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CORPORATE SOCIAL RESPONSIBILITY: DANGEROUS AND HARMFUL, THOUGH MAYBE NOT IRRELEVANT

Yoshiro Miwa†

The view has been gaining widespread acceptance that corporate officials and labor leaders have a “social responsibility” that goes beyond serving the interest of their stockholders or their members. This view shows a fundamental misconception of the character and nature of a free economy. In such an economy, there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud. . . . It is the responsibility of the rest of us to establish a framework of law such that an individual in pursuing his own interest is, to quote Adam Smith again,

“led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good.”¹

INTRODUCTION

Professor Friedman’s rebuttal to the social responsibility of corporate directors came to mind when I received an invitation to participate in this conference. When I first encountered Professor Friedman’s position as an undergraduate in the late 1960s, my first reaction was surprise. At that time, most Japanese economists agreed that corporate directors have a fiduciary obligation that extends beyond their shareholders. For years I disagreed with Professor Friedman’s argument, even though admittedly I did not completely understand it.

Three decades have now passed since my initial exposure to Professor Friedman’s argument against corporate social responsibility,

† Professor, Faculty of Economics, University of Tokyo. This Article is based on a paper that the author presented at the Cornell Law Review’s symposium on corporate social responsibility. The author is grateful to Harvard Law School Professor J. Mark Ramseyer for his insightful comments and suggestions.

¹ MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 133 (1962) (citation omitted).

and I have changed my position. Today, whenever I face an argument in support of “corporate social responsibility,” I immediately respond with several questions:

If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest? Is it tolerable that these public functions of taxation, expenditure, and control be exercised by the people who happen at the moment to be in charge of particular enterprises, chosen for those posts by strictly private groups?²

Among the factors that shape corporate governance in general and influence the decision-making processes of corporate directors in particular is the legal system. Legal constraints on corporate decision making have varied over time and between nations, and corporate directors in different countries often have different concerns, advocate different policy initiatives, and draw different conclusions. Much like the United States, Japan confronts the controversial issue of whether corporate directors have obligations to corporate stakeholders other than shareholders. Since at least the 1960s, commentators have surrounded this topic with a constant refrain of “vague, result-oriented conceptions of basic fairness and equity, as well as other, equally value-laden terms like economic efficiency and reliance.”³

This Article focuses on corporate governance and the decisions of directors in large Japanese firms. Specifically, it presents an overview of the Japanese corporate law framework, outlines the debate over corporate social responsibility in Japan, and illustrates the impact of corporate social responsibility in Japan. I conclude that the view that corporate directors owe a duty to stakeholders other than shareholders of their firms is dangerous and harmful, though maybe not irrelevant—that is, unimportant, insignificant, meritless, or valueless.

Some readers inevitably will express surprise that I have decided to promote the Japanese experience at a time when most people are disappointed with the performance of Japanese companies, management, government, and economy. Had I participated in a similar conference a decade ago, however, I would have presented nearly the same views. Skeptics who believe that the governance of large Japanese firms is fatally flawed should recall that the so-called “Japanese system” bore, grew and allowed to flourish some of Japan’s most successful companies, including Honda, ORIX, Panasonic, Seven-Eleven

² *Id.* at 133-34.

³ Jonathan R. Macey & Geoffrey P. Miller, *Corporate Stakeholders: A Contractual Perspective*, 43 U. TORONTO L.J. 401, 401 (1993).

Japan, SONY, and Toyota. Moreover, Japan achieved its historic post-war industrial success under this system. To be sure, the Japanese system has had its failures, but the American system has had similar failures as well.

Although this Article limits its analysis to the relationship between corporate social responsibility and Japanese firms, it applies universally to firms worldwide. Most people overestimate the differences between corporate behavior and the legal framework in Japan and those in other countries. The structure and conduct of Japanese firms, as well as the applicable corporate law, are virtually identical to their counterparts in the rest of the world. Similarly, as a nexus of contracts among rational agents, a Japanese firm is much the same as an American firm and generally behaves rationally.⁴ Like most firms in the United States, Japanese businesses rarely remain poorly managed for very long⁵ because most firms with weak management will either dismiss their managers, improve their performance, or go out of business.

I base this Article's argument on standard economic principles that scholars apply universally to all economies. The fundamental factor that determines the form, character, and conduct of every company is the organization-specific human capital in the body of its employees. Because this principle is not unique to Japan, this Article supports the traditional doctrine: directors of public corporations owe fiduciary duties to shareholders and shareholders alone. This is not to suggest that crucial differences do not exist between the economies of different countries. Rather, the existing differences are not the product of any great differences in the basic underlying corporate structure. Nevertheless, as I have argued elsewhere, political debate and academic research about Japan are riddled with misconceptions that flow from inaccurate statements about Japan's economy.⁶ This Article seeks to set the record straight.

