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What Can We Learn from Foreign Systems?

Stakeholder Protection in Germany and Japan

Mark J. Loewenstein*

This Essay considers the stakeholder debate in the context of the German and Japanese legal systems. Although, nominally, corporations in those countries must operate in the interests of shareholders, in fact nonshareholder constituencies have considerable influence on corporate decision makers. Of equal importance, weak securities markets and ineffective or nonexistent legal protections for shareholders are also important factors in strengthening the position of nonshareholder constituencies and freeing directors to consider their interests. Thus, the stakeholder debate is more of an issue in the United States and Britain, where more shareholder-centric models flourish.

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I. INTRODUCTION

As one tours the corporate globe, it appears that explicitly recognizing stakeholder concerns is largely an Anglo-American problem. The stakeholder movement, which began in the 1980s in the United States, was initiated by corporate directors seeking legislative protection for considering the interests of stakeholders other than shareholders when deciding how to respond to a hostile takeover offer.1 The movement has been successful; about thirty jurisdictions have

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1. There is extensive literature on this topic. See, e.g., DOUGLAS M. BRANSON, CORPORATE GOVERNANCE § 8.03, at 397 (1993 & Supp. 2001); Committee on Corporate Laws, Other Constituencies Statutes: Potential for Confusion, 45 BUS. LAW. 2253 (1990) (criticizing the statutes); Timothy L. Fort, Corporate Constituency Statutes: A Dialectical Interpretation, 15 J. L. & COM. 257, 294 (1995) ("Stakeholder/corporate constituency analysis asks the right question of what duties corporations owe to non-shareholder constituents. As creatures obtaining social benefits in the form of limited liability and other corporate features, corporations have duties to members of society."); Lawrence E. Mitchell, A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes, 70 TEX. L. REV. 579 (1992) (arguing in favor of such statutes because the costs to other stakeholders often outweigh the gains to shareholders).
adopted some form of stakeholder legislation, although Delaware has not. There are at least three factors that explain why the stakeholder movement has not been a concern in most of the world: first, most industrialized economies outside of the United States and Great Britain are characterized by corporations lacking the emphasis on shareholder supremacy that is becoming the hallmark of the Anglo-American corporation; second, in most other economies, the hostile takeover is virtually unknown; and third, outside of the United States, the shareholder derivative action is rare. Combined, these factors mean that, for the most part, directors of non-U.S. companies are simply less accountable to the interests of shareholders than are the directors of a U.S. company. In a non-U.S. environment, the director may be more concerned with the effect of a decision on employees or the local economy than would a U.S. director. As a result, the issue of whether directors should be empowered, when exercising their decision-making authority, to take into account the interests of corporate stakeholders other than shareholders has not been much of an issue outside of the United States and Great Britain. This Essay examines the corporate governance mechanisms in Germany and Japan, two of the major economic competitors of the United States, to explore the extent to which their systems accommodate the concerns of other stakeholders.


3. The stakeholder debate has touched the British Isles. For example, Senior Lecturer Ben Pettet of the University College London explains:

In England the corporate social responsibility question, although largely in the form of the related industrial democracy debate, had acquired a high public profile by the late 1970s, when the majority report of the Bullock Committee recommended having worker representation on company boards. In 1980 Parliament enacted that boards of directors must have regard to the interests of their employees as well as their members . . . . [although] it would be virtually impossible for employees to get any legal remedies.


5. But see id. at 333 n.63 (pointing out that stakeholder concerns have been addressed in Korea and Indonesia).
II. GERMAN CORPORATE GOVERNANCE

From an American perspective, the German model of corporate governance has two striking characteristics. First, as a matter of positive law, the system provides strong protection for employees of the company, giving them a direct role in corporate governance. Second, as a result of various economic and social factors, large German banks have become the largest shareholders and most active board members in the large corporations. To the extent that stakeholder questions are questions about employee interests, the German system would seem to provide an example of progressive stakeholder legislation. However, large corporations have stakeholders other than their employees and shareholders, and it is fair to inquire whether the German model is responsive to the interests of those other stakeholders. For instance, if a German company is considering a restructuring that would have an effect on the community in which its principle operations are located, to what extent would those community interests get a fair hearing before the corporate decision makers? While the answer to this question might depend on the identity and predilections of the decision makers, likely answers may also come from important factors in the system, such as the structure of corporate governance itself, and the role of employees, labor unions, and banks. I will return to this question after a summary of the German system.

