

## **Corporate governance reforms and labor and employment relations in Japan: whither Japan's practice-dependent stakeholder model?**

**Takashi Araki\***

The University of Tokyo

### **Abstract**

Analyzing features of share ownership, management and employment relations in Japan, this article characterizes the traditional Japanese corporate governance system as an employee-centered stakeholder model which relies heavily on practices. The main pillars that have sustained the Japanese stakeholder model have been: cross-shareholdings and long-term shareholding, internal promotion of management and acceptance of dual-function directors onto the management board, long-term employment, and voluntarily established forums for labor-management consultation.

The article then examines recent changes that might affect the traditional governance model. As for the structural changes in shareholders and its influence, the effects of the dissolution of cross-shareholdings, increasing foreign investment, the revision of corporate laws to facilitate shareholders representative suits and reduced importance of banks are examined. Drastic revisions to corporate law that have given large companies the option of adopting a US-type corporate governance system utilizing outside directors might change the nature of the management. The employment system is also experiencing transformation. In the last decade, Japan repeatedly achieved worst-ever unemployment figures. Lateral mobility has increased and the state's labor market policy has tilted toward the activation of the external labor market. Stable regular employment has gradually shrunk and currently non-regular and contingent workers account for 30% of all workers.

In spite of changes surrounding corporate governance, this article confirms that there are countertrends and countermeasures against the one-sided progress towards the shareholder value model. It also examines recent survey results proving that the stakeholder model is still supported widely in Japanese society. These examinations lead the author to the view that the reconsideration of current corporate governance is realignment of the order of priority of various stakeholders' interests occurring within the stakeholder framework, and that stakeholder model in Japan is not likely to completely convert into the shareholder value model at least for the time being.

### **1. Introduction: from an employee-centered stakeholder model to a shareholder model?**

#### **1.1. Japan's traditional employee-centered stakeholder model**

Debates on corporate governance have traditionally converged along two axes: (a) corporate governance in the broad sense: for whose benefit does a corporation exist and in whose interest should it be administered?; and

---

\* Professor of Law, the University of Tokyo. A different version of this article will appear in H. Gospel and A. Pendleton, *Corporate Governance and Labour Management* (OUP, forthcoming).

- (b) corporate governance in the narrow sense: how should corporate managers be controlled or monitored?

The latter issue can be further divided into two types: corporate governance to ensure sound management or prevent illegal management; and that to increase efficiency and to strengthen a corporation's competitiveness.

In the United States, corporate governance debates have focused on the relationship between shareholders and managers and paid little attention to the role of employees in such governance.<sup>1</sup> Such debates presuppose that a corporation is the property of shareholders and the purpose of the corporation is to maximize the interest of shareholders. Therefore, these debates on corporate governance concentrate on how to control managers for the shareholders' interest.

The Japanese Commercial Code adopts the same presupposition and provides the shareholders' general meeting with the power to appoint the directors. Unlike the German co-determination law, Japanese corporate law does not give employees or their representatives any status as a constituent of the corporation.<sup>2</sup> However, it has long been believed that despite the ostensible principle in the statute, in reality employees are the corporation's most important stakeholders. In 1994, Kenjirō Egashira, a leading corporate law scholar, wrote: "There has been a consensus among most corporate law professors that, irrespective of the principles and theories stated in the corporate laws, in practice larger companies are administered by prioritizing interests of employees including both blue and white collar workers."<sup>3</sup> Hideki Kanda, another leading scholar on corporate law, pointed out in a lecture in 1992 as follows:

"The [German co-determination] system [which attracted attention both in the US and Japan in the 1970s] was not accepted and supported in the United States and Japan. The reasons were, however, quite different. In the United States, shareholders are the owner of the corporation, and thus the employees participation in the corporate administration is unacceptable. In Japan, by contrast, it is because employees are already owner of the corporation."<sup>4</sup>

Since the late 1980s, Noriaki Itami of Hitotsubashi University's Department of Commerce and Management has advocated the notions of the "employee-sovereign corporation" or "employee-centered corporation" and justifies such governance by the fact that the contributions and risk exposure of the core employees are greater than those of shareholders and that employees have invested a hidden contribution via the seniority-based wage and retirement allowance system.<sup>5</sup> Until the collapse of the bubble economy in the early 1990s, his argument seemed to fit to the perception of both the Japanese managers and employees.

Such traditional corporate governance in Japan can be defined from various

---

1 Blair and Roe 1999, 1.

2 Okushima 1991, 75.

3 Egashira 1994, 3.

4 Kanda 1992, 28.

5 Itami 1987; Itami 2000.

viewpoints. However, the significance of the status of employees in corporate governance is universally stressed. Ronald Dore points out four dominant features of Japanese capitalism:

- (1) firms which, in balancing the interests of employee and shareholder stakeholders, lean heavily towards employees;
- (2) relational trading (as opposed to impersonal spot-market trading);
- (3) a greater tilt towards cooperation in the cooperation/competition balance among competitors; and
- (4) a strong role for government as producer of public goods and umpire arbitrating clashes of private interests in matters where Anglo-Saxon countries would leave the market to sort things out.<sup>6</sup>

Curtis Milhaupt nominates the four central features of the governance environment in Japan as:

- (1) the “main bank” system and its role in corporate governance;
- (2) the absence of an external market for corporate control;
- (3) the structure and role of Japanese boards; and
- (4) the lifetime employment system.<sup>7</sup>

Mitsuhiro Fukao sees three features:

- (1) the “lifetime employment” system which guarantees stable employment and seniority-based wages even, at the expense of the corporation's pure financial interests;
- (2) the “main bank” system under which the corporation has a long-term relationship with one or a few banks through cross-shareholding and anticipates support during any business slump; and
- (3) the “keiretsu” system under which companies form a group with long-term trading relationships, sometimes also with cross-shareholdings.<sup>8</sup>

Takeshi Inagami defines an ideal-typical Japanese corporation as follows: an insider-based dual monitoring model, whose purpose is to prioritize its continuing existence and development as an enterprise community, managed by directors who have been promoted to the directorship through the internal job hierarchy, and who simultaneously serve as employed executive officers, and its operations are sustained by cross-shareholdings with silent and stable shareholders, indirect financing through the main-bank system, and long-standing relationship of mutual trust with employees and other stakeholders.<sup>9</sup>

As examined in detail below, viewed from the perspective of three parties to corporate governance, namely shareholders, management, and employees, the traditional corporate governance in Japan can be summarized as follows:

- (1) Because of the cross-shareholdings and existence of a stable body of

---

6 Dore 2000a, 51.

7 Milhaupt 2001, 2085.

8 Fukao 1999, 177.

9 Inagami and RIALS 2000, 40.

shareholders, the primary concern of shareholders has not been the dividend on the stock but the long-term relationship with the trading partners, and thus they have not actively intervened in corporate governance.

- (2) The directors are mostly promoted from within, and quite a large proportion of board members bear the double functions of director and employee (*jūgyōin kenmu torishimariyaku*), and thus management and employees have shared views and interests.
- (3) The internal labor market has developed through the practice of long-term (so-called "lifetime") employment, and cooperative industrial relations have formed through voluntarily established forums for labor-management consultation.

It is from these features that Japan's employee-centered stakeholder model has emerged.

From the point of view of the relationship between the type of corporate governance and legal intervention, the distinctive characteristic of Japan's stakeholder model is its reliance on practices or nonlegal norms, and hence its classification in this article as a "practice-dependent stakeholder model".<sup>10</sup> This is conspicuous when compared with Germany where the stakeholder model is sanctioned by legislation. Therefore environmental changes may modify Japan's traditional corporate governance more easily than in other countries where the stakeholder model has legislative force.

## 1.2. Corporate governance reforms toward a shareholder-centered model

Through the 1990s and early 2000s, Japan has witnessed a prolonged economic slump, the bankruptcy of large banks and financial institutions, and large corporate scandals revealed by whistle blowing such as false labeling and misrepresentation by food companies and an electric power company's mendacious report concealing defects in a nuclear power station. Japan's traditional corporate governance, especially the absence of the external market for corporate control, faced severe criticism.

In 1998, the Corporate Governance Forum of Japan, an advocate of American style corporate governance reforms, published "Corporate Governance Principles—A Japanese View".<sup>11</sup> In its report, the Forum states: "global competition might be interpreted as a survival race between two corporate systems for higher managerial efficiency: one system seeking a singular value for shareholders, and the other pursuing multiple values including those of employees".<sup>12</sup> The Forum goes on: "What should be done in Japan first is to share the recognition among the people that shareholders are owners of corporation and the purpose of corporation is to pursue interest".<sup>13</sup>

Certainly the circumstances surrounding corporate governance in Japan have changed. The system of cross-shareholding is dissolving. In particular, because of the 2001 regulations which limit a bank's shareholding so as not to exceed the amount of its own core capital, major banks have been forced to sell the shares

10 See Araki 2000a, 259; Araki 2000b, 87. Similar observations are made by Dore 2000, 182, 215 and Milhaupt 2001, 2083.

11 Corporate Governance Forum of Japan 1998.

12 Corporate Governance Forum of Japan 1998, 8.

13 Corporate Governance Forum of Japan 1998, 10.

they have held in their trading customers. Drastic corporate law reforms facilitating corporate restructuring have occurred since the late 1990s, and the 2002 revision introduced the American model of a board of directors with great emphasis on external directors. The media repeatedly reports on the collapse of the concept of lifetime employment and union density continues to decline. The question then is, is Japan's traditional employee-centered stakeholder model heading towards the shareholder-centered model?

This article<sup>14</sup> first examines the traditional features of shareholdings in Japan and recent developments on that front. Then it reviews the features of conventional management institutions and the drastic legislative changes affecting them. Next it looks at long-term practice and cooperative labor-management relations, recent changes in that area, and recent labor law developments dealing with such changes. Finally, some evaluation of the current situation and likely evolution of corporate governance in Japan will be provided.

## 2. Shareholders in Japan

### 2.1. Traditional picture: stable and long-term shareholders

The distinctive feature of traditional corporate governance in Japan has been the existence of stable and long-term shareholders and wide-spread cross-shareholding (See Table 1).

Table 1: Ratio of stockholders in the U.S., Japan and Germany (by presumed purpose of investment) (%)

	U.S.	Japan	Germany
Individuals	30-35	20	4
Institutional owners (stable and long-term)	2	40	27
Institutional agents (for pure investment)	55-60	6	3
Corporations	2-7	30	41
Government	Negligible	Negligible	6
Foreign investors	6	4	19

Source: Porter 1992.

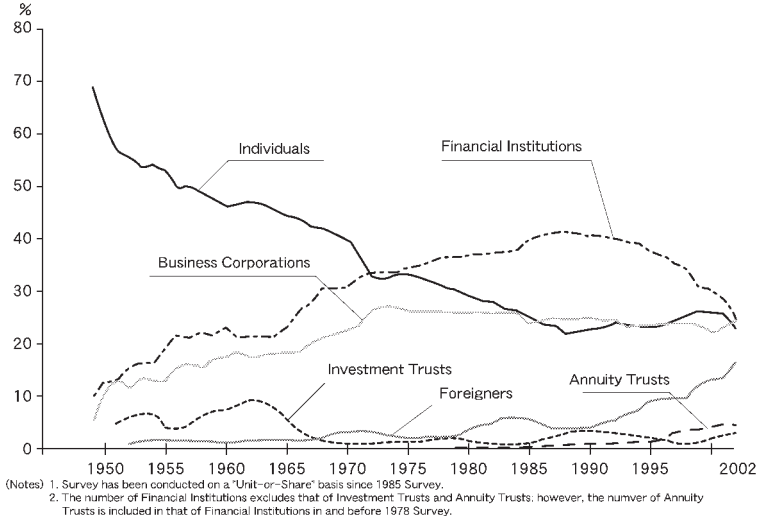
Historically, in the immediate years after the Second World War, the *zaibatsu* (financial combines) were dissolved, holding companies were prohibited by the Anti-Monopoly Law, and shareholding by corporations was generally prohibited. The ratio of individual shareholders was as high as 69.1% in 1949 and there were no stable, long-term shareholders. However, corporate shareholdings, namely shares held by financial institutions (banks and securities companies) and by business corporations, increased steadily and by the mid-1960s surpassed shareholding by individuals. In 1990, corporate shareholding had reached 70.4% and the proportion of individual shareholding stood at 23.1% (Figure 1).

In Japan, it is quite common for large business partners to own each other's stock (cross-shareholding). When such cross-shareholding evolves among banks from which other companies obtain long-term credit, these banks become "main banks" for those companies.<sup>15</sup> According to the Top Management Survey

<sup>14</sup> Some parts of this article related to the analysis of the traditional model derive from Araki 2000b.

<sup>15</sup> Yamakawa 1999, 5.

Figure 1: Distribution of unit shares held by types of shareholders



Source: National Conference of Stock Exchanges 2002.

conducted by the Inagami group in 1999,<sup>16</sup> 98.4% of surveyed companies have “stable shareholders”. In the survey the notion of “stable shareholders” was not defined. Therefore the response relied on the respondents’ notion of stability. Non-response was only 0.7%, so more than 99% of respondents have an established notion of stable shareholders. The percentage of shares held by stable shareholders in all issued shares is 53.8%. Of the surveyed companies, 39.2% have cross-shareholdings with stable shareholders.

Several factors constitute the background of this structure of shareholding. Though the *zaibatsu* were dissolved by order of the Occupation Authority, personal networks among the *zaibatsu* families led to the forging of new links between the *zaibatsu*-related companies. Relaxing of anti-monopoly regulations facilitated such trends. Japan’s enrollment in the OECD in 1964-entailing liberalization of capital markets to foreign investment-induced Japanese corporations to develop a pattern of cross-shareholding to defend themselves against foreign acquisition.<sup>17</sup>

These stable shareholders are not very motivated by short-term profit. Their purpose is to be stable shareholders, each protecting the other against hostile takeovers. In the case of cross-shareholding between banks and business corporations, the banks’ main concern is to ensure the repayment of interest and capital on loans. Therefore, the stable, long-term prosperity of business is much more important than short-term profit to the banks. Thus, shareholders of large

16 The survey on corporate governance to the top management (hereinafter “Top Management Survey”) was conducted in February 1999 by a study group headed by Professor Takeshi Inagami, University of Tokyo, within the Research Institute for Advancement of Living Standards (RIALS). RIALS is a think tank of *Rengō* (The Japanese Trade Union Confederation). The study group, to which the author belonged, distributed questionnaires to the top management in all 1307 companies listed in the first section of the Tokyo Stock Exchange and received responses from 731 companies. The resultant analysis was published in Inagami 2000, 346.

