Seeking the right model - corporate governance in Japan

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Speedread

Since the introduction of the Companies Act in 2005, studies and discussions regarding corporate governance have raged in Japan. This article considers some of the views concerning independent directors and statutory auditors.

Since the introduction of the Companies Act in 2005, studies and discussions regarding corporate governance have raged in Japan.

For non-Japanese investors, Japanese corporate governance was difficult to understand and perceived as being somewhat loose; they frequently required improvements in management and reporting rules so that they could reduce perceived risks of investing in Japanese companies.

The Companies Act approved the establishment of companies with committees (*Iinkai-Setchi Kaisha*) similar to structures provided for under US corporate laws in addition to companies with statutory auditors. However, many companies remain as companies with statutory auditors; such companies are required to appoint a statutory auditor who has general power of oversight of the directors.

In practice, statutory auditors are commonly connected to the company and very rarely take actions. In such a situation, foreign investors wanted to have independent directors, and reinforcement of the independence of "inside" directors.

The Financial Services Agency, the Ministry of Economy, Trade and Industry, the Tokyo Stock Exchange, and the Japan Federation of Economic Organisations (JFEO) (a body organised mainly by companies on the first section of the Tokyo Stock Exchange) have been separately discussing how to provide for better corporate governance in Japan.

The JFEO published their interim report in April 2009 in which they suggest that:

> Appropriate governance should be decided by each company, and having an independent director does not, of itself, result in better governance.
>
> The independence of directors and statutory auditors (*Kansayaku*) or otherwise should be a matter for each company to decide on an individual basis and should not be the subject of strict and impartial rules or laws.
>
> Statutory auditors have sufficient authority to govern the company and companies should provide opportunities to statutory auditors to govern.

Statutory auditors should not have authority to appoint accounting auditors (*Kaikei-kansa-nin*) or decide the terms of reimbursement for such accounting auditors as this creates a duality of decision-making within the company; such authority should remain with the directors.

Companies are becoming better at disclosing the results of voting at general shareholders' meetings and mandatory disclosure of this can be overly time and cost consuming.

Large-scale allocations of shares to third parties approved by resolutions of the board can lead to an unfair dilution of the rights.

The issue regarding independent directors is particularly controversial. Market makers seek to introduce a mandatory requirement to appoint independent directors. The JFEO, on the other hand, opposes this and asserts that:

The US model of corporate governance (which includes a mandatory requirement to appoint independent directors) has failed.

The US corporate governance model is not necessarily appropriate for other countries.

Corporate governance in Japan is no less effective than corporate governance in the US, UK and the rest of Europe.

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