The origins of German stakeholder governance can be traced back to approximately 1870, before which German companies were subject to oversight and control by the government. Governmental control, of course, reflects the influence of socialism at that time. The Reform Act of 1870 replaced the direct state oversight with a system that required an outside board, called the Aufsichtsrat, which was to be the intermediary between the management team, called the Vorstand, and all outside interests. It was meant to reflect the interests of all stakeholders including the investors, workers, the state, and others.


8. See Klaus J. Hopt, The German Two-Tier Board (Aufsichtsrat): A German View on Corporate Governance, in COMPARATIVE CORPORATE GOVERNANCE 3, 6 (Klaus J. Hopt & Eddy Wymeersch eds., 1997).

9. See id.
Thus, the split two-tier system of a supervisory *Aufsichtsrat* board and a management *Vorstand* board was born.  

As first created, the two-tier system fell short of expectations. The supervisory board was to be responsive to nonshareholder outside interests, as well as those of shareholder owners, but failed to accomplish these ends. Instead, owners took the withdrawal of direct state oversight as license to abandon the interests of other stakeholders and focus on profits. In response, starting in 1884, the government initiated corporate governance reforms improving the protection of nonowner stakeholders. These reforms reached an extreme point, as did many things, during the period of Nazi rule in Germany. Hitler's government enacted a new business corporation statute in 1937, requiring the “managing board . . . to manage the corporation as the good of the enterprise and its retinue and the common weal of folk and realm demand.” The Nazis sought to invoke a legal system that would allow the state to discipline businesses that did not direct their efforts in support of Nazi policies. This twist in the evolution of Germany's codetermination history threatened the viability of the concept in the postwar period, as critics perceived “non-shareholder constituency statutes—which potentially include the communitarian goals of codetermination—as the first step down the road to statism, collectivism, and the destruction of individual entrepreneurialism.” Postwar reforms, however, did not abandon the concept and culminated in the Codetermination Act of 1976, which requires mandatory and significant employee representation on the supervisory *Aufsichtsrat* board.

It is interesting to note that the history of these reforms has shown consistency in two ways. First, German legislators have upheld the two-tier system, despite a considerable debate over its efficiency as a governance system and its effectiveness as a social policy. Second, and more importantly, German socio-political forces have adhered to the policy that economic efficiency is worth sacrificing to “protect”

10. *See id.* at 3-4.
11. *See id.*
14. *See id.*
nonshareholder constituents of the corporation. Although there has been a pronounced focus on “shareholder value” in Germany in recent years, the Wall Street Journal Europe reported in a July 2001 article that, “[w]hile preaching the virtues of shareholder value, many Germans—both left and right—remain loyal to their ‘stakeholder’ system that spreads interests among managers, community, government, employees and shareholders.”  

The Codetermination Act of 1976, together with subsequent reforms, require all stock corporations, Aktiengesellschaft (AG), and all other business entities over a certain employee base, to have a two-tiered board structure that includes significant employee representation on the supervisory Aufsichtsrat board. For these entities, the supervisory Aufsichtsrat board oversees the management Vorstand board much as a board of directors oversees corporate officers in the United States. For entities that have between 500 and 2000 employees, one-third of the supervisory Aufsichtsrat board must consist of employee representatives. For entities with 2000 or more employees, one-half of the supervisory Aufsichtsrat board must be employee representatives, and some of these must be representatives of the unions. Typically, if the company has more than 20,000 workers, the Aufsichtsrat board consists of twenty members, of which ten represent the shareholders, seven the workers, and three the unions.

In all cases, the shareholders elect the nonworker/nonunion Aufsichtsrat board members. For the larger entities, the shareholders elect the board chair, who holds two votes and can thus break ties if the workers and shareholders deadlock. Consequently, the shareholder
contingent holds a voting majority as long as it votes as an undivided block. The supervisory board meets periodically, receives audit and other information, sets goals and direction for the entity, and evaluates the performance of, and hires and fires the members of, the management board. To protect the independence of the Aufsichtsrat board, the law prohibits management Vorstand board members from sitting on the supervisory Aufsichtsrat board.26

Only German stock corporations, AGs, are eligible to be traded publicly on the stock exchange. However, a large number of other entities also fall under the Codetermination Act of 1976. As of October 1996, 740 enterprises were covered, including 406 AGs, 329 limited liability companies Gesellschaft mit beschränkter Haftung (GmbHs), and five other noncorporate entities.26 Extending codetermination to nonstock companies demonstrates a commitment to stakeholder values, at least as far as the labor force is concerned. For present purposes, however, of greater concern is the treatment of nonshareholder stakeholders by the publicly held AGs. In this regard, the pattern of ownership of these corporations is important.