17 Itō 1993, 154.

Japanese companies tend to be noninterventionist and aptly described as *mono iwanu kabunushi* (silent shareholders).<sup>18</sup> This silence allowed Japanese companies to pursue long-term strategies and was evaluated positively until the collapse of the bubble economy in the early 1990s.

## 2.2. Recent changes in shareholders

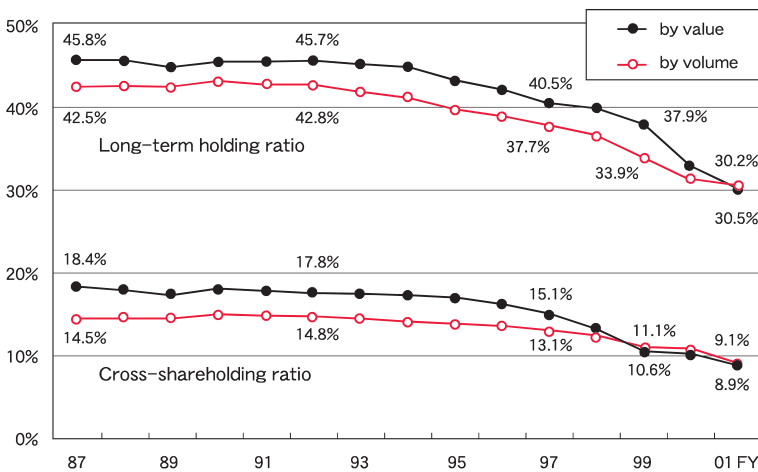
However, the recent changes in shareholder structure and stock market environments are notable.

### 2.2.1. Shrinking cross-shareholding and long-term shareholding

First, cross-shareholdings and long-term shareholdings, especially those between banks and their customer corporations, are shrinking in a rapid pace (see Figure 2).<sup>19</sup> In 1987, the cross-shareholding ratio in the overall market was 18.4% whereas the figure in 2001 declined to 8.9% on a value basis. Stable, long-term shareholding ratios including cross-shareholding in the overall market declined from 45.8% in 1987 to 30.2% in 2001 on a value basis. Although the stable, long-term shareholding ratio in business corporations declined modestly from 12.2% in 1996 to 11.4% in 2001, that in financial institutions drastically fell from 29.8% in 1996 to 18.8% in 2001 and that in banks from 15.1% in 1996 to 8.7% in 2001 on a value basis.<sup>20</sup>

Such drastic decline in cross-shareholdings and stable shareholding was caused under the following circumstances. The introduction of the mark-to-market method of calculating the value of holding shares at market prices from 2001 and the continuous decline of stock prices induced many companies to sell unprofitable stocks. Furthermore, the 2001 Law Restricting Banks' Shareholding calls for banks to reduce shareholdings so as not to exceed the amount of its own capital by the end of September 2004. This Law forced banks to sell their shares

Figure 2: Cross-Shareholding and Long-Term Shareholding Ratios



Source: Kuroki 2002, 5.

<sup>18</sup> Yamakawa 1999, 5; Charkham 1994, 81.

<sup>19</sup> See Kuroki 2002.

<sup>20</sup> Kuroki 2002.



in customer corporations and triggered a reciprocal sell-off of bank stocks by the customers.

Another survey conducted by the Ministry of Finance endorses the dissolving of cross-shareholdings. In 1999, 88.4% of surveyed corporations had cross-shareholdings, whereas in 2002, the figure fell down to 83.2% (see Table 2).

Table 2: Ratio of cross-shareholdings in 1999 and 2002

	Capital (Billion [thousand million] yen)					Total
	Less than 1	1-3	3-10	10-30	30-	
1999 (875 companies)	89.5%	87.6%	85.7%	92.0%	90.5%	88.4%
2002 (1216 companies)	77.4%	82.2%	83.2%	86.8%	84.6%	83.2%
Difference	-12.1	-5.4	-2.5	-5.2	-5.9	-5.2

Ministry of Finance, Policy Research Institute 2003, Table 3-4.

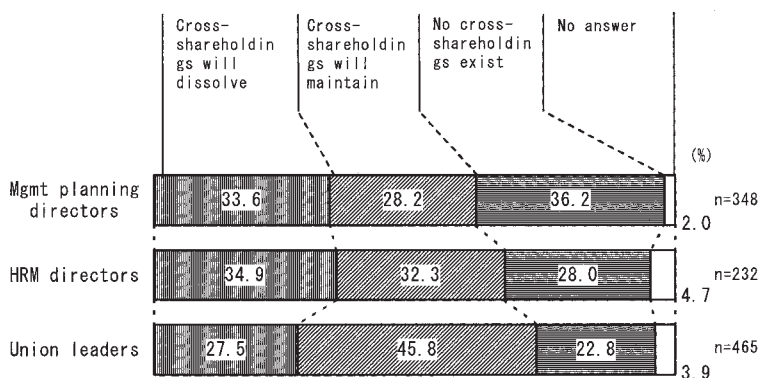
However, as this survey confirms, we should note the fact that more than 80% of surveyed companies still maintain cross-shareholdings. The survey also asked why they maintain cross-shareholdings. More than 70% of surveyed companies replied “cross-shareholdings promote the formation of stable and long-term trading relations”.

As mentioned above, although cross-shareholdings with banks and other financial institutions are rapidly dissolving, those among business corporations have not changed so much. According to a survey conducted by the Japan Productivity Center for Socio-Economic Development (JPC-SED) in 2001, there are competing predictions as to the dissolution or maintenance of cross-shareholdings, among not only union leaders but also management planning directors and HRM directors (Figure 3). Therefore, it is premature to state that cross-shareholdings are dissolving across the board.

**2.2.2. Increase in foreign investors**

Another important development in the structure of shareholdings in the 1990s is the rapid increase of foreign investors. The proportion of shares owned by foreigners rose from 4.7% in 1990 to 18.8% in 2000 on a market value basis (see

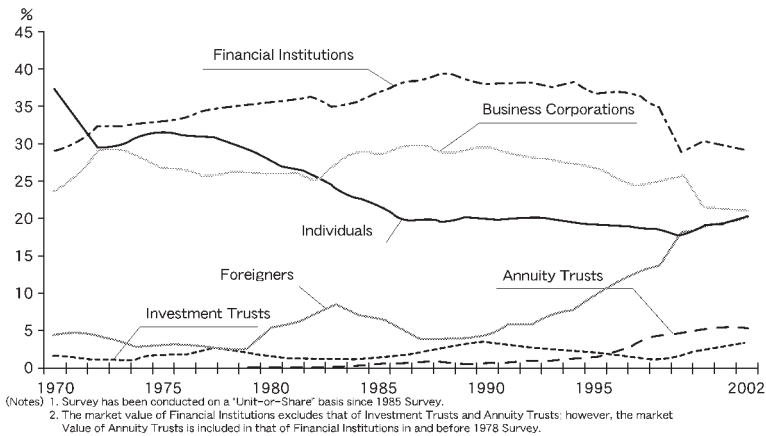
Figure 3: Future Prospect of Cross-shareholdings



Source: JPC-SED 2003.



Figure 4: Distribution percent of market value owned by types of shareholders



Source: National Conference of Stock Exchanges 2002.

Figure 4). Although the ratio of foreign investors fell slightly in 2001 (18.3%) and 2002 (17.7%), their presence in the Japanese stock market is significant. Unlike traditional Japanese shareholders, foreign investors will require more shareholder-value-oriented corporate governance than ever. Since their

investments tend to concentrate in larger companies,<sup>21</sup> their attitude can have more impact towards corporate governance than their real presence.

### 2.2.3. Shareholders' representative suit

In the past, the plaintiff in a shareholders representative suit was required to pay a filing fee, which escalated in accordance with the amount claimed. Therefore, if the plaintiff claimed a huge amount of damages for misadministration by corporate management, the filing fee could be prohibitively high. In order to remove this barrier to shareholders representative suits and activate monitoring of companies by their shareholders, the 1993 revision of the Commercial Code fixed the filing fee at a nominal amount (8200 yen or about US\$68).

Faced with the increase in the number of shareholders representative suits, however, the business circle and the Liberal Democratic Party (the ruling party) proposed a limit to directors' liability. The resulting 2001 revision of the Commercial Code makes it possible for the shareholders meeting to limit the liability of representative directors to six times their annual remuneration, that of other directors to four times their annual remuneration, and that of external directors to twice their annual remuneration. Therefore, to some extent, the promotion of external control through shareholders representative suits is under reconsideration.

## 3. Corporate management and monitoring system

### 3.1. Overview of corporate management and monitoring system

Influenced by German law and subsequently by American law,<sup>22</sup> the legal

21 Ministry of Finance, Policy Research Institute 2003, 2-3-1 Overview of shareholders' structural change.

22 See generally Oda 1999, 216.

structure of Japanese corporate management and the corporate monitoring system reveals some unique features.

At first, the Japanese Commercial Code enacted in 1899 adopted a dual monitoring structure of managing directors and auditors modeled on German law. In 1950, Japanese company law introduced the system of a “board of directors” under the influence of American law. Under this system, the board of directors supervises the corporate management administered by representative directors and other directors. However, since the auditor system was never abolished, corporate management has been monitored by both the board of directors and auditors (dual monitoring system, see Figure 5 “Traditional Model”).<sup>23</sup>

However, as discussed below in detail, the 2002 revision of the Commercial Code introduced a new, American-style governance model. The new model is called *iinkai-tō setchi gaisha* (company with three committees), as opposed to the traditional governance model now known as *kansa-yaku sonchi gaisha* (company maintaining auditors). It is not compulsory but optional to adopt the new governance model, which requires the majority of the members of the three committees to be external directors. Therefore, Japan has entered an era of competition between two different governance models (see Figure 5).<sup>24</sup>

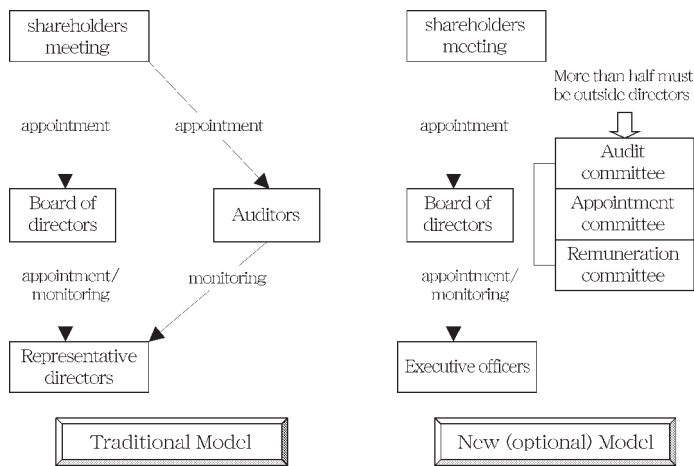
**3.2. Traditional governance model (dual monitoring system)**

**3.2.1. Board of Directors**

In the Japanese corporate management system, the board of directors, and especially representative directors, have real power to govern the corporation.

From a comparative perspective, the first major feature of the board of directors is its large size: boards with more than twenty members were common in Japan.<sup>25</sup> Excessive size has been cited as a key cause of board dysfunction in terms of

Figure 5: Two competing governance models



23 Kansaku 2000, 169.  
24 Egashira 2002, 412; Kanda 2003, 153.  
25 Kawahama 1997, 38.

effective decision making and monitoring.<sup>26</sup> In the late 1990s, there was a trend to implement the executive officer system in order to reduce the number of directors. According to the Top Management Survey, 48.6% of surveyed companies had already reduced the size of the board at the time of survey in 1999. Nonetheless, the average number of directors is 17.5<sup>27</sup> which is still much larger than in the United States where the average number is 12.<sup>28</sup>

The second feature of the Japanese board is that there is no sharp demarcating line between board members and employees in terms of mentality, function and remuneration.

In terms of mentality, according to the Top Management Survey, 75.6% of board members are promoted from within, not hired from the outside.<sup>29</sup> Most of those remaining board members who are *not* promoted from within are from parent or affiliated companies. Therefore they are not 'outsiders' to the company. This internal promotion practice stems from measures for democratization of Japan's economy encouraged by the Occupation Authority after the Second World War. In 1947-48, prewar and wartime management were purged and a young elite was promoted to management positions from within.<sup>30</sup> In accordance with the spread of long-term or lifetime employment, the promotion of incumbent employees to a board memberships has become commonplace. The board membership is given to employees as a final stage of promotion for their excellent performance throughout their working career and denotes the crowning success of their career as an employee. This is one of the main reasons for the large size of the typical Japanese board.

With regard to remuneration, there is no significant gap between the remuneration of board members and that of employees. As Figure 6 shows, one can see the apparent continuity of the remuneration profile between a department head who is a managerial employee, and an ordinary (low level) director. As a result, the remuneration gap between employees and board members is quite narrow. For instance, the average annual remuneration of board members amounts to only nine times that of graduate recruits.

In terms of functions, ordinary (junior) directors usually have dual functions, as both junior board members and managerial employees of their respective departments. According to the Top Management Survey analysis, half of all board members fit into the category of dual-function directors.<sup>31</sup> According to another survey,<sup>32</sup> 73.3% of the annual salaries of these dual-function directors is remuneration for the employee function and 26.7% is for the directorship. Therefore junior dual-function directors are more like employees than directors.

---

26 However, Dore criticizes that the critics of traditional governance disregards various function of Japanese board of directors, such as information diffusion and concomitant commitment-reinforcement, tension-defusing, resentment-reducing expression of sectional interests, middle-management motivator, etc. Dore 2000b, 163-164. See also Dore 2000a, 87-88.

