo since 2004.

In 2007, Steel Partners offered to buy a majority stake. Sapporo rejected the offer and introduced takeover defense measures. Steel Partners responded by launching a bid to buy up to 33% of the shares.

In 2008, Steel Partners withdrew the bid.