In Germany, individual stock ownership is very low, especially in comparison to the United States.27 Although this is changing—between 1997 and 2001 the number of individuals owning stock in Germany more than doubled to over twelve million28—large banks and other institutions account for the vast majority of stock ownership. Individual Germans tend to store wealth in bank accounts, interest

25. See André, supra note 16, at 86.
26. See Hopt, supra note 8, at n.77 (citing WSI-Mitteilungen 468 (1990); Götz Hueck, Gesellschaftsrecht § 24.II.2(a), at 226-27 (19th ed. 1991); Werner Tegtmeier, Sachgerechte Dynamik, Mitbestimmung, Oct. 1996, at 28, 28-31, for the more recent figures). Including nonstock enterprises under codetermination is paramount because stock corporations are relatively few in number and not widely held. Between 1950 and 1990, the total number of AGs fluctuated between 2000 and 3000. By comparison, there were over 500,000 GmbHs in 1992. See Rolf Birk, Germany, in THE LEGAL BASIS OF CORPORATE GOVERNANCE IN PUBLICLY HELD CORPORATIONS 53, 54 (Arthur R. Pinto & Gustavo Visentini eds., 1998).
27. Professor André noted, “At least until the partial privatization of Deutsche Telekom AG in late 1996, less than six percent of German households owned stock (and only about five percent of private financial assets were held in equities).” See André, supra note 16, at 98 (footnotes omitted).
28. See Jack Ewing, Commentary: German Investors Show Pluck—Germany Inc. Doesn’t, at http://www.businessweek.com/magazine/content/01_36/b3747147.htm (last visited Feb. 19, 2002) (noting that according to the German Share Institute, there has been a tremendous rise in individual ownership, and despite the recent bear market, individual German investors have held steady; by contrast, institutional and other large German investors have reduced their holdings).
bearing notes, real estate, and other conservative investments. Banks are often the repository of this wealth and, in turn, own large blocks of stock. While German banks have been liquidating many of their holdings in recent years, the number of large blocks (five percent to fifteen percent) is increasing. Low individual ownership together with presence of powerful unions explains why labor has such a prominent role in corporate governance.

Arguably, bank ownership in German AGs supplies a counterweight to the power of unions; however, this might not always be the case, at least when the bank is also a lender to the company (which is frequently the case). In such circumstances, the bank director might elect a conservative course of action, preferring the bank's interests as a lender to its interests as an equity holder. On this view, the corporation might forego a potentially profitable, but risky, endeavor. Labor, too, may prefer such a course of action. These and other possible voting distortions have given rise to the observation that some German scholars cast doubt on the desirability of this feature [bank participation] of German corporate governance. In particular, they argue that banks' influence among others (such as cross holdings among corporations) is one of the main reasons for inflexibility in German corporate governance. At the same time, the critics yearn for more active and interested, yet dispersed shareholders.

There is no definitive study as to how these interests play out, but surely employee and banking representations provide a significant source of influence that is often different than that of traditional shareholders. The idea that self-interested directors, which might accurately describe directors who are also bank officers and rank-and-

29. See André, supra note 16, at 97-98.
30. Banking power in Germany is concentrated in a few banking giants, in particular, Deutsche Bank, Dresdner Bank, and Commerzbank. These banks, in turn, are prominent players on the nation's supervisory Aufsichtsrat boards, controlling over 10% of the seats on the supervisory councils of Germany's 100 largest companies. Furthermore, German banks are much larger than their American counterparts; the largest three American banks have assets equal to 7% of American GNP, while the largest three German banks control assets valued at 36% of Germany's GNP, making the German banks five times "stronger" than the United States ones. Robilotti, supra note 13, at 548-49 (footnotes omitted).
file workers in the company, would be favorably inclined to further the agenda of other constituents is certainly not intuitive.