27 Inagami and RIALS 2000, 337 (Q19-8).

28 See Charkham 1994, 188.

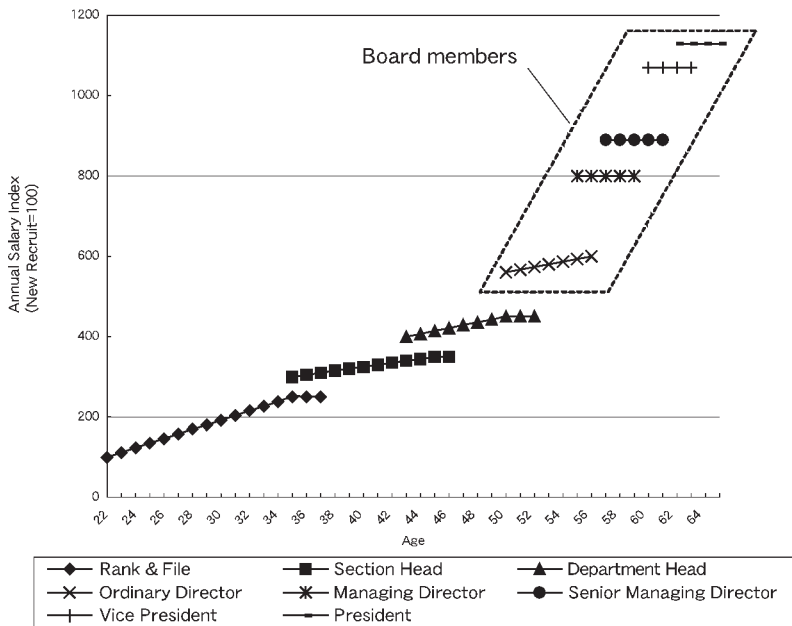
29 Inagami and RIALS, 324.

30 Okazaki 1993, 103, 114, 125.

31 According to Michio Nitta's analysis, the average number of board member is 17.5 and average number of dual-function directors is 8.3: Nitta 2000, 87.

32 Rōmu Gyōsei Kenkyū-jo 1999, 2.

Figure 6: Employee and Management Career and Remuneration in Japanese Corporations



Source: Rengō Sōken 1999.

In a sense, Japanese management boards have accepted employee representation by accepting these dual-function directors. In many cases, the expected role of those junior directors on the board is, as head of a department, to represent that department, including conveying the voices of rank and file employees in the department, rather than to hammer out management policy of the whole corporation. As mentioned above, they are promoted to directors not because their ability to decide managerial policy but in order to reward diligent and successful employees with the status of board members. Corporate Governance Forum of Japan, which advocated drastic corporate governance reforms, states “[those dual-function directors] are actually recognized as employees’ representatives”.<sup>33</sup>

These attributes of board members have significantly influenced Japan’s stakeholder model of corporate governance. According to the Top Management Survey, only 8.5% of respondents support an opinion that “a corporation is the property of shareholders, and employees are merely one of the factors of production” whereas 85.8% support an opinion that “Shareholders are not the only stakeholder of the corporation. Therefore, the interests of various stakeholders must be reflected in the corporate management”.<sup>34</sup>

These features of the board of directors have certainly facilitated cooperative labor and management relations and thus enhanced efficiency of corporate administration, as will be seen below. However, such “insiderism”<sup>35</sup> of the

33 Corporate Governance Forum of Japan 1998, 9.

34 Inagami and RIALS 2000, 334. However, it is also noteworthy 49.9% of respondent support the following opinion: “The primary role of the management is to enhance capital efficiency to maximize the profit of shareholders.” Management becomes more conscious of capital efficiency than ever. Id.

traditional board system has been less effective in preventing illegal acts by management and in making the management accountable to shareholders. In practice, the nomination of vice presidents and other executives is strongly influenced by the president's opinion.<sup>36</sup> Nearly half of all board members are dual-function directors and are thus subject to the directions of their employer, namely the president, as employees. As a result, the board of directors tends to be subject to the leadership of the representative director or president rather than *vice versa*.

### 3.2.2. Auditors

Auditors monitor the legality of a corporation's finances and directors' business administration.<sup>37</sup> Though this dual structure of management originally stems from German law, there are quite significant differences between the German supervisory board (*Aufsichtsrat*) and the Japanese board of auditors.

Firstly, whereas a German supervisory board at companies with more than 500 employees<sup>38</sup> contains representatives of both shareholders and employees, the Japanese auditor system is not a worker-participation scheme. The appointment of Japanese auditors has been *de facto* determined by the representative directors, who have a right to propose a list of nominees to a general shareholder meeting. It has been rather common that the representative directors nominate auditors from among the supervisory employees or board members.<sup>39</sup> Secondly, whilst the German supervisory board has the power not only to audit finance and monitor business administration but also to appoint and discharge board members, Japanese auditors do not have the latter power. As for the former jurisdiction over the financial and business administration, their scrutiny is narrowly understood to be confined to legality checks and does not extend to the appropriateness of corporate administration.<sup>40</sup>

Because it is difficult to expect the board of directors to supervise the representative director's business administration, all efforts to reform the monitoring system in Japanese corporate law have concentrated on measures to strengthen the power of auditors and ensure their independence.

In 1974, the auditor's supervising power was expanded to corporate administration. The 1981 amendment required an appointment of three or more auditors, and at least one full-time auditor to larger companies. In 1993, the terms of auditors was expanded from two to three years to strengthen their independence, and larger companies<sup>41</sup> were required to have at least one outside

---

35 Dore 2000a, 77, 87.

36 According to the Top Management Survey, 85.8% of respondents affirmed this. Inagami and RIALS 2000, 327.

37 In smaller corporations (with capital of one hundred million yen or less and debt of less than 10 billion yen), the auditor's power is confined to financial auditing and does not cover scrutiny of business administration.

38 Companies with less than 500 employees are not obliged to establish an employee participated supervisory board. Currently two thirds of German workforce are employed at such co-determination-free companies. See, Lowisch 1996, 261.

39 Kubori 1994, 41.

40 Whilst debate continues as to whether auditors' scrutiny covers efficiency or appropriateness of corporate administration, the majority opinion is that auditors' scrutiny is confined to legality checks and it is the board of directors that supervises the issue of efficiency or appropriateness of corporate administration. See Maeda 2000, 238; Yoshihara 2001, 192.

auditor and adopt the board of auditors system.

The 2001 revisions of the Commercial Code further strengthened auditors' power and independence. Auditors' tenure was extended from three to four years. In larger companies, at least half of the auditors must be external. The so-called "five-year rule", which regards former directors or employees who left the company more than five years ago as outsiders, will be abolished as of May 1, 2005. The board of auditors in a larger company is given the right to veto a proposal to the shareholder meeting nominating auditors and to submit its own proposal.<sup>42</sup>

In spite of these amendments to strengthen the power and independence of auditors, it was still being said in the late 1990s that the auditor system fell short of expectations.<sup>43</sup> In 1998, the Corporate Governance Forum of Japan proposed a quite radical reform plan: to allow parties to abolish the auditor system by adopting an American-style 'board of directors' system utilizing external directors.<sup>44</sup> The proposal was mostly adopted by the interim draft of the revisions of the Commercial Code and related laws (hereinafter "interim draft") by the Legislative Council of the Ministry of Justice (*Hōsei Shingikai*), an advisory council to the Minister of Justice, and resulted in the 2002 revision of the Commercial Code that introduced a new governance model explained next.

### 3.3. Introduction of a new governance model utilizing outside directors

#### 3.3.1. *The new governance model*

The Legislative Council's interim draft of April 18, 2001 points out the defects in the then current system of boards of directors, under which directors were to supervise corporate management through representative and other directors. As for the idea of the monitoring function of the board of directors, it is said to have an inherent defect in that the monitors (i.e. the directors) themselves engage in corporate administration. As for practice, the number of directors is said to be too large to function effectively. Moreover, most are dual-function directors and thus they are *de facto* subject to the representative directors. To cope with these problems, the interim draft states, it is necessary to:

- (1) separate the monitoring mechanism from corporate administration in order to strengthen the former;
- (2) delegate board members' power to independent executive officers (*shikkō-yaku*) in order to enhance effectiveness of business administration; and
- (3) establish three committees (audit, appointment and remuneration) utilizing outside directors in order to enhance the monitoring mechanism's independence from the board of directors.

The 2002 revisions of the Commercial Code and other related laws in essence adopted the plan shown in the interim draft and the revised Code took effect on

---

41 Art. 2 defines larger companies as those that have capital exceeding 500 million yen or debts exceeding 20 billion yen (Special Measures Law to the Commercial Code on Audit).

42 Egashira 2002, 390; Kanda 2003, 139.

43 Keizai Dōyūkai 1996, 7; Yoshihara 2001, 185.

44 Corporate Governance Forum of Japan 1998, 43.

April 1, 2003. The 2002 revision introduced a new governance model called *inkai-tō setchi gaisha* (company with three committees). To adopt this model, it is required to establish three committees: an audit committee, an appointment committee and a remuneration committee. There must be more than three directors on these committees, and the majority of them must be outside or non-executive directors. Upon adopting this new governance model, the company's auditors or board of auditors are replaced by the audit committee. Such company must have one or more executive officer(s) (*shikkō-yaku*). The directors and board of directors concentrate on monitoring and the corporate administration is entrusted to the executive officers (see Figure 5).

This American-style, single tier monitoring model with three committees is optional. Therefore, companies can either maintain the traditional dual monitoring system or, by modifying the articles of incorporation (memorandum of association), adopt the new governance model (see Figure 5). These revisions took effect on April 1, 2003.

### **3.3.2. Minimal adoption of the new governance model**

This revision is one of the most fundamental changes in postwar corporate law history. Unlike the traditional governance model with internally promoted directors, the management in this model, or the majority of the three committees, consists of outside directors representing the interests of shareholders. If widely adopted, the new governance model might have a significant impact on labor and employment relations.

So far, however, the number of companies which has adopted the American-style new governance model is rather small. According to the Nikkei (June 15, 2003), only 35 listed companies adopted the new governance model although they include such leading corporations as Sony, Toshiba, Mitsubishi and Hitachi.

The scale on which the new governance model would be adopted was predicted in advance. According to the survey by the Ministry of Finance, Policy Research Institute,<sup>45</sup> the traditional governance model is thought to be superior to the new model in terms of management effectiveness to allow a manager to exert his/her leadership, flexible administration to suit the situation in individual corporations, and effective and expeditious corporate administration; whereas the new governance model has merits in increasing monitoring power and enhancing accountability and transparency of management. The scarcity of available candidates for the positions of outside director has further hindered the adoption of the new governance model. As a result, the majority of listed corporations continue to maintain the traditional corporate governance model.

## **4. Employment**

Employment security has had a high priority in Japanese corporate governance. Employees in Japanese companies have been seen not merely as a factor of production which can be adjusted in accordance with fluctuating economic needs. Instead employees have been treated as important constituents of the corporation.

---

45 Ministry of Finance, Policy Research Institute 2003, Table 3-24.



However, in the last ten years, circumstances surrounding employment have changed dramatically. Traditional lifetime employment is said to be at an end. After the collapse of the bubble economy in the 1990s, the unemployment rate has gradually, and rapidly since 1997, increased and repeatedly reached new records, hitting 5.4% in 2002 (see Figure 7). Reflecting the increased need for corporate restructuring, case law started to relax the economic dismissal regulations. In 2003, an important legislative change has been made to incorporate case law into the Labor Standards Law. This part reviews the traditional employment system and its recent changes.

#### 4.1. Long-term employment practice

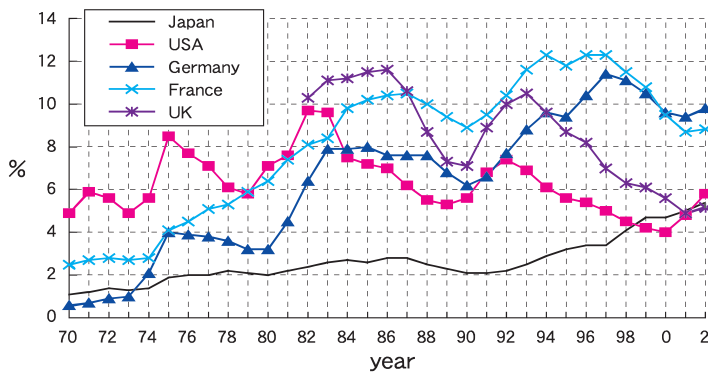
Japan boasted a low unemployment even after the two oil crises. Japan's system of lifetime or long-term employment respecting employment security has been sustained by various social institutions: legal rules concerning dismissals, state employment maintenance policy, and social norms respecting employment.

##### 4.1.1. Case law restricting dismissals without just cause

From a comparative perspective, legal rules concerning dismissals in Japan show several distinctive features. First, until the 2003 revision of the Labor Standards Law, employment security was provided not by legislation but by case law or judge-made law.<sup>46</sup> Japanese courts established a case law rule called the "abuse of the right to dismiss" theory that regards a dismissal without just cause as an abuse of the right to dismiss and thus null and void.

The "abuse of the right to dismiss" theory arose in the context of post-war socio-economic conditions which made protection of workers' employment security imperative. Immediately following Japan's defeat in World War II, when there was a shortage of food, a lack of employment opportunities, and a superfluous workforce, dismissal meant loss of livelihood for many workers.

Figure 7: Unemployment rates in advanced countries



Source: ILO Yearbook of labor statistics and others

46 It is true that the Labor Standards Law and other statutes prohibit discriminatory dismissals and dismissals of pregnant workers and victims of work-related injury. Furthermore, unlike the American "at will" doctrine, the Labor Standards Law generally requires 30 days advance notice or an advance notice allowance in lieu of the notice (LSL Art. 20). However, apart from these regulations, Japanese legislation has not required just cause for dismissals. For details of dismissal law in Japan, see Sugeno 2002, 473; Araki 2002, 17.

Even after Japan overcame such difficult times, and the long-term employment practice had become firmly established, dismissal was viewed as detrimental to a worker's seniority (a decisive factor in the personnel management and wage systems), for the seniority he had gained through his previous employment would not necessarily carry over to his new employment. Dismissal also placed such a worker at a serious disadvantage as finding comparable employment was extremely difficult in Japan's external labor market.