It is true that requiring corporations to bear a social responsibility, provided it concerns simply a choice between feasible alternatives under normal conditions, *directly* influences directors' conduct only marginally. In other words, even if the law imposed such a responsibility on corporations, its corresponding direct effect on firm's behav-

⁴ See J. Mark Ramseyer, *Columbian Cartel Launches Bid for Japanese Firms*, 102 YALE L.J. 2005, 2020 (1993) ("Elementary notions of comparative advantage suggest that some firms in any country will *always* be uncompetitive compared to firms in the same industry elsewhere.").

⁵ See *id.* at 2019-20.

⁶ See YOSHIRO MIWA, *FIRMS AND INDUSTRIAL ORGANIZATION IN JAPAN* 8 (1996). For an accurate discussion of the current Japanese economy, see *id.* at 8-16, which outlines five misconceptions of that economy. It provides a beginner's guide to the study of Japan's economy today.

ior would be limited. The indirect effects of a mandatory corporate-social-responsibility regime, however, would endanger a free market economy. If the public-social-responsibility position were to achieve the level of widespread acceptance in Japan that it held until very recently, then it would indirectly but nevertheless seriously influence corporate behavior and the decision making of directors.

Part I of this Article briefly introduces relevant provisions of the Japanese Commercial Code. Part II outlines the theoretical foundation of firms and organizations, and identifies the "controlling group" in most large Japanese firms. Part III analyzes the roles of directors and friendly shareholders and explains why they remain friendly. Part IV first supposes that mandating corporate "social responsibility" is desirable and then discusses how—and at what cost—society could enforce such a requirement. Part V examines the goals that proponents of corporate social responsibility pursue and asks whether those objectives are obtainable. Using concrete examples, Part VI illustrates the success that profit-maximizing policies have had in rewarding shareholders of large Japanese firms (the residual claimants) generously. Part VII presents a series of examples which show that corporate social responsibility is dangerous and harmful, but maybe not irrelevant. The conclusion offers some final thoughts.

I

A BRIEF OVERVIEW OF JAPANESE CORPORATE LAW

The Japanese Diet enacted the *Sho-ho*, or Commercial Code, shortly before the turn of the century.⁷ The Diet revised the Commercial Code, which the drafters modeled on Prussian law,⁸ after World War II to reflect more closely U.S. commercial law.⁹ Despite these postwar modifications, the Code remains more detailed and less flexible than its statutory counterpart in the United States.

The *kabushiki kaisha*, or public corporation, is the most popular business form for both large and small Japanese businesses.¹⁰ It shares many fundamental features with the prevailing U.S. corporate form.¹¹ Shareholders of Japanese public corporations are subject to liability only to the extent of their capital contributions.¹² They gener-

⁷ See Kenzo Takayanagi, *Historical Introduction to 1 THE COMMERCIAL CODE OF JAPAN ANNOTATED* ix, xxxiv (Codes Translation Comm., League of Nations Ass'n of Japan 1931).

⁸ See *id.* at xxxi.

⁹ See Elliott J. Hahn, *An Overview of the Japanese Legal System*, 5 *Nw. J. INT'L L. & BUS.* 517, 522 (1983).

¹⁰ See YUKIO YANAGIDA ET AL., *LAW AND INVESTMENT IN JAPAN* 271 (1994).

¹¹ See *id.*

¹² See SHŌHŌ art. 200, para. 1, *reprinted in* 2 *LAW BULLETIN SERIES: JAPAN (EHS)* at JA 49 (1997) [hereinafter SHŌHŌ] (English translation).

ally have one vote per share¹³ and usually can recover their investment only by selling their shares. They exercise influence over corporate management by holding shareholder meetings, which the Code requires them to hold at least once a year.¹⁴ Shareholders also may hold meetings at the request of the board of directors,¹⁵ with court permission,¹⁶ and at the request of a group of shareholders that collectively owns at least three percent of the firm's outstanding shares.¹⁷ The Code requires a majority vote to pass shareholder resolutions unless the resolution falls within a statutory exception or the firm's articles of incorporation provide otherwise.¹⁸

The shareholders elect directors at their annual meeting¹⁹ to manage the corporation.²⁰ Each director serves on the board for a term that lasts no longer than two years,²¹ and shareholders can remove directors before their terms expire.²² The Code vests broad statutory authority in the board to manage the corporation.²³ Enumerated responsibilities of Japanese boards include convocation of general shareholder meetings,²⁴ approval of transactions between directors and the company,²⁵ and financial reporting to auditors.²⁶

Japanese corporate law does not require boards of directors to delegate management authority to corporate officers. In Japan, individuals whom U.S. companies would consider "senior management" are directors. The Code requires that Japanese boards of directors appoint at least one "representative director" who has actual authority to bind the corporation on certain enumerated issues.²⁷ A duty of care and a duty of loyalty govern the relationship between directors and the firm, and a breach of either is grounds for a shareholder lawsuit.²⁸ The board must monitor the activities of each individual direc-

¹³ See *id.* art. 241, para. 1.