The main effects of codetermination can be broadly categorized in three areas: management-labor relations, management-shareholder relations, and relations between management and the market for corporate control. With regard to the first of these, having heavy employee representation on the supervisory Aufsichtsrat board forces direct negotiation and resolution of employee-based objectives. Traditionally, these objectives centered on conditions of employment and pay, but they could also reach broader issues, such as community support and environmental concerns. But do workers have a stronger inclination to consider the community or the environment than shareholders or management generally? To the extent that workers live in a community, they would, most likely, be concerned with corporate policies that adversely affect the community. The community would benefit from workers' resistance to layoffs, exportation of jobs to other countries with lower labor costs, and restructurings that result in a loss of jobs. But would the worker-director support policies that benefit the community at the expense of labor, such as higher charitable contributions to local community organizations in lieu of higher wages? Similarly, would the worker-director support environmental policies that result in layoffs, in which the net benefit to the community lies with the environmental initiatives?

A second area regarding the effects of codetermination relate directly to corporate management, which can be considered a separate stakeholder in the organization. Executive compensation is an important tension point in the relationship between management and shareholders, as the interests of each are, at least to some extent, in conflict. The separation of management from control, which is arguably more pronounced in the United States, explains, in part, why executive compensation is more generous in the United States than in Germany. Of equal importance, however, is the participation of employee representatives on the supervisory Aufsichtsrat board. If half the directors are employee representatives, a discussion of CEO remuneration is likely to have a much different tone, and result, than

34. See Robilotti, supra note 13, at 547-48; see also Charny, supra note 31, at 158-59.
36. See Robilotti, supra note 13, at 548.
when the relevant decision makers are themselves well-compensated CEOs at comparably sized companies. To the extent that the stakeholder debate centers on management self-aggrandizement at the expense of other constituencies, particularly shareholders, the German model is, again, a progressive one.

A third important effect of codetermination is its effect on the market for corporate control; codetermination may have a chilling effect on hostile takeovers. German companies have experienced relatively few hostile takeovers as compared to the United States and Britain, and labor representation on the board may be a factor. Where a potential takeover has an adverse effect on labor, it is not unreasonable to assume that the acquirer is deterred from engaging in a battle, as its adversary has such a strong self-interest in the outcome. While management in the United States might be similarly situated to labor in Germany, both in terms of adverse interest and ability to influence the outcome, it may be that the price to mollify U.S. management is less than that to mollify German labor. Moreover, with strong, direct support from labor, German management, which has its own interests to protect, is in a relatively better position than their U.S. counterparts to resist shareholder pressure to accept a hostile offer.

It is important, however, not to make too much of this speculation, inasmuch as derivative and class action shareholder suits

37. Professor Susan J. Stabile explains:

It is generally believed that union representation on the board of directors tends to result in more egalitarian compensation practices than in other countries . . . .

... American executives are paid much more lavishly than their foreign counterparts and they are paid so on the backs of workers.

Stabile, supra note 33, at 85-86 (footnote and quotations omitted); see also Loewenstein, supra note 35, at 4.

38. See Robilotti, supra note 13, at 552-53.

39. Professor André explains:

[T]he evidence bears out the fact that hostile acquisitions in Germany are in fact quite rare. For example, [at least until 1997] there has never been a successful takeover by means of a hostile public tender offer in Germany, and there has never been a takeover of a company whose shares make up part of the DAX “blue chip” index.

Quite aside from whether German companies in general make attractive takeover candidates, there are any number of possible explanations for the lack of hostile takeover activity in Germany. The most obvious explanation is surely the relatively small number of publicly traded companies and hence potential takeover candidates.

André, supra note 16, at 119 (footnotes omitted).
are unknown in Germany. Thus, an available tool for U.S. shareholders to hold corporate management accountable for management's response to a hostile takeover is unavailable in Germany. Many of these factors came into play in the case of the first and only successful hostile takeover of a German company by a foreign company. In November 1999, the United Kingdom’s Vodaphone launched a bid at about 200 euros per share for Germany’s Mannesmann, with the goal of creating the world’s largest telecommunications company. Vodaphone succeeded three months later, paying over 372 euros per share. Though one can reason that the Aufsichtsrat simply did its job in holding out for a higher price, another view is that codetermination and other uniquely German factors increased the price of the takeover significantly. In any case, the rarity of hostile takeovers is an important factor in the stakeholder debate, because it is in that context that stakeholder concerns often emerge. With labor’s direct involvement on the Aufsichtsrat board, its interests seem to be protected and, with it, the interests of other stakeholders as well.