Under such circumstances, Japanese courts thought that workers should be provided a degree of protection by restricting the employer's right to dismiss at will. Relying on the general clause of the Civil Code that prohibits abuse of rights (Civil Code Art. 1, Para. 3), Japanese courts handed down decision after decision holding that an objectively unreasonable or socially unacceptable dismissal was an abuse of the right to dismiss. Such dismissals were declared null and void. The theory of abuse of the right to dismiss was thus created by judicial precedent in lower courts and finally endorsed by the Supreme Court in 1975.<sup>47</sup>

Under this case law, an employer is required to demonstrate the existence of just cause. Courts interpret just cause very strictly, and tend to deny the validity of the dismissal unless there has been serious misconduct by the worker. A court will consider all of the facts favorable to a worker's case and strictly scrutinize the reasonableness of the dismissal.

The second feature is that Japanese case law sets stringent restrictions on economic dismissals. Individual dismissals are universally restricted in most developed countries. However, regulations on economic dismissals are quite different from country to country. One of the features of Japanese case law is that it restricts economic dismissals more severely than in other developed countries.

The recession triggered by the oil crises in the 1970s caused Japanese companies to streamline and execute large-scale restructuring of their operations. However, since the long-term employment practice had taken root in Japanese corporate society by that time, major companies refrained from resorting to employment adjustment through dismissals. After careful consultation with their enterprise-based unions, corporate management chose to take various cost-cutting measures to avoid layoffs as much as possible. Such unions also cooperated with management in implementing relocation and transfer programs designed to avoid employment adjustment dismissals.

The courts adopted the practices between larger companies and their unions as general rules concerning economic dismissals. What resulted was a case law which dictates that any adjustment dismissal should be rejected as an abuse of the right to dismiss unless it meets four requirements.

First, there must be business-based need to resort to reduction of personnel. Second, the employer must take every possible measure to avoid adjustment dismissals such as: reduction in overtime; reduction in regular hiring or mid-term recruitment; implementation of transfers (*haïten*) or 'farming out' (*shukkō*) with respect to redundant workers; non-renewal of fixed-term contracts or contracts of

---

47 The *Nihon Shokuen Co.* case, 29 *Minshū* 456 (Supreme Court, April 25, 1975).

part-timers; and solicitation of voluntary retirement. In other words, dismissals must be the last resort to cope with the economic difficulties. Third, the selection of those workers to be dismissed must be made on an objective and reasonable basis. Lastly, the management is required to explain the necessity of the dismissal, its timing, scale and method to the labor union or worker group if no union exists, and consult with them concerning the dismissals in good faith.

Among these four requirements, the second requirement (the 'last resort' requirement) compels Japanese companies to exhaust all options to avoid economic dismissals. Since in Japanese employment relations, employers have many alternatives for cost reduction and maintaining redundant workers, it is difficult for them to satisfy this requirement and at least the case law requires time-consuming process.

The third feature is that the remedies against unjust dismissals are highly protective. In many countries, unjust dismissals result in the payment of money in the form of damages or redundancy payment. By contrast, under the abuse of the right to dismiss theory in Japan, the employer is obliged not only to pay wages during the period of dismissal, but also to reinstate the dismissed employee since the dismissal is null and void.

As a result, if a dismissal is held to be abusive, the employer cannot dissolve the employment relationship with the employee no matter how much the employer pays the employee. Though payment of lost wages itself is a heavy burden for the employer,<sup>48</sup> on top of this, the employer must reinstate the worker. This functions as a disincentive for Japanese employers to resort to arbitrary dismissals.

#### **4.1.2. Internal flexibility to secure long-term employment**

When dismissals are severely restricted, employment relations lacks numerical flexibility. To compensate for such rigidity, the Japan's employment system has introduced internal or functional flexibility. In other word, through flexible modification of terms and conditions of employment and flexible deployment of workers, Japanese companies have accommodated changing socio-economic circumstances while maintaining employment security.<sup>49</sup>

First, flexible modification of working conditions is made possible by the practice in which the employment contract does not specify the conditions of employment, particularly the place and type of work. In Japan, the clarification of place or types of work at the conclusion of an employment contract is not construed as specification of terms which cannot be modified without the worker's consent. Employers, in drafting the work rules, reserve the right to deploy workers based on business necessity, including the right to order transfers which entail changes in the place and/or type of work. Therefore, the employer can unilaterally order a change of place and/or type of work without obtaining the worker's consent. However, modifications in the place and/or type of work may be reviewed for their validity by the courts since such changes can cause

---

48 Since there is no cap on the payment for lost wages, when a worker has spent 10 years to win the case, the employer is obliged to pay wages for the ten years, though the worker's intermediary incomes can be deducted to the extent of 40% of his/her wages. The *Beigun Yamada Butai* case, 16 *Minshū* 1656 (Supreme Court, July 20, 1962).

49 Araki 2002, 48.

workers significant personal inconvenience.

Second, the Supreme Court has established a unique response to unfavorable modifications of work rules: a “reasonable modification” of the work rules has a binding effect on all workers, including those who opposed the modification.<sup>50</sup> Work rules are a set of regulations set forth by an employer for the purpose of establishing uniform rules and conditions of employment at the workplace (LSL Art. 89). In drawing up or modifying the work rules, the employer is required to ask the opinion of a labor union organized by a majority of the workers at the workplace or, where no such union exists, the opinion of a person representing a majority of the workers. However, a *consensus* is not required. Even when the majority representative opposes the content of the work rules, the employer may submit them to the Labor Standards Inspection Office with an opposing opinion and the submission will be accepted. In this sense, the employer can unilaterally establish and modify work rules.

The LSL states that employment contracts that stipulate working conditions inferior to those provided in the work rules shall be invalid and that such conditions are to be replaced by the standards in the work rules (LSL Art. 93). In contrast, the Law remains silent regarding the effect of work rules when they set inferior standards to those in individual employment contracts. This leads to a difficult legal question when an employer facing economic difficulties modifies work rules unfavorably to workers. The binding effect of such modified work rules has been challenged in courts. On this issue, the Supreme Court created a unique principle that when the modification is reasonable, such modified work rules are binding to all employees in the establishment. Despite severe criticism asserting that there was no legal ground for recognizing such a binding effect, the Supreme Court has adhered to this principle and reconfirmed its position repeatedly.<sup>51</sup>

Underlying this ruling are the concerns of employment security and the necessity of adjusting working conditions. Traditional contract theory dictates that an worker who refuses modifications of working conditions be discharged. However, under the case law, such a dismissal may well be regarded as an abuse of the right to dismiss.<sup>52</sup> On the other hand, because the employment relationship is a continuous contractual relationship, modification and adjustment of working conditions are inevitable. In light of these circumstances, Japanese courts have given unilaterally modified work rules a binding effect on the condition that the modification is reasonable. The implication of this rule is that courts give priority to employment security, and in exchange therefor, workers are expected to accept and be subject to reasonable changes in working conditions. This is a manifestation of internal or qualitative flexibility of the Japanese employment

---

50 The *Shuhoku Bus* case, 22 *Minshū* 3459 (Supreme Court, December 25, 1968).

51 The *Takeda System* case, 1101 *Hanrei Jihō* 114 (Supreme Court, November 25, 1983); The *Omagari-shi Nōkyō* case, 42 *Minshū* 60 (Supreme Court, February 16, 1988); The *Dai-ichi Kogata Haiya* case, 1434 *Hanrei Jihō* 133 (July 13, 1992); The *Asahi Kasai Kaijō Hoken* case, 50 *Minshū* 1008 (March 26, 1996); The *Daishi Ginkō* case, 51 *Minshū* 705 (Supreme Court, February 28, 1997); The *Michinoku Ginkū* case, 54 *Minshū* 2075 (Supreme Court, September 7, 2000).

52 However, one lower court decision in 1995 held that the employer could discharge workers who had opposed the proposed new working conditions under certain conditions. For a critical analysis of this case, see Araki 1995, 5.

relationship, where allowing flexible modifications of working conditions compensates for the lack of external or quantitative flexibility surrendered in order to ensure employment security.

#### **4.1.3 Governmental employment maintenance policy**

Government employment policy<sup>53</sup> has greatly contributed to employment security. After World War II, Japan's employment policy started with remedial measures such as unemployment benefit programs and job-creation measures to absorb unemployment through public works or government provided unemployment countermeasures. From the mid-1960s, however, in accordance with the spread of the practice of long-term employment, the importance of employment policy moved towards preventive measures such as providing various subsidies to enable employers suffering from economic difficulties to retain their workers without resorting to adjustment dismissals. In particular the Employment Adjustment Allowance (a subsidy now known as the Employment Adjustment Assistance Allowance) was frequently utilized for employers who were compelled to temporarily shut down operations due to economic downturn and this program significantly contributed to the maintenance of employment security. The main focus of employment policy is to maintain employment and prevent unemployment, rather than to absorb unemployment which has already occurred. This is consistent with Japan's vocational training policy, which does not stress public vocational training for the unemployed to facilitate their finding new jobs, but prefers measures to support companies in conducting on-the-job or off-the-job training, which enables the employers to retain their workers.

Under the prolonged recession, Japan's employment policy is shifting its emphasis from avoiding dismissals and securing employment to smooth reallocation or transfer of the redundant components of the workforce without unemployment. However, as far as budget allocation is concerned, employment maintenance measures are still important. The government is increasing its expenditure on policies to encourage labor mobility in order to cope with increasing unemployment, while maintaining the traditional policy of security in employment.<sup>54</sup> Therefore the current state of employment policy can be viewed as a diversification of policies in accordance with the diversification of the work force or a partial adjustment of employment policy which has, in the past, been overly skewed towards employment maintenance of regular workers.<sup>55</sup>

#### **4.1.4. Norm consciousness of employment security**

Leaving aside the above-mentioned case law and the government's employment policy, the view that dismissals are condoned only as a last resort is widely and deeply rooted in Japanese society. It would be more appropriate to state that case law and government employment policy has been a outgrowth of the prevailing practices respecting the employment security.

In 1993, faced with the recession triggered by the collapse of the bubble economy, some Japanese employers canceled their tentative employment agreements with

---

53 See generally Araki 1994, 385; Takahashi 1997, 5; Takanashi 1999, 7; Ōtake 2000, 5.

54 However, subsidies for declining industries are being reduced since such payment is criticized as delaying structural changes and hindering an appropriate redistribution of workers among industries.

55 Araki 1999, 5.

new graduates who were yet to begin their employment. These unilateral cancellations drew public attention and were exposed through wide media coverage as violating social norms. The Ministry of Labor publicized the names of the companies which had canceled their tentative agreements to hire, which subjected such companies to the social stigma attached to such actions. These events reflected the social norm consciousness that employment relations, once established, should not be unilaterally broken by the employer, and that this principle applies to situations in which the actual employment relationship has not yet even begun.

It is true that the number of labor cases in Japan is extremely small compared to other countries. The number of labor-related cases filed to the first instance in Germany was 578,265 in 1999 and in France 163,218 in 2000. Although rapidly increasing, the number of labor-related cases newly filed in Japanese local courts (first instance) in 2001 was still 3,029 (2,119 ordinary civil cases; 749 provisional disposition cases; and 161 administrative cases). The paucity of litigation triggers debate on the significance and effectiveness of case law. However, if the limited effectiveness of the case law allowed Japanese employers to dismiss redundant workers without much restraint, Japan's lower unemployment rate in the unprecedented and persevering economic slump in the 1990s following the collapse of the bubble economy could not be explained (see Figure 7). It would be fair to say that case law, government employment policy to maintain employment and social norms respecting employment security have jointly sustained the practice of long-term employment.

## **4.2. Changing employment security and new developments in regulations on dismissals and utilization of contingent workers**

### **4.2.1. *Increasing mobility in employment***

Employment is becoming more unstable, and atypical or non-regular employment is increasing. In 1990, non-regular employees made up 20.2% of the Japanese work force, whereas in 2002 this had risen to 29.8% (see Figure 8). To cope with increased lateral mobility, the Japanese government has provided a series of measures to activate the external labor market.<sup>56</sup>

The regulations on fixed-term contracts in Japan were originally quite relaxed. Unlike many European countries where objective grounds are required to conclude a fixed-term contract, in Japan no objective ground is required to conclude and renew fixed-term contracts. The sole legal restriction on fixed-term contracts was that the agreed term of the contract should not exceed one year. Therefore parties to a contract could not agree to a two year term, although it was and is completely legal to conclude a 6 month contract and to renew it three times. However, the 2003 revision of the Labor Standards Law further relaxed the upper limit of the agreed term from one year to three years.

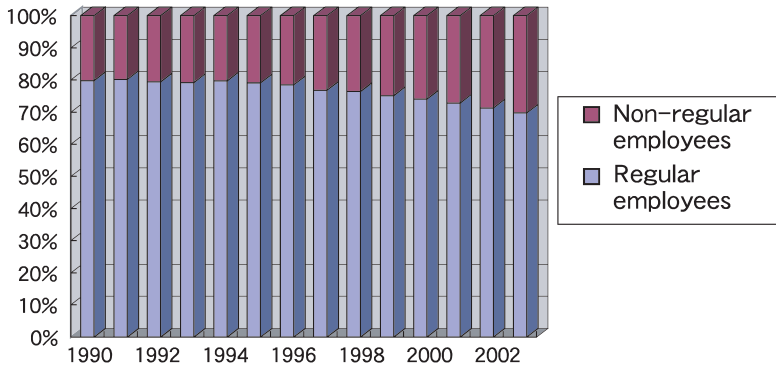
Worker dispatching businesses engaged in labor hire were first legalized in Japan by the enactment of the Worker Dispatching Law (WDL). After several moderate revisions in the 1990s, the 1999 revisions of the WDL generally liberalized worker dispatching by lifting the general prohibition. The 2003 revisions further legalized worker dispatching to production sites, which was prohibited under the

---

<sup>56</sup> Araki 1999, 5.



Figure 8: Ratio of Regular/Non-Regular Employees



Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, Labor Force Survey

1999 revision.