¹⁴ See *id.* art. 234, para. 1.

¹⁵ See *id.* art. 231.

¹⁶ See *id.* art. 237, para. 2.

¹⁷ See *id.* art. 237, para. 1.

¹⁸ See *id.* art. 239, para. 1.

¹⁹ See *id.* art. 254, para. 1.

²⁰ See *id.* art. 260, para. 1.

²¹ See *id.* art. 256, para. 1.

²² See *id.* art. 257, para. 1. Directors, however, can seek damages when removed without cause. See *id.*

²³ See *id.* art. 260.

²⁴ See *id.* art. 231.

²⁵ See *id.* art. 265, para. 1.

²⁶ See *id.* art. 274, para. 2.

²⁷ See *id.* art. 261.

²⁸ In 1950, the Commercial Code incorporated the *kabunushi daihyo soshu*, or shareholders' derivative suit. Oddly, the provision does not include a requirement that the representative "fairly and appropriately" represent the shareholders' interests. For comprehensive treatment of this provision, see Yoshiro Miwa, *kabunushi daihyo soshu*, in YOSHIRO MIWA ET AL., *KAISHA-HO NO KEIZAIGAKU* 151 (1998).

tor, and the Code prohibits the board from delegating decision-making authority on certain key issues to specific directors.²⁹ Shareholders also can petition a court to enjoin action by directors when irreparable damage to the firm otherwise will result.³⁰

II

WHO CONSTITUTES THE "CONTROLLING GROUP"?

My approach toward corporate behavior is along the nexus of contract theory of the firm associated with Jensen and Meckling.³¹ This theory does not emphasize the legal definition of a firm because basing an analysis of a formal organization on its legal definition creates the risk of easily misidentifying "the effective boundaries of the organization."³² As Jean Tirole has observed, the economist's contractual view of a long-term arrangement has "relatively little to do with the legal definition of a firm."³³ The constraints that the law imposes on firms are only one set of many limitations that restrict the decision-making authority of corporate directors and managers.

Instead, the fundamental question that underlies any discussion of corporate structure is the identification of those players that constitute what Herbert Simon has called the "controlling group."³⁴ In my view, the employees usually constitute this key group, which has "the power to set the terms of membership for all the participants" of the organization.³⁵ The reason for this view is that employees not only invest specific human capital in the organization, but also select the

²⁹ See SHŌHŌ, *supra* note 12, art. 260, para. 2.

³⁰ See *id.* art. 272.

³¹ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

³² PAUL MILGROM & JOHN ROBERTS, *ECONOMICS, ORGANIZATION AND MANAGEMENT* 20 (1992). Because a firm in the real world is just a legal fiction, the legal boundary of any given firm usually does not coincide with the boundary used by the controlling group in their decision making. A firm, for Coase in particular and economic analysis in general, is a set of activities and agents within the boundaries given by the controlling group, which hereafter will be referred to as the effective boundary. The basic factor that determines an organization's controlling group is not capital ownership (shareholdings) or corporate financing (loans, bonds, and so on) or its representative directors. Rather, it is the organization-specific human capital accumulated in the body of employees. For this controlling group, the legal boundary is only one of many constraints in the decision-making process and may not significantly affect the intrafirm organization or interfirm relationships. The inside-outside characterization of a firm, as described by Coase, depends on transaction costs. Again, the legal definition necessarily does not affect the economic definition of a firm. In this view, it is in the interest of even a firm owner-manager to be friendly to the body of employees. Therefore, the question of whether the management is separated from control is irrelevant.

³³ JEAN TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION* 16 (1988).

³⁴ HERBERT A. SIMON, *ADMINISTRATIVE BEHAVIOR* 118 (1957).

³⁵ *Id.* I decided against replacing the label "controlling group" with a more descriptive term such as "managing group" or "administrative group" because doing so actually would have led to greater confusion. As I explain in Part III *infra*, shareholders select

directors and managers who serve as their representatives in operating the company. Employees support the directors and senior management only if the directors and senior managers make decisions that generally are consistent with the employees' interests. Although managers who control a firm's resources sometimes will try to pursue their own interests at the expense of their investors, the dynamics of a free market economy inevitably serve as an invisible hand to constrain their self-serving decisions. In the end, managers also must act with the investors' best interests in mind because "[t]hose [managers] who promise the highest returns . . . will obtain the largest investments."³⁶ The stakeholders in an organization, such as friendly shareholders and friendly lenders,³⁷ therefore defer to the controlling group.³⁸

Once we have identified the body of employees as the controlling group, we must then identify those factors that enable the employees to further their interests and defend themselves from other stakeholders, especially shareholders in the firm. To survive and flourish in today's market, a firm must do more than merely "carry out routine work steadily." Market competition demands that firms continuously search for new business opportunities, acquire knowledge, pursue innovation,³⁹ and accumulate a stock of human capital that can ensure long-term development. This accumulation is a long-term process that requires some assurance that the firm will not take any action in the near future that drastically might devalue the accumulated human capital. In turn, this guarantee requires the support of friendly shareholders.