On balance, codetermination appears to be a model of corporate governance that protects stakeholders. Clearly, the interests of labor are well represented and, from all available information, well protected. The employees’ natural ties to the communities in which they reside suggest that labor might often serve as a proxy for the community’s interests in corporate decision making. Similarly, the

40. See Susan Jacqueline Butler, Models of Modern Corporations: A Comparative Analysis of German and U.S. Corporate Structure, 17 ARIZ. J. INT'L & COMP. L. 555, 601 (2000); see also Singhof & Seiler, supra note 32, at 556-59 (noting that the considerable obstacles to derivative litigation in Germany precluded effective enforcement of fiduciary duty of management through such litigation).


43. German scholars Bernd Singhof and Oliver Seiler note that while the German law seems to articulate a goal of shareholder wealth maximization, there is a long-standing debate in Germany about the strong emphasis on protecting shareholder interest. Some scholars maintain that corporate officers owe fiduciary duties not only to shareholders, but also to other constituents, such as employees. Creation and maintenance of "shareholder value" as the first and foremost goal of management is still a source of discussion and is not easily explained.

Singhof & Seiler, supra note 32, at 551 (footnotes omitted).
presence of bank involvement on the supervisory board assures that the interests of another corporate stakeholder, the creditors of the corporation, are represented. Moreover, the paucity of hostile takeovers combined with the lack of litigation to hold management accountable to shareholder interests, suggests that corporate management has more freedom of action and can, if it is so inclined, take into account nonshareholder interests. This freedom of action is clearly more limited in the United States. The costs associated with this system of governance, however, are many. This may partially explain why the German securities market is weak. United States companies may be more able to adjust to market downturns and seize market opportunities if they are freed from the constraints imposed by an entrenched labor pool and conservative bank directors. This past summer, labor representatives on Volkswagen's board of directors defeated management's proposal to add workers at reduced wages because the wages were below union scale and the jobs were only guaranteed for three years, not for life. The labor representatives' action was striking because the German unemployment rate at the time was nine percent, more than three times the U.S. rate. Germany's system of corporate governance may affect its ability to compete in a global market, but whether this price is acceptable is, of course, a political decision and one that will change only gradually, if at all.

III. JAPANESE CORPORATE GOVERNANCE

Like the German system of corporate governance, the Japanese system, for different reasons, isolates corporate management from market forces and direct shareholder influences. This system potentially frees Japanese managers to be responsive to nonshareholder constituencies. Unlike the German (and U.S.) systems, however, the

44. According to Professor Mark J. Roe:
The weakness of the supervisory board might be structurally linked to codetermination. If so, prevailing reform proposals (e.g., limiting the number of boards an individual can serve on) may fail to improve the board much, because they fail to address a fundamental structural dilemma for Germany. Moreover, the weakness of German securities markets may in important ways be due to the weakness of the German supervisory board.


46. See id.
aspects of Japanese corporate governance that have these isolating effects are informal, not legal, in nature. Indeed, the formal structure of Japanese corporate governance bears a far greater resemblance to the American system than it does to Germany’s. In Japan, as in the United States, shareholders alone elect the board of directors and have ultimate legal control. The board has fiduciary duties to the corporation enforceable (in theory) by the shareholders in derivative actions, and, for publicly traded companies, similar disclosure obligations apply. Of equal importance, Japan appears to have a more robust equity market than does Germany, thus suggesting a market for corporate control and director accountability to shareholders. Yet, despite these important similarities to the United States, corporate governance in Japan is, in practice, fundamentally different from the United States. In Japan, corporate governance is strongly influenced by relationships: relationships between the company and its employees who expect lifetime employment, relationships between the company and its customers and suppliers, and, most importantly, relationships between and among the company and its banks. These relationships influence and, to some extent determine, board composition and company policy. The history of corporate governance in Japan identifies the factors that led to the current situation.