#### 4.2.2. *New interpretation relaxing economic dismissal restriction*

Recently, there has been a noteworthy development concerning economic dismissals. Traditionally, as mentioned above, the validity of economic dismissals depends on whether all four requirements are met or not. If one of four requirements is not satisfied, the dismissal has been regarded as an abuse of the right to dismiss.

A recent decision rendered by the Tokyo District Court<sup>57</sup> rejects this interpretation because, it says, there is no solid legal ground for insisting that all four requirements must be satisfied for economic dismissals. According to the Tokyo District Court, what the court should determine is whether a dismissal is abusive or not. The so-called “four requirements” are merely “four factors” to analyze abusiveness. Therefore, according to the position of the Tokyo District Court, if one of the “four factors” (for example, consultation) is not met, such an economic dismissal can still be held legal and valid by taking all other factors surrounding the dismissal into consideration.

This new approach by the Tokyo District Court has provoked heated discussion and particularly severe criticism from labor-oriented lawyers. However, more and more decisions by courts and scholarly opinions support a “four factors” rule rather than a “four requirements” rule. They consider the inevitable necessity for corporate reorganization to cope with structural changes in the economy.

Having stated that, from a comparative view, even if the “four requirements” rule becomes “four factors” rule, restrictions nevertheless will still be more stringent than in the United States<sup>58</sup> and probably more so than in Germany.<sup>59</sup>

57 The *National Westminster Bank* case (3rd Provisional Disposition), 782 *Rōdō Hanrei* 23 (Tokyo District Court, January 21, 2000).

58 In the United States, the classic employment-at-will doctrine is certainly eroding and is being modified by case law. Stringent anti-discrimination laws also restrain American employers from arbitrarily dismissing employees. However, compared to situations in European countries and Japan, American employers still enjoy more freedom to dismiss employees and there is hardly any restriction on economic dismissals. See Summers 1995, 1036.



### 4.3. Countermeasures protecting employees' interests

Several countermeasures against the promotion of corporate reorganization and increase in labor mobility have been adopted for protecting employees' interests.

#### 4.3.1. Labor Contract Succession Law of 2000

To facilitate corporate restructuring and reorganization to cope with the sluggish Japanese economy, the so-called "corporate division scheme"<sup>60</sup> was introduced by amendment to the Commercial Code in 2000. However, it was feared that the corporate division scheme could be easily abused for downsizing or streamlining of redundant workers and employment security would be severely damaged. Therefore, to protect employees' interests in the event of corporate division, the Labor Contract Succession Law (LCSL) was enacted with effect from April 1, 2001. Under the LCSL, employment relations are, under certain conditions, automatically transferred to the newly-established corporation.<sup>61</sup>

##### 4.3.1.1 Succession of employment relations under the Labor Contract Succession Law

The LCSL approaches the issue of transfer of workers under the corporate division scheme by distinguishing three groups of workers in accordance with their involvement in the work in the severed department.

First, when workers who had been engaged mainly in the work of the department to be severed are excluded from the subject of transfer in the corporate division scheme, they have the right to file an objection to such exclusion (LCSL Art. 4 Para. 1). If a worker files an objection in writing within a certain period,<sup>62</sup> his or her employment contract with the original corporation is assigned to the transferee corporation (LCSL Art. 4 Para. 4). In contrast, if such workers are subject of transfer in the corporate division scheme, their employment relations are automatically assigned to the transferee (LCSL Art. 3). Such workers do not have a right to refuse the transfer.

This treatment is based on the idea that the disadvantage to employees who have been engaged mainly in the work of the department to be split off is particularly serious when they are excluded from the transfer, since they will be separated

---

59 Though German law requires detailed procedures for economic dismissals including establishing a "social plan", if employers follow those procedures it seems easier to reduce redundant employees in Germany than in Japan. As a matter of practice, economic dismissals accompanied by a settlement payment are widespread. *E.g.* Oppolzer 1998, 47; Neef 2000, 8.

60 Prior to the 2000 revision of the Commercial Code, corporation division was carried out through transfer of business or undertakings. However, in order to transfer business, the transferor corporation must obtain individual consent of all creditors as well as those of workers transferred to the transferee corporation. Such cumbersome procedures were thought to have hindered corporate restructuring and reorganization in Japan. The 2000 revision of the Commercial Code introduced simplified procedures for the division of corporation. When a corporation division plan is approved by the shareholders meeting by special resolution, corporation division becomes legally binding on all parties concerned without obtaining their individual consent, though dissenting creditors can express objection and seek liquidation.

61 See Yamakawa 2001, 6; Araki 2002, 142; Araki 2003, 27.

62 For the purpose of providing workers who may be affected by the division with an opportunity to consider and file an objection, the LCSL requires the transferor employer to give notice to its workers regarding their treatment at least two weeks before the shareholders' meeting that determines the adoption of the division plan or contract (Art. 2 Para. 1).

from the work in which they have been mainly engaged. Automatic transfer will generally benefit such employees since they can continue to work in a substantially similar organization and the contents of their employment contract remain unchanged following the transfer.<sup>63</sup>

Second, when workers who have been engaged only peripherally in the work of the split-off department are listed in the corporate division scheme, they may file an objection within a certain period. If this objection is filed, their employment contract shall not be assigned to the transferee corporation despite being named in the corporate division plan or division contract. For instance, if a worker belonging to the human resources (“HR”) department had worked exclusively for the department and the HR department is to be split off, he or she is regarded as mainly engaged in the work of the HR department. By contrast, if such worker had worked both for the HR department and the public relations department, whether he or she has worked mainly or peripherally for the HR department is determined in light of the totality of circumstances, including how much time the worker had spent in the HR department, the role that the worker has been playing in each department, and so forth.<sup>64</sup>

Third, since the corporate division scheme presumes the assignment of an undertaking or business to the transferee corporation, workers who have not engaged in the business of the department to be split off are understood not to be subject to the scheme from the outset. Therefore, the above-mentioned regulations do not apply to such workers. If an employer wants to transfer such workers to the new corporation, it is necessary to obtain those workers' consent.

#### 4.3.1.2 *Effect of succession*

When an employment contract is transferred to the transferee corporation, the effect of succession is automatic and comprehensive as in the case of merger. Therefore, rights and duties in the employment contract or terms and conditions of employment are transferred to the transferee without modifications. However, adjustments in the terms and conditions of employment are not prohibited before or after the corporation division. Given the necessity to establish uniform working conditions and adjust them to changing corporate circumstances, it seems possible for the transferor or transferee to vary working conditions through reasonable modification of work rules as well as through agreement with individual workers or with labor unions.<sup>65</sup>

The guideline<sup>66</sup> confirms that the transferor and transferee shall not discharge their workers solely by reason of the division of the corporation.

#### 4.3.1.3 *Succession of collective agreements*

When workers are assigned to the transferee, it was apprehended that they may lose the benefit of protections provided by any collective bargaining agreement with the previous corporation under the system of Japanese enterprise unionism.

63 Yamakawa 2001, 8.

64 Guideline regarding the enforcement of the Labor Contract Succession Law, Rōdō-shō Kokujī, No. 127 December 27, 2000. The guideline indicates various factors to be considered in determining assumable controversial cases. See Yamakawa 2001, 9.

65 Yamakawa 2001, 10.

66 *Supra* note 64.

Though the terms and conditions of employment provided by the collective agreement are to be transferred as they are, they can be changed unfavorably to workers by individual consent if there is no normative effect of the collective agreement (Trade Union Law, Art. 16).

Therefore, the LCSL provides that when a transferee corporation takes over unionized employees, it is deemed that a collective bargaining agreement with the same terms is concluded between the transferee and the union to which those workers belong (LCSL Art. 6 Para. 3).

#### 4.3.1.4 *Comparative features of the LCSL*

Since the LCSL prescribes automatic succession of employment relations to a newly established or succeeding company, the LCSL can be seen as a Japanese version of the EC directive on transfer of undertakings. However, there are significant differences between the EC directive and the LCSL. The most important difference is that the LCSL application is confined to divisions of corporations, whereas the EC directive covers not only merger and division of corporations but also transfer of undertakings. Under the Japanese law, unlike EU law, automatic and mandatory transfer of an employment contract is not required in the event of transfer of undertakings.

Compared to the situation in the United State where no employment protection is provided in the process of corporate restructuring,<sup>67</sup> it is notable that the Japanese legislature thought it necessary to provide certain protection for employees in the event of division of corporation. In the process of enacting the legislation, a fair balance between the necessity of promoting corporate reorganization and the protection of employees was sought and the midway between the EU and US approach was adopted.

#### 4.3.2. *The 2003 Revision of the Labor Standards Law*

The 2003 revision of the Labor Standards Law (LSL) made the case law rule on abusive dismissals an explicit provision in the Law. A new provision (Art. 18-2) was inserted into the LSL: "In cases where a dismissal is not based upon any objectively reasonable grounds, and is not socially acceptable as proper, the dismissal will be null and void as an abuse of right."

In the tripartite Council Deliberating Working Conditions which *de facto* determined the contents of the government's bill, the labor side sought to introduce provisions declaring the "four requirements" rule on economic dismissals. However, as mentioned above, the "four requirements" rule is developing into a "four factors" rule, and thus the management side strongly opposed stating a "four requirements" rule in the Law. Consequently, no agreement was made in the tripartite council for establishing a new provision concerning economic dismissals.

The bill drafted by the government had put the following sentence before the above-quoted provision nullifying abusive dismissals: "Employers can dismiss their employees providing that the Law and other enacted laws do not restrict their right to dismiss." However, labor unions, opposition parties, the Japan

---

67 Schwab 2003, 183.

Federation of Bar Associations and other bodies raised objections, contending that this sentence could give the impression that employers have a free hand in dismissals. Government parties yielded and eliminated the sentence.

The 2003 revision of the LSL also introduced provisions requiring clarification of grounds for dismissals (Art. 89 No. 3) and obliging the employer to deliver a certificate stating the reasons for dismissals upon the employee's request even during the period between the notice of dismissal and the date of leaving employment (Art. 22 Para. 2).

Labor unions and labor scholars had long argued the necessity to enact laws expressly requiring just cause for dismissals, because of the lack of transparency in a contradictory situation where enacted laws did not require any just cause but case law *de facto* did. However, their proposals had never been adopted by the legislature in the past. This time, the plan to revise the LSL to clarify the dismissal rules was raised by the Koizumi cabinet and its Council for Regulatory Reform. They intended to relax the case law rules which, they thought, were so rigid that they hindered structural changes entailing mobilization of the workforce.

Since the labor unions were arguing for a strengthening of dismissal regulations, naturally they strongly opposed relaxing the case law rule by new legislation. As to a new proposal to introduce monetary solutions to resolve dismissal disputes, which was also suggested by the Council for Regulatory Reform and requested by the management side, the tripartite council could not reach an agreement and no legislative proposal was made on monetary solutions. In the result, what the tripartite council agreed was to write down precisely the above-mentioned basic principle of the case law, namely an abuse of the right to dismissal being null and void, without mentioning rules on economic dismissals or monetary solutions.

The government proposal (LSL Art. 18-2) stated as follows: "An employer may dismiss a worker where his right to dismiss is not restricted by this Law or other laws. Provided that a dismissal shall be treated as a misuse of that right and invalid, where the dismissal lacks objectively rational grounds and is not considered to be appropriate in general societal terms." However, during deliberations in the Diet, the first part of the proposed Art. 18-2 which declares the employer's right to dismiss was feared to have the declaratory effect of encouraging dismissals. As a result, the first part was deleted and the enacted Art. 18-2 reads "A dismissal shall, where the dismissal lacks objectively rational grounds and is not considered to be appropriate in general societal terms, be treated as a misuse of that right and invalid."

Considering the crystallization of non-written case law as an explicit provision in the LSL, the omission of the part of the Bill stating the employer's right to dismissal, and other revisions requiring clarification of dismissal reasons (Art. 89 No. 3) and notification of them to dismissed workers (Art. 22 Para. 2), the overall direction of the 2003 LSL revisions was in fact to counterbalance increasing mobility of the workforce.

##### **5. Industrial relations, employee participation and corporate governance**

The prominent feature of Japan's industrial relations is stable and cooperative

relations between labor and management developed under enterprise unionism. Previously, some attributed Japan's cooperative labor relations to cultural factors such as the Japanese people's 'harmonious' and 'non-contentious' nature. However, from the end of World War II through the 1960s Japan experienced turbulent labor-management confrontations.<sup>68</sup> It is a rather recent phenomenon (after the first oil crisis), that industrial relations have become very stable (see Figure 9). Therefore the cultural explanation is not persuasive.

Japan's current stable industrial relations should be understood as the result of the following three factors: (1) Japan's enterprise unionism; (2) widespread joint labor-management consultation practices; and (3) internal management promotion practices.

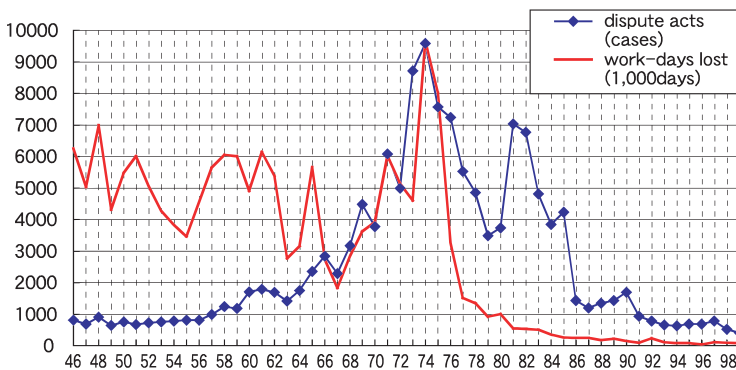
### 5.1. Enterprise unionism

Enterprise unionism<sup>69</sup> is a hallmark of Japanese industrial relations. Currently 95.6% of unions in Japan are enterprise-based unions and 91.2% of all unionized workers belong to enterprise unions.<sup>70</sup> Enterprise unionism is a system in which unions are established within an individual enterprise, collectively bargain with a single employer, and conclude collective agreements at the enterprise level. Enterprise unions within the same industry often join an industrial federation of unions, and the industrial federations are affiliated with national confederations. However, industry-level collective bargaining is very rare.