An effective accumulation process has four defining characteristics. First, each participant makes a long-term investment in his own human capital. Second, investors generally gear their investments toward the particular organization. In other words, the skill is organization-specific. Third, the team production process that Alchian and Demsetz describe—namely, that the product is not a sum of the indi-

directors and senior managers on the basis of their support of present directors and the controlling group.

³⁶ Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, in *CORPORATE LAW AND ECONOMIC ANALYSIS* 182, 185 (Lucian Arye Bebchuk ed., 1990). Easterbrook and Fischel note:

The corporation and its securities are products to as great an extent as the sewing machines or other things the firm makes. Just as the founders of a firm have incentives to make the kinds of sewing machines people want to buy, they have incentives to create the kind of firm, governance structure, and securities people value. The founders of the firm will find it profitable to establish the governance structure that is most beneficial to investors, net of the costs of maintaining the structure.

Id.

³⁷ For a discussion of the role of friendly shareholders, see *infra* Part III.

³⁸ See MRWA, *supra* note 6, at 202-09.

³⁹ See Ken'ichi Imai, *kigyo gurupu*, in K. IMAI & R. KOMIYA, *NIHON NO KIGYO* 141 (1989).

vidual products of each cooperating resource and that the resources that the team production uses do not belong to any one individual—applies.⁴⁰ Fourth, long-term investors have the right to membership in the organization and can recover their investment by maintaining, rather than withdrawing, their investment in the organization. Because the skills are organization-specific, a withdrawal has the effect of devaluing the skills achieved.

Participants are reluctant to invest in the acquisition of the requisite organization-specific skill when the risk of change in the incentive system (such as pay raises and promotions) or in the basic corporate strategy destabilizes the organizational structure. This disincentive weakens the firm's overall performance, which in turn discourages talented young recruits from joining the firm. Uncertainty among some participants about the organization's stability even can diminish the aggregate value of the skills of those workers who remain confident about the firm's future. This result can occur because the less confident workers have lower skill levels. In short, the maintenance of a stable organizational structure is essential to ensure a competent and efficient workforce.

In addition to large, stable shareholders who support existing management, the stability of an organization depends on the selection of existing firm employees as directors and senior-level managers. Even the emergence of a *de facto* rule of selecting directors from employee ranks can instill confidence about the organization's stability. The reason is twofold: First, shareholders easily can remove directors who are unfamiliar with the firm's operations or hostile to the firm's interests. Second, a director with thirty years of experience as an employee already has made a long-term organization-specific investment that enables him to understand the inner workings of the firm's business.

Recall that those directors are elected at the shareholders meeting, where a small group of the largest shareholders easily can take concerted action in their own interest. Neither directors nor those shareholders are obliged to bear or actually have any "social responsibility" for stakeholders other than shareholders. The economic organization through which resource owners cooperate will make better use of their comparative advantages to the extent that the organization facilitates the payment of rewards based on productivity. This applies to every resource owner. Investors, for instance, part with their money willingly, putting it in equities rather than other investment alternatives because they believe the returns on equities are relatively more attractive. The same analysis holds true in determining invest-

⁴⁰ See Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 781-83 (1972).

ment alternatives in the case of firms. Once owning the equity of a firm, the investor realizes the importance of the organization's stability and wants to be a friendly, but profitable, shareholder. Investors can recover their investments and receive their rewards by selling their equity. They also can decrease the risk of investment by diversifying their portfolio. Neither option is feasible, however, for an employee investing in organization-specific skill.

Note two points. First, because this observation results from a world of exchange by agreement rather than by coercion, who "controls" the firm is a matter of definition. Thus, any attempt to generalize an answer to such a question is futile. Therefore, my argument that the body of employees is the controlling group is a judgement based both on the theoretical model and on the observations shown above and discussed below. Second, some commentators discuss a "discretionary" power of managers of large firms and apply it to firms in which the employees constitute the controlling group. If a return on investment depends largely on the performance of the directors, however, why do shareholders willingly allow directors to act contrary to their interests?

III

THE ROLE OF DIRECTORS AND FRIENDLY SHAREHOLDERS IN JAPANESE FIRMS

This Part discusses the two factors that enable the body of employees constituting the controlling group in most Japanese firms to further its interests and defend itself from other stakeholders, especially company shareholders. The primary factor is that the controlling group generally exercises its control in a way that benefits the other stakeholders. An additional factor is that *antei-kabunushi*, or shareholders who are friendly to existing management, will reinforce the controlling group's control by defending management against hostile shareholders in a variety of contexts, such as takeover bids.