Modern Japanese corporate governance had its start, like Germany’s, in the late-nineteenth century. The Japanese Commercial Code of 1899, which established Japanese corporate law, was modeled after German laws. This law reflected the corporate responsibility to shareholders and other stakeholders, including employees, and is a view that persists today. As one Japanese scholar has observed:

50. See id. at 114-15.
51. See id.
53. See id. at 458.
54. See Kanda, supra note 49, at 112.
Historically, support for the corporate social responsibility argument has been much stronger in Japan than in the United States. This trend reflects the Germanic and Marxist economic theory that dominated economic discussions in Japan from the turn of the century until the 1970s . . . . In fact, the notion that Japanese corporate responsibility extends beyond the shareholders was so widespread in the prewar period that virtually no one asserted the opposite view.55

This scholar further noted that Marxist theories persist in the Japanese psyche, which results in a distrust of unrestrained market capitalism.56

After Japan’s defeat in World War II, American influence on Japanese corporate law displaced the German influence. The Japanese Commercial Code was rewritten to adopt all the major features of the American system.57 These changes were buttressed with the Japanese Securities Act of 1948, which was modeled on the United States Securities Act of 1933 and Securities Exchange Act of 1934.58 Together, these reforms created a U.S.-style shareholder-centric model, and, in theory at least, surpassed the U.S. system.59 In this regard, one Japanese scholar has observed:

Japanese corporate law values the principle of stock majority more than its American counterpart . . . . Japanese shareholders have broader voting rights than American shareholders, including rights to determine dividends and executive compensation. Directors cannot be elected by either preferred shareholders or by different classes of common shareholders, for directors may be elected only by the common shareholders as a whole.60

56. Id. Professor Sanford M. Jacoby opines:
   In a nutshell, Japan and Germany had big governments before big business . . . .
   . . . [This] meant that corporate law at an early stage limited shareholder rights so as to promote various national interests. Those interests include a strong military, regional development, and the establishment of rudimentary worker rights . . . . Workplace representation along these lines started in Germany and Japan around the time of World War I, with strong support from government. . . .
   The situation in the United States was completely different. At the beginning of the twentieth century, the United States had the weakest national government in the developed world: small, constrained by federalism, and with relatively little directive power over economic development. On the other hand, American corporations were the largest in the world. . . .

Jacoby, supra note 52, at 463-64 (footnote omitted).
57. See Kanda, supra note 49, at 112.
58. See Milhaupt, supra note 47, at 2098; see also Kanda, supra note 49, at 112.
59. See Milhaupt, supra note 47, at 2098-99.
60. See Shishido, supra note 48, at 198 (footnote omitted).
However, the scholar notes, "many will agree that Japanese corporate practice is employee-oriented rather than pro-shareholder" and that societal norms play a larger role in this difference than legal or economic influences.  

Under Japanese law, the shareholders hold an annual meeting to elect a board that appoints the executive officers of the company from among its ranks. The board supervises the officers, makes important corporate decisions, and owes duties of care and loyalty to the corporation, which may be enforced by the shareholders through derivative actions. These familiar structural elements are, however, implemented in a very different fashion in Japan. The first, and possibly most important, difference is that, by custom, long-term employees of the corporation are the primary source of new directors. For instance, in 1993, "[a]ll fifty-five directors on the board of Toyota were former employees, thirty-one of Honda's thirty-three directors were former employees, thirty-four of Nihon Denso's thirty-five directors were former employees, and twenty-five of Aisin Seiki's twenty-eight directors were former employees."

As a result of this custom, the board and senior management likely have an employee's perspective on corporate policy, thus providing, informally, protection for employees similar to that in Germany under codetermination. Whether this employee orientation is, on balance, positive for Japanese companies or the Japanese economy is beyond the scope of this Essay. Suffice it to say that there are obvious advantages and disadvantages to a system that protects employees. Firms invest in human capital and realize the advantages of a stable, well-trained, and loyal workforce. On the other hand, this same stability means that Japanese companies forego new employees in favor of retaining permanent employees, possibly sacrificing new talent and future leaders and disrupting normal promotion and career progress. Also, when Japanese companies experience hardships they often choose to sacrifice profits, dividends, or shareholder value

61. Id. at 201.
62. Miwa, supra note 55, at 1231.
63. Kanda, supra note 49, at 112-13. While these aspects parallel the U.S. system, Japanese law has an additional feature unknown under U.S. law: directors are liable to third parties if they act in bad faith or are grossly negligent. Id. at 113.
64. See Miwa, supra note 55, at 1238.
65. Id.
66. See Milhaupt, supra note 47, at 2091.
instead of employees,\textsuperscript{68} possibly affecting the firm's long-term competitiveness.