An enterprise union organizes workers in the same company irrespective of their jobs. As a result, both blue and white collar workers are organized in the same union. Enterprise unions normally confine their membership to regular workers though there are no legal obstacles which prevent enterprise unions from organizing part-time workers or temporary workers.

There are several reasons for the dominance of this pattern of union organization.

Figure 9: Dispute Acts and Work-Days Lost



Source: Ministry of Health, Labor and Welfare, Survey on Labor Disputes

68 See Araki 2002, 206; Koshiro 2000. Hiwatari 1999, 276 states "Japan's enterprise unionism emerged in the years after World War II, largely as an unintended outgrowth of revolutionary unionism..."

69 See generally, Sugeno and Suwa 1996; Araki 2002, 164.

70 Ministry of Labor 1997.

Historically Japan had little experience with industry-wide unionism before World War II, and the experience of the wartime regime that mobilized all workers into units at the enterprise level may have had some influence. After the war when employers could no longer suppress union activities, workers freely used the enterprise-level workplace approach as the most convenient basis for organization.

Enterprise unionism has continued to predominate, however, because it has served well as a key component of Japanese employment relations. Under the long-term employment system, dismissals are avoided at all cost. In exchange, workers accept the flexible adjustment of working conditions. In the highly developed internal labor market, employees are transferred within a company and receive in-house education and on-the-job training. The promotion and wages of each employee are decided mainly by that individual's length of service and performance. In this context, industrial-level or national-level negotiations have made little sense. Enterprise unions and enterprise-level collective bargaining have been the most efficient mechanism in reconciling the requirements of an internal labor market with the workers' demands.

When unions have their basis in a particular company, they tend to be more pragmatic than ideological and more conscious about their own company's productivity and competitiveness.

## **5.2. Compensatory system of enterprise unionism**

Enterprise unionism has several defects, such as weak bargaining power, the lack of a universal impact across the industry or nation, and the lack of social and political influence on national labor policy.<sup>71</sup>

### **5.2.1. *Shuntō* (The Spring wage offensive)**

To compensate for the weakness in bargaining power and lack of industry or nation-wide impact of collective bargaining, union leaders devised in 1955 a unique wage determination system called "*Shuntō*" (the spring wage offensive).<sup>72</sup> Under the *Shuntō* system, every spring, industrial federations of enterprise unions and national confederations set the goal for wage increases and coordinate the time schedule of enterprise-level negotiations and strikes across enterprises and industries. According to the schedule, strong enterprise unions in a prosperous industry are chosen as a pace setter to commence negotiations and set the market price for that year. Other unions then follow suit. The market prices established in *Shuntō* have also been reflected in the public sector where strikes are prohibited, and also in regional minimum wages which are revised every fall by the tripartite Minimum Wages Council within the framework of the Minimum Wages Law. In this manner, the *Shuntō* strategy has compensated for the limitations of enterprise unionism in terms of bargaining power and establishing social standards across companies.

### **5.2.2. Development of the macro and meso-Corporatism**

Under enterprise unionism, where union influence is confined to particular

---

<sup>71</sup> Sugeno and Suwa 1996.

<sup>72</sup> For details of the historical development and economic analysis of *Shuntō*, see Takanashi 2002.

enterprises, issues which should be dealt with by national legislation or national labor policy cannot be properly addressed.<sup>73</sup> In order to fill this void and respond to these issues, the Japanese Trade Union Confederation (*Rengō*) was established in 1989 by the merger of four former national confederations. *Rengō* has 8 million members, two thirds of all union members in Japan.

Another important compensatory tool is joint labor-management consultation at the industrial and national level. At the national level, the tripartite council called “*Sangyō Rōdō Konwa-Kai*” (the Industry and Labor Round Table Conference) was established in 1970. In this forum, representatives of labor, management, and the public interest (the government and academic experts) meet periodically to discuss and exchange opinions on industrial and labor policy.

In addition, the government has also established several official tripartite councils to advise on government labor and social policies. They have become the most important fora in determining the content of new labor legislation or labor policies. The content of drafts proposed to the Diet by the government is deliberated and decided in these Councils.

At the industry level, major companies and federation of labor unions in the same industry voluntarily establish labor-management councils. They exchange information and opinions on the state of the industry, working conditions and future strategies for the growth of the industry and enhancement of workers' welfare.

The Japanese macro and meso-corporatism is unique in that, in spite of the institutional and financial weakness of the labor organizations at the national level, labor interests have, comparatively speaking, been able to make great inroads in achieving their social policy outcomes.<sup>74</sup> In other words, although *Rengō* and the former national confederations of unions have never resorted to *direct* economic or political pressure to promote labor legislation for the labor side, the developments of labor legislation and labor policies in the past substantially reflected voices of labor through the consultation mechanism at the industry and national level. Therefore, it should not be overlooked that Japanese industrial relations based on the enterprise unionism is supplemented by the foregoing quasi-corporatist mechanism.

### 5.3. Joint labor-management consultation

Joint labor-management consultation is an established practice in Japanese industrial relations. Currently, 41.8%<sup>75</sup> of all surveyed establishments have such consultation bodies.<sup>76</sup> In unionized establishments, the figure is greater at 84.8%. In many countries, labor-management consultation was not voluntarily established. Therefore, the state intervened and forced companies to establish

---

73 Such issues include the rapid aging of society, offshore movement of industries to developing countries caused by the appreciation of the yen, international trade conflicts and the increased flow of migrant workers into Japan's labor market.

74 See Shinoda 1994, 357.

75 The figure is smaller than that in the previous survey in 1994 (55.7%). This is mainly because of the difference in the size of surveyed establishments. The 1994 survey sampled establishments with more than fifty employees and the 1999 survey sampled those with more than thirty.

76 Ministry of Labor 1999.



works councils or other channels for communicating and informing employees. In Japan, by contrast, labor-management consultation has been voluntarily established without any legal intervention.

This consultation is also strongly related to the historical development of Japan's industrial relations. After World War II, Japan experienced harsh confrontations between labor and management. Both parties were exhausted by adversarial relations and looked for new, more pragmatic and cooperative relations.

In 1955, the Japan Productivity Center was established by business circles under the auspices of the Ministry of International Trade and Industry (MITI) and the American government to promote the Productivity Increase Movement and joint consultation practices. Though leftist unions, especially *Sōhyō*, were skeptical and regarded the Movement as a new type of rationalization or exploitation and strongly opposed it, the national confederation of moderate unions (*Sōdōmei*), took the position of participating in the Movement on the condition that the opinions of the union concerned should be fully respected. Thus *Sōdōmei* and the Japan Productivity Center confirmed the three following basic principles of the Productivity Increase Movement.

- (1) The productivity increase shall enhance employment security. Redundancies in transitional stages shall be resolved not by layoffs but by transfers or other measures.
- (2) Labor-management consultation must be promoted in order to determine concrete measures to increase productivity.
- (3) The fruits of increased productivity must be distributed fairly among management, employees and customers in accordance with the conditions in the national economy.

In short, Japanese employers promised not to lay off redundant employees as a result of increased productivity and to maintain their employment by transfer and re-training. At the same time, in order to enhance mutual understanding and smooth implementation of productivity enhancement, they advocated establishing joint labor-management consultation. These three basic principles, namely employment security, dense communication through joint consultation, and fair distribution of the enhanced productivity, became the basic principles of the Japan's cooperative labor relations in the subsequent years.

Left-wing unions remained skeptical of the productivity increase movement. However, after the defeat of the leftist union movement during the giant confrontation that resulted from the *Miike* coal mine dispute in 1960, pragmatic and cooperative labor relations gradually started to take root in Japanese industrial relations. Labor and management voluntarily established consultation mechanisms and developed rich communication channels through joint consultation. Employers provided various information for unions, and unions cooperated with management in increasing productivity. In fact, this information flow was indispensable in acquiring the unions' cooperation for implementing restructuring plans entailing wide-range transfers to avoid economic dismissals.

Japanese labor and management learned from their bitter confrontations that adversarial relations benefited neither party, and found that by establishing

cooperative relations and enhancing productivity they could change a zero-sum game into a win-win game.

However, it should not be overlooked that joint consultation has been encouraged by the sanction of a union's right to bargain. In accordance with the stabilization of Japan's industrial relations, some point out the formalization of joint consultation.

#### **5.4. Internal promotion of board members**

Internal promotion of management has also contributed to Japan's cooperative industrial relations and employee-centered corporate governance.

In most larger companies in Japan, union shop agreements are fixed. Under the union shop agreement, all employees are obliged to join the union. This means that current executives were members of the enterprise union in their 20s or 30s when they were rank-and-file white-collar workers.<sup>77</sup> Furthermore, according to the Top Management Survey, 28.2% of top management had previously been not only union members but also leaders of an enterprise union.<sup>78</sup> In a sense, labor-management relations in Japanese enterprises is the relation between present union members and former union members (sometimes between current union leaders and former union leaders). This brings about a consciousness that both labor and management belong to the same community, facilitates labor and management to find common interests, and leads Japanese management to take a consensual-rather than an adversarial-approach.

In corporations adopting the traditional governance model, nearly half of board members are dual-function directors. By accepting such dual functionality, it can be said that Japanese corporations have established a channel to voice employees' opinions to corporate management. However, in the corporation adopting new governance model, the majority of the committee members must be outside directors. The adoption of the new governance model will significantly affect the internal promotion system and the acceptance of dual-function directors. However, as mentioned earlier, few Japanese corporations have adopted this model so far.

#### **5.5. Recent developments in industrial relations**

In industrial relations, there have been no drastic legislative changes. However, recent changes in the environment surrounding industrial relations have led to calls for the reconsideration of the worker representation system.

##### ***5.5.1. Legislative developments promoting corporate restructuring***

First, from the late 1990s, the Japanese government took a series of measures to promote corporate restructuring or reorganization and market-oriented management in order to cope with the prolonged economic slump. In 1997, a stock option system was introduced and the previous prohibition of genuine holding companies was liberalized by the revision of the Anti-Monopoly Law.

---

<sup>77</sup> Since an enterprise union in Japan organizes workers in the same company irrespective of their jobs, both blue and white collar workers are organized in the same union.

<sup>78</sup> Inagami and RIALS 2000, 339.

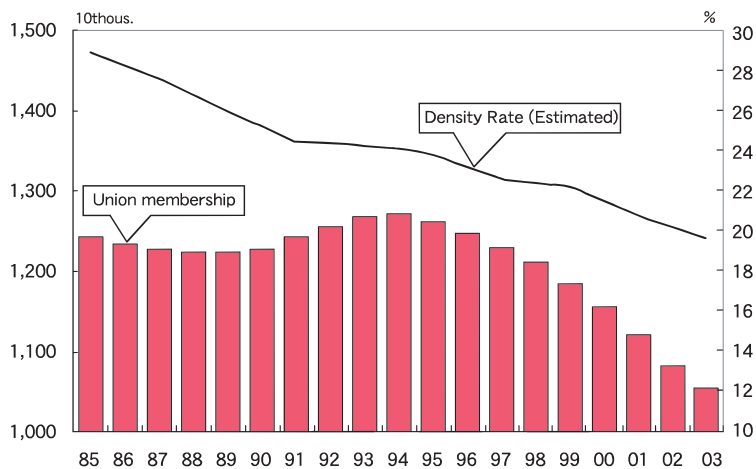
The year 1999 saw the advent of the Industrial Revitalization Special Measures Law which encouraged and supported business revitalization and the Industrial Rehabilitation Law which prevented bankruptcies and rehabilitated companies in failing circumstances. In the same year, the stock exchange and transfer systems were introduced to facilitate forming the holding company system. As already discussed in detail, the corporate division scheme was introduced in 2000 to promote corporate reorganization and an option to adopt a US-type corporate governance was introduced in 2002.

This series of legislative changes aimed to promote corporate reorganization, which inevitably affected industrial relations. A trend emerged whereby a company is divided into several units and each unit becomes an independent company, while the headquarters of the original company becomes a holding company governing the newly created subsidiaries. When an enterprise union does not respond to such corporate reorganization, there will be an absence of collective bargaining because there may be no union members in the newly built company. One recent legal debate concerns whether a union that organizes workers in the subsidiary company can legally request collective bargaining with the holding company. According to the traditional interpretation, when there is no evidence that the holding company has actually intervened in and decided the working conditions of the subsidiary, the holding company does not bear the duty to bargain with the union organizing workers in the subsidiary company. However, since the holding company can decide the existence or abolition of the subsidiary as a decisive shareholder, some scholars argue for the holding company's duty to bargain.

### 5.5.2. Declining union density and emerging new representation system

Second, the unionization rate has continuously declined since 1975 and finally reached below 20% (19.6% in 2003, see Figure 10). Further, the diversification of the workforce has led to questions as to the representative legitimacy of enterprise unionism. Traditionally enterprise unions solely organized regular employees and non-regular workers such as part-time workers and fixed-term contract workers remained unorganized. However, currently 30% of all employees are

Figure 10: Union membership and density rate (estimated)



Source: Ministry of Health, Labor and Welfare, Basic Survey on Labor Unions

non-regular employees. The target of corporate restructuring in the 1990s concentrated on middle management employees. Employees promoted to middle management are supposed to leave unions. Therefore they are provided little protection by labor law and labor unions. These circumstances require reconsideration of the channel conveying employees' voice. Some scholars contend that Japan should introduce an employee representation system like the works council in Germany (*Betriebsrat*) which represents all the employees in the establishment irrespective of union membership.

The 1998 revision of the LSL introduced a new representation system called a *rōshi iinkai* (labor-management committee). Half of the members of this committee must be appointed by the labor union organized by a majority of workers at the workplace concerned, or with the person representing a majority of the workers where no such union exists. The labor-management committee must be established when the employer intends to introduce the discretionary work scheme (management planning type),<sup>79</sup> which functions as a Japanese counterpart of the white-collar exemption from overtime regulations. The labor-management committee is the first permanent organ with equal membership for labor and management that represents all the employees in the establishment. Therefore, this committee can be regarded as the embryonic form of a Japanese works council, although the jurisdiction of this committee is currently confined to regulation of working hours and its establishment is not compulsory.