To illustrate some typical characteristics of the shareholdings of large firms, consider the following data on large manufacturers of transportation equipment—automobiles, automobile parts, ships, and rail cars—that the Tokyo Stock Exchange lists.⁴¹ The data reveals two points. First, a small number of shareholders own the bulk of the equity in most large Japanese firms. For example, the average concentration ratio of the ten largest shareholders of eleven firms that had more than 10,000 employees in 1990 ("Group A") was 35.03% in 1980 and 36.49% in 1990. The average ranged from as little as 26.20% (Mitsubishi Heavy Industries) to as much as 59.50% (Isuzu) in 1990.

⁴¹ The author first analyzed this data in Miwa, *supra* note 6, at 202-05.

By contrast, the corresponding figures for twenty-nine firms that had between 2,000 and 10,000 employees in 1990 ("Group B") were 55.70% in 1980 and 54.53% in 1990.⁴²

Second, the largest shareholders are corporations—primarily financial institutions and trade partners. In 1990, the ten largest shareholders in all eleven firms in Group A were corporations. In fact, within Group A, financial institutions were the ten largest shareholders in two of the eleven firms, the nine largest shareholders in eight of the firms, and the eight largest shareholders in one firm. Noncorporate shareholders, including employees' shareholding associations, were among the ten largest shareholders in only three of twenty-nine Group B firms in 1990, while an average of 7.6 financial institutions were among the ten largest shareholders. For example, by April 1990 all of Nissan and Honda's ten largest shareholders were financial institutions. Even when the largest shareholder was not a financial corporation, all of the other large shareholders often were financial institutions.⁴³

Most commentators incorrectly define the term *antei-kabunushi* as "stable shareholder."⁴⁴ When used in the context of shareholding, the word *antei*, or stable, has a dual meaning; it describes the stability of shareholding behavior and their friendly support for the stability of the directors.⁴⁵ I prefer the translation "friendly shareholders" because I emphasize the latter meaning. Large shareholders often enjoy stable ownership for an extended period. On average, between seven and eight shareholders of corporations in Group A were among the ten largest shareholders in both 1980 and 1990.⁴⁶ Furthermore, most of the large shareholders that had joined the list in 1990 were financial institutions that had been among the largest eleven to twenty shareholders in 1980. The only two nonfinancial institutions that were newcomers on the list of the ten largest shareholders in these eleven Group A firms were Ford (the largest shareholder of Mazda, holding 24%) and General Motors (the third largest shareholder of Suzuki, with 3.6%).

The experience of Koito, a manufacturer of automobile parts, provides a strong illustration of the stability of large shareholders. Between 1989 and 1991, Boone Pickens, a prominent American corpo-

⁴² See generally MrWA, *supra* note 6, at 202 (describing this data in more detail).

⁴³ See *id.* at 202-03. For example, Ford held 24% of Mazda, Toyota held 14.19% of Daihatsu, Nissan held 4.24% of Fuji Heavy Industries and 32.10% of Aichi Machine, and Yamaha held 33.42% of Yamaha Motor. See *id.* Nine of the 10 largest shareholders of Toyota were financial institutions. See *id.* The fourth largest shareholder was Toyoda Automatic Loom, which held 4.35% of Toyota's total equity. See *id.*

⁴⁴ See *id.* at 203.

⁴⁵ See *id.*

⁴⁶ See *id.*

rate raider, attempted to acquire Koito.⁴⁷ With ownership of 26.43% of the total outstanding shares at the end of March 1990, Pickens was Koito's largest shareholder.⁴⁸ Even though the price per share rose dramatically from 500 yen, where it had hovered for some time, to 5,470 yen on March 31, 1989,⁴⁹ only three of the largest shareholders in Koito dropped out of the list of the firm's twenty largest shareholders between March 1980 and March 1990. None of the remaining seventeen shareholders reduced their shareholdings, and fourteen actually increased their ownership amounts. None of the three shareholders that disappeared from the list in 1990 had been among the ten largest shareholders in 1980. Moreover, the combined holding of the three shareholders was only 3.24% of the total outstanding shares in 1980. Aside from Boone Pickens, the two newcomers to the list of the twenty largest shareholders in 1990 were mutual life insurance companies whose combined holdings were only 2.17% of total ownership. "In 1980, the ten largest shareholders had 50.78% ownership and the twenty largest had 61.71% ownership."⁵⁰

As a result of large shareholder stability, corporate leaders almost always can expect strong support from the controlling body as long as their actions generally comport with the employees' interests. However, the real puzzle is why shareholders remain friendly and loyal to existing management even on rainy days? As Part II discussed, companies select their directors and managers from the employee ranks. As long as directors and managers make decisions that are consistent with the employees' interests, they almost always can rely on strong support from the employees as a group.