In addition to the employee orientation of the board of directors, four other characteristics of Japanese corporate governance differentiate the Japanese system from the American system, resulting in a relative isolation of the Japanese board from typical shareholder pressures. These characteristics include: the "main bank" relationship, cross-shareholdings, the ineffectiveness of shareholder suits, and the lack of hostile takeovers. The first characteristic, the relationship between the corporation and its principle lenders, stems in part from the Japanese traditional reliance on bank financing in lieu of public debt.\textsuperscript{69} These bank-lenders also typically are shareholders of their borrowers. Although banks are limited to a five percent equity stake in any one company, the lending group typically owns between twenty and twenty-five percent of a company's stock and acts in concert,\textsuperscript{70} with the largest lender of the group assuming the position of the "main bank." The main bank is not a legal concept, but rather describes a relationship in which the main bank assumes some responsibility for its borrowers in financial difficulty. The main bank typically eschews a foreclosure in favor of a restructuring. To American sensibilities, the terms of this restructuring are somewhat surprising:

[T]he main bank typically waives a portion of the debt in return for a restructuring plan by the borrower. Although the main bank almost always has a first priority security interest in the collateral of the debtor, the bank, in effect, voluntarily subordinates its interest to that of the other lenders . . . .

. . . [T]he entire main bank system is supported by a cluster of norms that encourage banks to support weak firms (at least those for which a return to solvency and profitability are possible) in return for a nonlegally enforceable promise by the government to prevent bank failure. Indeed, until the early 1990s, there was not a single Japanese bank failure in the postwar period.\textsuperscript{71}

Thus, the main bank insulates the company from negative external pressures. Banks are generally risk averse, and main banks are said to keep their corporate partners from aggressive high-risk,

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\textsuperscript{68} See Jacoby, supra note 52, at 462.
\textsuperscript{69} See Kanda, supra note 49, at 115.
\textsuperscript{71} Milhaupt, supra note 47, at 2088-89 (footnotes omitted).
high-reward activities such as new start-up ventures. In terms of stakeholder protection, the effect of the main-bank system is classically pro-stakeholder. Weak firms, otherwise destined for liquidation, are saved along with the jobs of workers and the interests of the community, suppliers, and subordinate lenders.

The stabilization and insulation by the main bank system is enhanced by another Japanese practice: cross-shareholding. Cross-shareholding typically involves a reciprocal understanding between two companies to own one percent or so of each other's common stock. This arrangement often exists with many companies, usually customers or suppliers, with the result that a substantial portion of a company's stock is illiquid. The largest of these cross-shareholding arrangements are called *keiretsu*. While the *keiretsu* may be on a slight decline, recent data demonstrates that the shares of over fifty percent of large Japanese corporations are held by a combination of main-bank and cross-shareholding arrangements, with the implicit understanding to hold the shares indefinitely. Outside shareholders thus have little influence on corporate management; members of the *keiretsu* support one another, creating a stable system resistant to dramatic change. This system, by necessity, quite directly protects the interests of customers and suppliers, classic stakeholders who rarely are formally protected. Therefore, the pressure of the stock market, an important factor in the governance of U.S. companies, is much less of a factor, if at all, in Japan.

The absence of market pressures is complimented, at least traditionally, by a lack of shareholder suits against management. Class action suits are unavailable for Japanese shareholders and, until 1993, derivative suits were quite rare. In 1993, however, the filing fees for derivative suits, which had been prohibitively high, were made nominal. As a result, the number of such suits increased from less than twenty filings nationwide between 1950 and 1990 to nearly 300 suits pending in 1999. Derivative suits do not, however, meet with great success in Japan because of the deference given by courts to

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72. See Fort & Schipani, supra note 70, at 835; Jacoby, supra note 52, at 469.
73. See Shishido, supra note 48, at 210-11.
74. See Kanda, supra note 49, at 115.
75. See Fort & Schipani, supra note 70, at 847-49; see also Jacoby, supra note 52, at 469.
76. See Shishido, supra note 48, at 207-08.
77. Id. at 197; see also Mark D. West, Why Shareholders Sue: The Evidence from Japan, 30 J. LEGAL STUD. 351, 352 (2001).
78. West, supra note 77, at 351-55.
79. Id.
business executives, similar to the deferential business judgment rule
in the United States. \textsuperscript{80} Nevertheless, this dramatic increase in filings
has shaken the business climate and made corporations more
cognizant of outside shareholders. \textsuperscript{81} A likely result of this new
sensitivity would be to make managers more shareholder-centric and
less responsive to the demands of other constituents. However, the
claims that have been brought tend to allege serious directorial
misconduct, not that the directors have unlawfully favored
nonshareholder constituencies. \textsuperscript{82}