Since the procedures to adopt the discretionary work scheme are very complicated, currently there are very few labor-management committees. However, the 2003 revision of the LSL simplified the procedure to introduce the discretionary work scheme. Previously, decision making in the committee was by unanimous agreement, but under the revised LSL, it can be achieved by four-fifths majority among the committee members. Although it remains to be seen whether the labor-management committee will become more common and solidify as a system of employee representation, the introduction of this embryonic form of representation by recent legislative change is noteworthy.

## **6. Summary and future of Japan's practice-dependent stakeholder model**

### **6.1 Brief summary of Japan's practice-dependent stakeholder model**

As mentioned at the outset, Japan's employee-centered stakeholder model relies heavily on customary practices. The main pillars that have sustained the Japanese stakeholder model have been: cross-shareholdings and long-term shareholding, internal promotion of management and acceptance of dual-function directors into the management board, long-term (lifetime) employment, and voluntary developed joint labor-management consultation (see section 1. above).

This article has reviewed how these practices formed and sustained the traditional stakeholder model in Japan. Then, it has examined recent changes that might affect the traditional governance model. It is true that considerable changes are taking place. As for the structure of shareholdings, cross-shareholdings are being dissolved, and foreign investors are increasing. The

---

<sup>79</sup> There are two types of discretionary work scheme: professional work type and management planning type. For details, see Araki 2002, 94.

revision of the corporate law in the 1990s to facilitate shareholders representative suits necessitates a style of corporate governance which is more conscious of shareholder value. After the collapse of bubble economy, together with a shift from indirect finance via banks to direct finance, the importance of Japanese banks in corporate governance has been reduced. In these circumstances, it is no surprise that shareholder value has surfaced as a new criterion (see section 2. above).

Drastic revisions to the corporate law have given large companies the option of adopting a US-type corporate governance system utilizing outside directors, which might also change the nature of the management (see section 3. above). The employment system in Japan is also experiencing transformation. In the last decade, Japan repeatedly achieved worst-ever unemployment figures. Lateral mobility has increased and the state's labor market policy has tilted toward the activation of the external labor market. Courts have started to relax restrictions on economic dismissal. Stable regular employment has gradually shrunk and currently non-regular and contingent workers account for 30% of all workers (see section 4. above). In the area of collective labor relations, drastic legislative changes have not occurred. However, the decline in union density and the diversification of the workforce is progressing and might require reconsideration of the traditional collective labor relations system (see section 5. above).

Compared to a legally-sanctioned stakeholder model like that in Germany, Japan's practice-dependent stakeholder model is more vulnerable to environmental changes. Although a socio-economic system consisting of interdependent institutions is transformed into another only with difficulty,<sup>80</sup> in an era of disequilibrium, when several institutions change simultaneously, such change might occur. Therefore, the question is whether or not the aforementioned changes will lead to fundamental institutional changes that transform the current stakeholder model into the shareholder-value model.

## **6.2 Whither Japanese corporate governance?**

Considering the existence of countermeasures against a governance style oriented solely towards maximizing shareholder value and various research results discussed below, the author is in the opinion that, at least for the time being, the current stakeholder model will survive. What is occurring now can be viewed as the realignment of the priority of various stakeholders' interests in the framework of the stakeholder model.

First, it should be confirmed that there are countertrends and countermeasures against the one-sided progress towards shareholder value model. Although cross-shareholdings are dissolving, it is still the case that more than 80% of surveyed companies maintain cross-shareholdings and they recognize the merit of forming stable and long-term trading relations (Table 2 and Figure 3). The ratio of foreign investors started to decline since 1998 (Figure 1). The 2001 revision of the Commercial Code limits directors' liability in a shareholders representative suit. Although the 2002 corporate law revisions introduced the US-style governance model, the vast majority of Japanese corporations maintain the traditional model. As for employment security, the enactment of the Labor

---

80 Aoki and Okuno 1996, 1.

Succession Law in 2000 was a systemic countermeasure to protect employees' interest in the face of increasing corporate reorganizations. The 2003 revisions of the Labor Standards Law that incorporate the case law rule on abusive dismissals have a symbolic significance to explicitly confirm the norm consciousness of employment security in Japanese society. Declining labor unions and workforce diversification call for new forms of worker representation. In this regard, a labor-management committee system introduced in 1998 attracts attention as to whether or not it will develop into a Japanese version of the works council representing all employees in the establishment. These developments serve to sustain the stakeholder model centered on employees' interests or at least put a brake on the radical transformation into the shareholder value model.

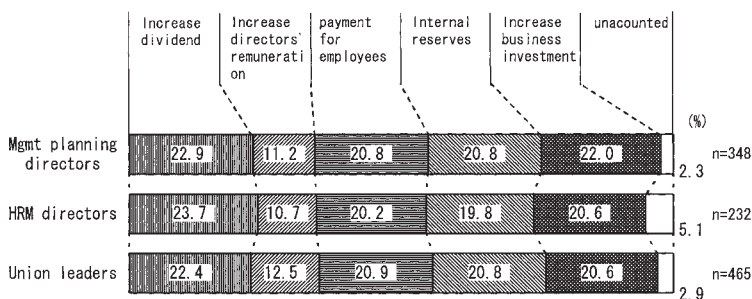
Second, several recent surveys prove that, despite the aforementioned changes towards the shareholder value model, the stakeholder model is still supported widely in Japanese society.

According to the JPC-SED 2003 survey, when a corporation has increased profits, they are not supposed to be distributed solely to shareholders but to be distributed almost evenly to shareholders, employees, internal reserves, and business investments. Such a view is supported not only by union leaders but also by management planning directors and HRM directors (see Figure 11).

According to the same survey, when asked about "recent recent changes within your company in the last three years," about 70% of the respondents indicated that their company had "adopted performance-based or achievement-based HRM" or had "adopted corporate restructuring or reorganization measures", but only 26% of them responded that their company "paid special consideration to the shareholders in management decision-making."

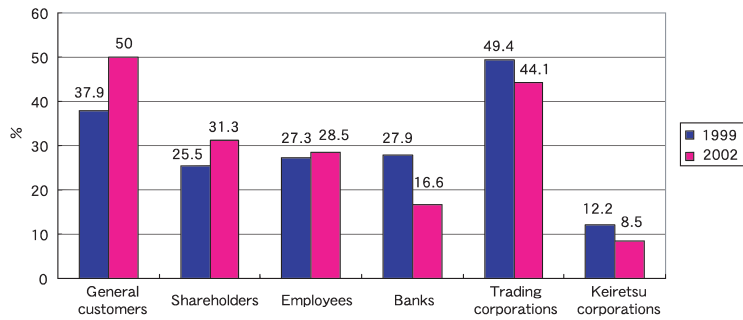
The Survey conducted by the Ministry of Finance, Policy Research Institute compared the changes in opinion between 1999 and 2002 concerning who the company regards as important stakeholders (see Figure 12). Banks and trading corporations become less important and general customers and shareholders are regarded as more important than ever. However, it should also be noted that employees are still regarded as an important stakeholder and the ratio is, though slightly, increasing. Although the importance of the external control is increasing, it is notable that general customers or the products market, which Japanese companies have traditionally respected, are more important than

Figure 11: To whom the increased profit should be distributed



Source: JPC-SED 2003.

Figure 12: Who is the important stakeholder?



Source: Ministry of Finance, Policy Research Institute 2003.

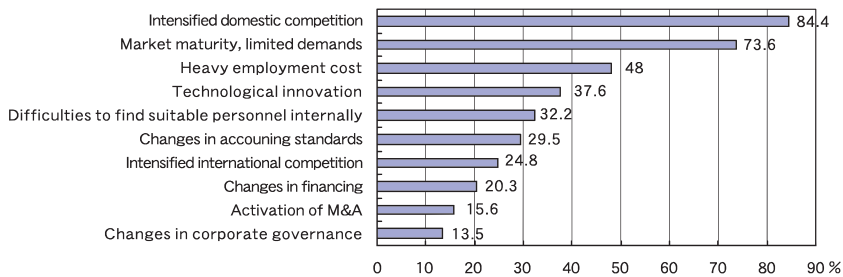
shareholders or the stock market.

A survey on “the relationship between corporate restructuring and employment” conducted by the Japan Institute of Labor in 2002<sup>81</sup> examined the factors that affected decisions to take restructuring measures entailing staff downsizing. Prominent factors affecting such management decision making are not “changes in corporate governance” (13.5%) but “intensified competition in the domestic market” (84.4%) and “Market maturity, limited demands” (73.6%) (see Figure 13).

Lastly, it is worth citing several interesting survey results which may hint at the future of corporate governance and industrial relations in Japan. The JPC-SED 2003 survey asked whether or not consultation with labor unions had the effect of hindering swift management decision-making. Not only the majority of union leaders but also the majority of the management planning directors and HRM directors thought that labor management consultation did not hinder speedy decision-making by management (See Figure 14).

Further of note in that survey is the result concerning the future of labor union involvement. Surprisingly, not only the majority of the union leaders but also 58.7% of management planning directors and 65.6% of HRM directors replied that labor unions should be involved in management decision-making into the

Figure 13: Factors affecting the corporate restructuring entailing downsizing

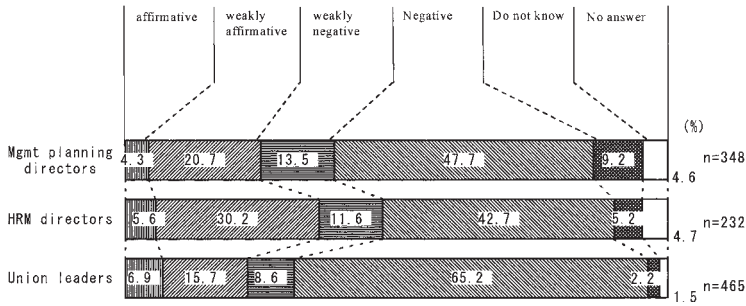


Source: Japan Institute of Labor 2002.

81 Japan Institute of Labor 2002.



Figure 14: Does consultation with labor unions hinder swift management decision-making?



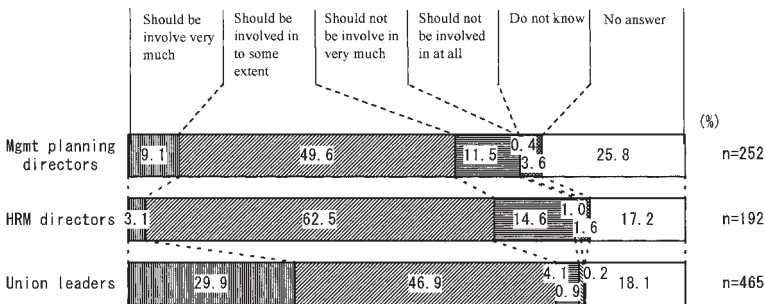
Source: JPC-SED 2003.

future. The negative responses are quite small in number (see Figure 15). This survey was conducted in July and August of 2001 when the Enron and WorldCom scandals had not yet come to light and US-style corporate governance was receiving its greatest accolades in the Japanese media. It is remarkable that, at such a time, labor and management at the workplaces still recognized the value of union involvement. This seems to reflect the deep-rooted consciousness in Japan that employees are an important constituent of corporations.

Some contend that under the stakeholder model, there are many interests to be considered and such complicated consideration makes governance policy confused and unclear. The shareholder value model can, the advocates believe, be regarded as an attempt to strike the balance of diversified interests by using a uniform index of the stock prices and gives a clear guiding principle for corporate governance. Where the shareholder structure is highly diversified - as it is in the United States - enhancing shareholder value might well mean the realization of such plural values. But it remains to be seen whether the structure of the Japanese stock market will become as diversified as its American counterpart in the near future. Furthermore it is highly questionable whether the shareholder value model can entirely replace the function of the worker participation system.<sup>82</sup>

As shown Figure 12, to meet the necessity to introduce the external control on

Figure 15: How far labor unions should be involved in management decision-making in the future



Source: JPC-SED 2003.

82 See Freeman and Rogers 1999, 3; Kruse and Blasi 1999, 618; Jacoby 2001, 449.

corporate governance, Japanese corporations are introducing external control by the customer or product market rather than by the stock market. The customer market control is more compatible with the respect of employment as Japan had experienced in the past. The customer market requires flexible management. For flexible management, the Japanese employment system has not relied on external or numerical flexibility meaning flexible adjustment of the number of workers, but introduced internal flexibility or flexible adjustment of terms and conditions of employment while maintaining employment. The Japanese labor law has developed rules governing such internal flexibility (see section 4.1.2. above).<sup>83</sup>

The key concept determining the relationship between Japanese corporate governance and industrial relations is employment security. As confirmed by the 2003 revision of the Labor Standards Law, employment security, although somewhat relaxed, remains critical in Japanese society. Under an employment system with employment security, negotiation is indispensable in adjusting terms and conditions of employment. Thus, both labor and management confirm the importance of labor-management consultation (see Figure 15).

Given these survey results together with the various countertrends and countermeasures for protecting employees' interests in the course of corporate restructuring, the author considers that Japan's stakeholder model will not be drastically modified in the near future. Current changes in shareholder structure and management machinery certainly require the reconsideration of priority orders of various stakeholders' interests. Shareholders' interests cannot be ignored any more and employment security is not absolutely supreme in corporate governance. However, such reconsideration seems to be occurring within the framework of the stakeholder model, and it is not likely that the model will completely convert into the shareholder value model at least for the time being.