Japanese corporate law authorizes large shareholders to remove existing directors from their leadership positions.⁵¹ Because a small group of few shareholders typically owns the majority of a firm's stock, a small group of shareholders often can control the outcome of shareholder votes, including the election of directors.⁵² Despite this legal authority and actual ability to remove directors, however, large shareholders usually faithfully support existing management. The reason for this loyalty is because they do not have any incentive to unite in a movement to oust existing management that could destabilize the firm's management.⁵³

⁴⁷ See *id.*

⁴⁸ See *id.* I am unsure whether Pickens ever intended to acquire Koito. Rumors abounded that it had been a greenmail attempt from the beginning and that Koito ultimately paid Pickens secret payoffs.

⁴⁹ See *id.*

⁵⁰ *Id.*

⁵¹ See SHŌHŌ, *supra* note 12, art. 257, para. 1.

⁵² See MfWA, *supra* note 6, at 203-04.

⁵³ See *id.* at 204.

Large Japanese firms select most of their directors from their pools of employees.⁵⁴ Consider four examples from 1993. All 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.⁵⁵ Smaller firms in Japan reflect the same pattern. For example, in 1993, all twenty-four directors of NOK, an automobile parts manufacturer, were former employees.⁵⁶ Similarly, nineteen of the twenty-one directors of Kayaba, another automobile parts manufacturer, were former employees.⁵⁷ Both of the remaining two directors of Kayaba were former managers of Fuji Bank, the firm's third largest shareholder.⁵⁸ Finally, sixteen of Koito's twenty directors were former employees.⁵⁹ Former managers of Toyota held three of the other four seats, and a vice-president of Matsushita, the third largest shareholder in Koito, held the remaining seat as an interlocking directorate.⁶⁰

Table 1 provides the average age of directors of major Japanese companies at the time of their appointment and the number of directors in selected firms in the years 1966, 1981, and 1996. Today, many firms elect employees as directors who are, on average, in their early fifties, and these directors serve for an average of six or seven years. For example, most of Toyota's fifty-five directors in 1993 had been elected to the board between the ages of fifty and fifty-three. Absent a resignation, the firm promoted these directors within four years to a senior position, such as president (*shacho*), vice president (*fukushacho*), managing director (*jomu*), or executive managing director (*senmu*). Toyota promoted twenty-three of the fifty-five directors that sat on its board in 1993, and the shareholders selected ten new directors at their 1993 general meeting.⁶¹ These figures are important for three reasons. First, they suggest that shareholders of Japanese firms select new directors annually from the pool of employees to replace seats that outgoing board members vacate. Second, as a result of the

⁵⁴ See Ronald Dore, *Japan's Version of Managerial Capitalism*, in TRANSFORMING ORGANIZATIONS 17, 18 (Thomas A. Kochan & Michael Useem eds., 1992) ("[I]t is now extremely rare . . . for a firm's CEO and any of the executive directors to be 'outsiders.'").

⁵⁵ See MIWA, *supra* note 6, at 204. The only exception in Nihon Denso involved an interlocking directorate of the chairman of Toyota, which owned 23.07% of the equity in Nihon Denso. The other three directors in Aishin Seiki were all from Toyota, which owned 21.67% of the equity in Aishin Seiki and one of them—a Toyota vice president—had an interlocking directorate. See *id.*

⁵⁶ See *id.*

⁵⁷ See *id.*

⁵⁸ See *id.*

⁵⁹ See *id.*

⁶⁰ See *id.*

⁶¹ See *id.*

first trend, former employees continuously dominate the board as directors. Third, large shareholders, both as individuals and together as a unit, solidify the employee-dominated board by continually selecting directors from the employees' ranks.

TABLE I
AVERAGE AGE OF DIRECTOR APPOINTMENT AND THE NUMBER
OF DIRECTORS

	1966		1981		1996	
	Average Age	Number of Directors	Average Age	Number of Directors	Average Age	Number of Directors
Panasonic	48.6	19	54	29	54.9	32
SONY	44.3	14	48.6	27	52.8	38
Hitachi	52.5	20	55	25	55.7	33
Toyota	45.6	18	50	35	52	55
Honda	43.3	11	46.7	32	49.6	35
Fuji Bank	48.2	19	50.3	30	50.6	36
Industrial Bank of Japan	48.2	19	51	34	51.5	37
Nomura Securities	42.8	33	44.5	40	45.7	43
Tokyo Electric	56	20	55.5	28	57.3	32

SOURCE: Yoshiro Miwa, *torishimariyaku-kai to torishimariyaku* [The Board of Directors and Its Members], in *KAISHA-HO NO KEIZAIGAKU* [THE ECONOMICS OF CORPORATE LAW] (Yoshiro Miwa et al. eds., 1998).