Finally, one must consider the extent to which hostile takeovers
affect managerial thinking. The takeover wave in the United States in
the 1980s undoubtedly had a dramatic effect in the corporate
boardroom. Indeed, the very term "shareholder value" entered the
corporate lexicon during that period and shaped much decision
making. The Delaware Supreme Court was a major player in this
arena, articulating a legal standard that limited the board's freedom of
action, albeit marginally, when faced with a hostile tender offer. \textsuperscript{83}
More importantly, the Delaware court made clear that, in responding to
a hostile offer, a board could take into account the interests of
constituents other than shareholders only when "there [are] rationally
related benefits accruing to the stockholders." \textsuperscript{84} Whatever may be the
legal standard for directors in Japan, there has been only one
successful hostile takeover in Japan during the last fifty years, and few
attempts. \textsuperscript{85} While the presence of main-bank and corporate cross-
shareholding could, theoretically, facilitate a hostile takeover, because
control is concentrated in a relatively few hands, in fact, this has not
been the case. These relationships foster a loyalty among the

80. \textit{Id.} at 353 ("Japanese shareholders rarely win, and, unlike their counterparts in the
United States, they only occasionally obtain settlement."); \textit{see also} Kenji Utsumi, \textit{The
Business Judgment Rule and Shareholder Derivative Suits in Japan: A Comparison with
81. \textit{See} West, \textit{supra} note 77, at 353.
82. \textit{See} id. at 362. Professor Curtis J. Milhaupt explains:

Until [the \textit{Daiwa Bank} case] in the fall of 2000, the only cases in which directors of
public companies had ever been found liable to their shareholders for breach of the
duty of care involved unambiguous violations of domestic law, such as violations
of the Commercial Code. The \textit{Daiwa Bank} case itself, which involves a \textit{Caremark}-
like failure-to-monitor claim, represents egregious directorial nonfeasance. . . .

Milhaupt, \textit{supra} note 47, at 2115 (footnote omitted).
83. \textit{See} Mark J. Loewenstein, \textit{Unocal Revisited: No Tiger in the Tank}, 27 J. CORP. L.
1 (2001).
1986).
85. \textit{See} Jacoby, \textit{supra} note 52, at 470; Milhaupt, \textit{supra} note 47, at 2089.
participants that is antithetical to a hostile takeover.\textsuperscript{66} Thus, another obstacle to the consideration of other constituents in Japan is lacking.

The insulation of Japanese corporate management from shareholder influences and the strong role of employees in the corporate boardroom has given rise to a culture of lifetime employment, stable relations with suppliers and customers, and a concern for nonshareholder stakeholders. However, global competition and technological changes are testing the resolve of the Japanese system and changes may be in the offing. Recent events, including formerly unheard of layoffs at large Japanese companies such as NTT (20,000 employees), Nissan (21,000 employees), and Sony (17,000 employees), may be a harbinger of things to come.\textsuperscript{67} The traditional risk aversion of Japanese companies may change as well, as economic pressures, including an economy suffering its third recession in ten years, motivate Japanese policymakers to seek solutions.\textsuperscript{68} It remains to be seen whether Japan will revert to an Anglo-American shareholder-centric model, or continue on its independent path.

IV. CONCLUSION

The Japanese and German systems of corporate governance share certain characteristics absent from the Anglo-American systems: significant involvement of labor in corporate decision making; cross-shareholding with suppliers and customers; bank influence (direct in Germany and indirect in Japan); an absence of hostile takeovers; and limited shareholder litigation. The aggregate affect of these factors in both countries is to isolate the board of directors from the kind of pressures the typical U.S. director receives from outside shareholders. In theory, the combination of employee influence and director isolation in Germany and Japan should facilitate the ability of directors in those countries to respond to the concerns of other stakeholders. Whether this is indeed the case is difficult to determine, and empirical work in this area is nonexistent. However, as a theoretical matter, it would appear that German and Japanese companies would be sensitive and responsive to the concerns of nonshareholder stakeholders. This would explain why one sees so little discussion in those countries on this issue and why it remains a topic of discussion in the United States.

\textsuperscript{66} Milhaupt, \textit{supra} note 47, at 2090.

\textsuperscript{67} See \textit{id.} at 2118.

\textsuperscript{68} In the United States, forty percent of the companies listed on the stock exchange are less than ten years old while in Japan this figure is less than one percent. See Fort & Schipani, \textit{supra} note 70, at 834.