## References

- Aoki and Okuno 1996: Masahiko Aoki and Masahiro Okuno, *Keizai Shisutemu No Hikaku Seido Bunseki* [Comparative Institutional Analysis of Economy], (Tokyo University Press, 1996).
- Araki 1994: Takashi Araki, "Promotion and Regulation of Job Creation Opportunities, National Report: Japan", in International Society of Labour Law and Social Security, Promotion and Regulation of Job Creation Opportunities (Proceedings of XIV World Congress of Labour Law and Social Security, Theme I), 385 (1994).
- Araki 1995: Takashi Araki, "Modification of Working Conditions Through Dismissals?: A Comparative Analysis of the SAS Case", 34(8) *Japan Labor Bulletin* 5 (1995).
- Araki 1998: Takashi Araki, "Accommodating Terms and Conditions of Employment to Changing Circumstances: A Comparative Analysis of Quantitative and Qualitative Flexibility in the United States, Germany and Japan", in Chris Engels & Manfred Weiss (eds.), *Labour Law And Industrial Relations At The Turn Of The Century* 509 (Kluwer, 1998).
- Araki 1999: Takashi Araki, "1999 Revisions of Employment Security Law and Worker Dispatching Law: Drastic Reforms of Japanese Labor Market

---

83 Araki 1998, 509; Araki 2002, 48.

- Regulations”, 38(9) *Japan Labor Bulletin* 5 (1999) <<http://www.jil.go.jp/bulletin/year/1999/vol38-09/06.htm>>.
- Araki 2000a: Takashi Araki “Nichi-Bei-Doku no Kōporēto Gabanansu to Koyō Rōshi Kankei” [Corporate Governance and Employment and Labor Relations in Japan, United States and Germany], in Inagami and RIALS 2000, 209 (Tōyō Keizai, 2000).
- Araki 2000b: Takashi Araki, “A Comparative Analysis: Corporate Governance and Labor and Employment Relations in Japan”, 22 *Comparative Labor Law and Policy Journal* 67 (2000).
- Araki 2002: Takashi Araki, *Labor and Employment Law in Japan* (Japan Institute of Labor, 2002).
- Araki 2003: Takashi Araki, “Corporate Restructuring and Employment Protection: Japan’s New Experiment”, in Roger Blanpain and Manfred Weiss (eds.), *Changing Industrial Relations and Modernisation of Labour Law - Liber Amicorum in Honour of Professor Marco Biagi*, 27 (Kluwer Law International, 2003).
- Barnard 2000: Catherine Barnard, *EC Employment Law* (2nd ed. 2000).
- Blair and Roe 1999: Margaret Blair and Mark Roe (eds), *Employees And Corporate Governance* (1999).
- Charkham 1994: Jonathan Charkham, *Keeping Good Company: A Study of Corporate Governance in Five Countries* (1994).
- Corporate Governance Forum of Japan 1998: Corporate Governance Forum of Japan, “Corporate Governance Principles”, 212 Bessatsu *Shōji Hōmu* 1 (1998).
- Dore 2000a: Ronald Dore, *Stock Market Capitalism: Welfare Capitalism* (Oxford, 2000).
- Dore 2000b: Ronald Dore, “Comment: Papers on Employees and Corporate Governance”, 22 *Comparative Labor Law and Policy Journal* 159 (2000).
- Egashira 1994: Kenjirō Egashira, “Kōporōto Gabanansu o Ronzuru Igi” [The significance of discussing corporate governance], 1364 *Shōji Hōmu* 2 (1994).
- Egashira 2002, Kenjirō Egashira, *Laws of Stock Corporations and Limited Liability Companies* (Yūhikaku, 2002).
- Freeman and Rogers 1999: Richard Freeman and Joel Rogers, “What do Workers Want? Voice, Representation and Power in the American Workplace”, in Samuel Estreicher (ed.), *Employee Representation in the Emerging Workplace: Alternative/Supplements to Collective Bargaining*, 3 (Kluwer Law International, 1999).
- Fukao 1999: Mitsuhiro Fukao, “Nihon no kin’yū shisutemu fuan to kōporēto gabanansu kōzō no jakuten” [Insecure financial system and weakness of Corporate Governance in Japan] , in Masahiko Aoki et al., *Shijō no Yakuwari, Kokka no Yakuwari* [The Role of the Market, the Role of the State] , 149 (Tōyō Keizai, 1999).
- Hiwatari 1999: Nobuhiro Hiwatari, “Employment Practices and Enterprise Unionism in Japan”, in Margaret Blair and Mark Roe (eds.), *Employees and Corporate Governance*, 276 (1999).
- Inagami and RIALS 2000: Takeshi Inagami and RIALS (ed.), *Gendai Nihon No Kōporēto Gabanansu* [Corporate Governance In Contemporary Japan] (Tōyō Keizai, 2000).
- Inagami 2001: Takeshi Inagami, “From Industrial Relations to Investor Relations? Persistence and Change in Japanese Corporate Governance, Employment Practices and Industrial Relations”, 4 *Social Science Japan*

- Journal 225 (2001).
- Itami 1987: Hiroyuki Itami, *Jinpon Shugi Kigyō* [The Employee-Centered Corporation] (Chikuma Shobō, 1987).
- Itami 1993: Hiroyuki Itami, “Kabushiki Gaisha to Jyūgyōin ‘Shuken’” [Corporations and employees’ “sovereignty”], in Hiroyuki Itami et al (eds.), 1 *Nihon No Kigyō Shisutemu: Kigyō to wa Nanika* [Corporation System In Japan: What is Corporation?] 154 (Yūhikaku, 1993).
- Itami 2000: Hiroyuki Itami, *Nihon-Gata Kōporēto Gabanansu* [Japanese-Style Corporate Governance] (Nihon Keizai Shinbun Sha, 2000).
- Itō 1993: Kunio Itō, “Kabushiki Mochiai” [Cross-shareholding, in Hiroyuki Itami et al (eds.), 1 *Nihon No Kigyō Shisutemu: Kigyō to wa Nanika* [Corporation System In Japan: What Is Corporation?] 154 (Yūhikaku, 1993).
- Jacoby 2001: Sanford M. Jacoby, “Employee Representation and Corporate Governance: A Missing Link”, 3 *University of Pennsylvania Journal Of Labor And Employment Law* 449 (2001).
- Japan Institute of Labor 2002: Nihon Rōdō Kenkyū Kikō [Japan Institute of Labor], *Jigyō Saikōchiku to Koyō ni Kansuru Chōsa* [Survey on relationship between corporate restructuring and employment] (2002) <[http://www.jil.go.jp/press/koyo/020617\\_03.html](http://www.jil.go.jp/press/koyo/020617_03.html)>.
- JPC-SED 2003: Shakai-Keizai Seisan-sei Honbu [Japan Productivity Center for Socio-Economic Development (JPC-SED)], Rōshi Kankei Tokubetsu Iinkai (Labor-Management Relations Committee), 21 *Seiki: Kigyō Keiei no Henka to Rōshi Kankei: Wagakuni ni okeru Kōporēto Gabanansu no Henyō o Fumaete* [Changes in Corporate Management and Labor-Management Relations in the 21st Century: Responding to Transformations in Corporate Governance in Japan (JPC-SED, July 31, 2003).
- Kanda 1992: Hideki Kanda, “Future of Corporate Law” 87 *Shihon Shijō* 23 (1992).
- Kanda 2003: Hideki Kanda, *Corporate Law*, 4<sup>th</sup> ed. (Kōbundō, 2003).
- Kansaku 2000: Hiroyuki Kansaku, “Kōporēto Gabanansu-rōn to Kaisha-hō” [Debate on Corporate Governance and Corporate Law], in Inagami and RIALS 2000, 165 (Tōyō Keizai, 2000).
- Kawahama 1997: Noboru Kawahama, “Torishimariyaku-kai no Kantoku Kinō [Supervisory Function of a Board of Directors]”, in Shigeru Morimoto et al. (eds), *Kigyō no Kenzen-Sei Kakuho to Torishimariyaku no Sekinin* [Maintaining Sound Corporate Management and Directors’ Responsibility] , 38 (1997).
- Keizai Dōyūkai 1996: Keizai Dōyūkai, 12 *Kigyō Hakusho* [White Paper On Corporations] (Keizai Dōyūkai, 1996).
- Koshiro 2000: Kazutoshi Koshiro, *A Fifty Years History Of Industry And Labor In Postwar Japan*, Japanese Economy & Labor Series No. 6 (2000).
- Kruse and Blasi 1999: Douglas Kruse and Joseph Blasi, “Employee Ownership, Employee Attitudes, and Firm Performance: A Review of the Evidence”, in Samuel Estreicher (ed.), *Employee Representation in the Emerging Workplace: Alternative/Supplements to Collective Bargaining*, 581 (Kluwer Law International, 1999).
- Kubori 1994: Hideaki Kubori, “Nihon no Kaisha Soshiki no Jittai to Kōporēto Gabanansu” [The Reality of Japanese Corporations and Corporate Governance], 1050 *Jurisuto* [Jurist] 41 (1994).
- Kuroki 2002: Fumiaki Kuroki, “Cross-Shareholdings Decline for the 11<sup>th</sup> Straight Year (FY2001 Survey)” (NLI Research Institute) <<http://www>.

- nli-research.co.jp/eng/research\_ind.html>.
- Löwisch 1996: Manfred Löwisch, *Arbeitsrecht (Labor Law)*, 4th ed. (Werner, 1996).
- Maeda 2000: Hitoshi Maeda, Kaisha Hō Nyūmon [Primer On Corporate Law], 7th ed. (Yūhikaku, 2000).
- Milhaupt 2001: Curtis Milhaupt, "Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance" 149 *University of Pennsylvania Law Review* 2083 (2001).
- Ministry of Finance, Policy Research Institute 2003: Zaimushō Sōgō Seisaku Kenkyūjo [Ministry of Finance, Policy Research Institute], "Shinten suru Kōporēto Gabanansu Kaikaku to Nihon Kigyō no Saisei" [Developing Corporate Governance and Regeneration of Japanese Corporations] [<http://www.mof.go.jp/jouhou/soken/kenkyu/zk063/cg.pdf>].
- Ministry of Labor 1997: Rōdōshō [Ministry of Labor], 1997 *Rōdō Kumiai Kiso Chōsa* [Basic Survey on Labor Unions] (1997).
- Ministry of Labor 1999: Rōdōshō [Ministry of Labor], *Heisei 12 nen Rōshi Komyunikēshon Chōsa* [Survey of communication between labor and management in 1999] <[http://www.jil.go.jp/kisya/daijin/20000619\\_02\\_d/20000619\\_02\\_d.html](http://www.jil.go.jp/kisya/daijin/20000619_02_d/20000619_02_d.html)>.
- National Conference of Stock Exchanges 2002: National Conference of Stock Exchanges, The 2002 Shareownership Survey (June 16, 2002).
- Neef 2000: Neef, "Das Kündigungsschutzrecht zur Jahrtausendwende" (Dismissal law at the turn of the millennium"), 2000 *Neue Zeitschrift für Arbeitsrecht* 8
- Nitta 2000: Michio Nitta, "Nihon Kigyō no Kōporēto Gabanansu: Genjō to Tenbō" [Japanese Corporations and Corporate Governance: present state and future] in Inagami and RIALS 2000, 75.
- Oda 1999: Hiroshi Oda, *Japanese Law*, 2nd ed., (Oxford, 1999).
- Ōtake 2000: Fumio Ōtake, "Special Employment Measures in Japan" 39(12) *Japan Labor Bulletin* 5 (2000) <<http://www.jil.go.jp/bulletin/year/2000/vol39-12/05.htm>>.
- Okazaki 1993: Tetsuji Okazaki, "Senji Keikaku Keizai to Kigyō" [Wartime Planned Economy and Corporations], in Tōkyō Daigaku Shakai Kagaku Kenkyūjo (ed.), 4 *Gendai Nihon Shakai: Rekishiteki Zentei* 103 (Tokyo University Press, 1993).
- Okushima 1991: Takayasu Okushima, "Employees' participation in the corporate administration" 132 *Hōgaku Kyōshitsu* 74 (1991).
- Oppolzer 1998: Oppolzer, *Individuelle Freiheit und kollektive Sicherheit im Arbeitsrecht* [Individual freedom and collective security in labor law], 1998 *Arbeit und Recht* 47 (1998).
- Porter 1992: Micael Porter et al., *Capital Choices: Changing the way America invests in industry* (1992)
- Rengō Sōken 1999: Top Management Survey: Interim Report, 127 Rengō Sōken Report Dio 19 (1999)
- Shinoda 1994, Toru Shinoda, "Ima Mata Kōporatizumu no Jidai Nanoka?" [The Era of Corporatism?], in Takeshi Inagami et al, *Neo-Kōporatizumu no Kokusai Hikaku* [International Comparison of Neo-Corporatism], 357 (Japan Institute of Labor, 1994).
- Sugeno 2002: Kazuo Sugeno (translated by Leo Kanowitz), *Japanese Employment and Labor Law* (Carolina Academic Press, 2002).
- Sugeno and Suwa 1996: Kazuo Sugeno and Yasuo Suwa, *The Three Faces of*

- Enterprise Unions: The Status of Unions in Contemporary Japan*, Japan International Labor Law Forum Paper No. 6 (1996).
- Summers 1995: Clyde Summers, "Worker Dislocation: Who Bears the Burden? A Comparative Study of Social Values in Five Countries", 70 *Notre Dame Law Review* 1033 (1995).
- Schwab 2003: Stewart Schwab, "United States", 47 *Bulletin of Comparative Labour Relations* 177 (2003).
- Rōmu Gyōsei Kenkyū-jo 2003: Rōmu Gyōsei Kenkyū-jo [The Institute of Labor Administration], "Saishin Yakuin Hoshu-shoyo, Irokin no Jittai" [Current state of executives' remuneration, bonus and severance pay], 3395 *Rōsei Jihō* 2 (1999).
- Takanashi 2002: Akira Takanashi et al., *Shunto Wage Offensive* (2<sup>nd</sup>. Ed.), Japanese Economy & Labor Series No. 1), (The Japan Institute of Labor, 2002).
- Takanashi 1997: Akira Takahashi, *Employment Insurance Law* (Japan Institute of Labor, 1997).
- Takanashi 1999: Akira Takanashi, *Japanese Employment Practice* (Japan Institute of Labor, 1999).
- Yamakawa 1999: Ryūichi Yamakawa, "The Silence of Stockholders: Japanese Labor Law from the Viewpoint of Corporate Governance", 38(11) *Japan Labor Bulletin* 5 (1999).
- Yamakawa 2001: Ryūichi Yamakawa, "Labor Law Issues Relating to Business Reorganization in Japan", 40(2) *Japan Labor Bulletin* 6 (2001).
- Yoshihara 2001: Kazushi Yoshihara et al., 1 *Kaisha Hō* [Corporate Law], 2<sup>nd</sup> revised ed. (Yūhikaku, 2001).