Figure 1 provides the average number of board members in five major Japanese automobile producers from the years 1960 to 1996. It also categorizes the directors into a hierarchy of several ranks that is usually based on seniority. Lower ranking directors, such as department chiefs, tend to be salaried employees, although Japanese corporate culture tends to consider these salaried employees on a higher rung of the corporate ladder than other categories of salaried employees. This pattern is very similar in other industries regardless of whether they are rapid-growth industries or those experiencing slow growth or decline.⁶²

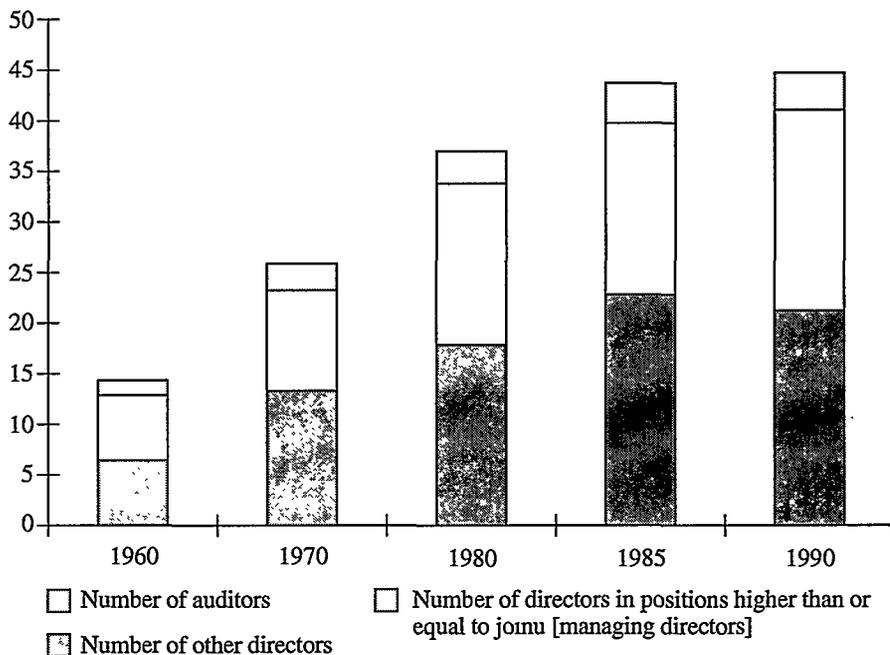
IV

WHY FRIENDLY SHAREHOLDERS REMAIN FRIENDLY

The body of employees can maintain stability and insulate itself from attack by other stakeholders because an attack against it usually will not benefit the other stakeholders. In addition, the existence of friendly shareholders bolsters the employees' stable position as the firm's controlling group. This situation leads us to consider again why friendly shareholders remain friendly. In a market in which agree-

⁶² See Yoshiro Miwa, *torishimariyaku-kai to torishimariyaku*, in Miwa et al., *supra* note 28, at 89.

FIGURE 1
THE AVERAGE NUMBER OF BOARD MEMBERS AND AUDITORS IN FIVE
MAJOR AUTOMOBILE MANUFACTURERS



ment and cooperation govern, shareholders remain friendly because the anticipated rewards that their friendliness will create are greater than the benefits that a hostile relationship will confer.

To win the support of shareholders, however, the controlling group must deliver rewards that are large enough to attract suppliers of resources. To ensure large stakeholders remain friendly, the controlling group not only must avoid making management decisions that conflict with the interests of all shareholders, but also must provide incentives beyond those offered to ordinary shareholders. Short of these measures, investors who are pessimistic about the firm's prospects will turn hostile or sell off their stocks.

Many Japanese firms employ three specific types of incentives to maintain the support of large shareholders.⁶³ The first type of incentive is the cross-holding of equity, an option that can protect the stability of both organizations by providing mutual benefits to friendly shareholders of both firms.⁶⁴ A second incentive that Japanese firms frequently use is cross benefits between trading partners.⁶⁵ Because a

⁶³ For a comprehensive discussion of these incentives, see *Miwa*, *supra* note 6, at 207-09.

⁶⁴ *See id.* at 207.

⁶⁵ *See id.*

business's success is a function of its stability, a firm can increase its profits by bolstering its stability. In turn, the firm can provide its buyers with better products at more competitive prices.⁶⁶ Conversely, the buyers have an interest in increasing the seller's stability because greater seller stability serves as a guarantee that its supply of products will not cease either at the supplier's will or as the result of forces beyond the seller's control, such as a hostile takeover by a competitor of the seller or the buyer. In short, both companies profit from a cross-benefit relationship.

A third incentive that many Japanese businesses provide is the distribution of lucrative business opportunities to the firm's buyers and sellers.⁶⁷ Mutual insurance companies (some of which are the largest shareholders in Japan) provide a good example of companies that benefit from this type of incentive. These insurance companies cannot take advantage of cross sharing because of their noncorporate status.⁶⁸ In most cases, these firms are neither large "purchasers of the manufacturing firms [that] they own nor do they have much interest in the stability of the manufacturing firm[s]' organization."⁶⁹ Yet these insurance companies engage in both loan transactions and insurer-customer relationships with their shareholding firms.

To summarize, I argue that the body of employees in most Japanese firms has the implied authority to select both friendly shareholders and the source of corporate funds (e.g., banks). My argument leads to three conclusions about corporate governance in large Japanese firms that conflict with the conventional view of the Japanese economy. First, the friendly shareholders are selected because they are *supposed* to be friendly to the present directors and managers. When once friendly large shareholders threaten the present management, the directors change their selection of the friendly shareholders. Cross-holdings or group holdings (for example, among "corporate group" firms)⁷⁰ are the result of such voluntary selection. Second, firms select lenders who are willing to support the incumbent board. The directors, therefore, will seek new sources of funding whenever the firm's current friendly lenders turn hostile toward the

66 *See id.*

67 *See id.*

68 *See id.*

69 *Id.*

70 Here readers might remember popular Japanese "corporate group" or *keiretsu* talks, most of which, however, are based on misconceptions and are flatly false. *See id.* at 123-41.

current management.⁷¹ This voluntary selection explains why the largest lender usually has a large share of the borrower's stock.⁷²

Third, present directors and employees try to select other directors and senior managers who will support them. Even directors who clearly favor the interests of other stakeholders remain friendly to the present body of directors as a result of this voluntary selection. Once the body of employees secures its position as the controlling group, large shareholders cannot unite to oust the incumbent management that the employees strongly support without great expense.⁷³ The controlling group will oppose vigorously any new management that seeks to revise the nature of the organization or its policy, whether the new management team is selected externally or internally. The reason for this opposition is that, first, the accumulated human capital is organization-specific, and second, the availability of management personnel from outside of the firm that can improve the firm's performance is limited. Even when a bank that owns a large share of firm X's equity appoints its own manager as the president of firm X, it is unlikely that any significant improvement will result. New directors can improve a company's policies only when they have the employees' support. Thus, the appointment of an outsider as a director usually does not improve a firm's performance.

⁷¹ Anyone who is familiar with the popular Japanese main bank argument, *see id.* at 100-22, may question the connection between my argument and the traditional role of main banks. Ronald Dore describes the Japanese main bank system as follows:

One of the banks is generally considered a firm's lead bank. It may provide only marginally more loan capital than other banks, but it will own more of the firm's equity, it will put more effort into monitoring the company's performance, and it will be the prime mover in any brink-of-bankruptcy reconstructions.

Dore, *supra* note 54, at 20 (citation omitted). Supporters of the traditional view often suggest that the lead bank, usually called the "main bank," has significant control over the borrower's management. If this is so, however, then why does the controlling group continue to choose a certain main bank? As I have expressed elsewhere, I am quite skeptical of the recent flood of literature on the Japanese main bank system that implicitly assumes that a tight cartel exists among Japanese financial institutions and dominates the nation's capital market. *See* Mirwa, *supra* note 6, at 224 ("A widely held misconception is that because of the closely connected network of inter-firm relationships, called *keiretsu*, competitive markets exist in a strictly limited area in Japan."). Given that main banks often withdraw before borrowers face financial turmoil, it is irrational for non-main bank lenders to reduce their monitoring costs by delegating the oversight function to main banks. Thus, if a main bank really does have superior monitoring capabilities and better knowledge of the borrower's financial statements than other banks, then why does it not take advantage of its stronger positioning by withdrawing?

⁷² *See* Mirwa, *supra* note 6, at 209.

⁷³ *See* Dore, *supra* note 54, at 21 ("[A]ttempts to mount a hostile takeover are rare.").

V

POSSIBLE MECHANISMS FOR IMPLEMENTING CORPORATE
SOCIAL RESPONSIBILITY

Ever since Adam Smith wrote *The Wealth of Nations*,⁷⁴ commentators have focused a great deal of attention on the separation of ownership from management and the separation of management from control. Berle and Means further provoked the public's interest in the firm's form of social control in *The Modern Corporation and Private Property*, where they concluded that "[o]wnership of wealth without appreciable control and control of wealth without appreciable ownership appear to be the logical outcome of corporate development."⁷⁵ This argument has prevailed in postwar Japan, and many commentators insist that the separation is greater in Japan than in the United States.⁷⁶

The traditional view of management is that the ownership interest of each shareholder is so small that the cost of uniting is prohibitive and thereby limits the effective control of management. This Article, however, presents a different view of the separation of ownership and management. When a small number of shareholders own the majority of the equity in a firm, the cost of uniting is not as high. Those shareholders usually are friendly to the incumbent management because being so is more advantageous than trying to manage the firm on their own or searching for a replacement management team. Thus, the separation of ownership from management and the separation of management from control in Japanese firms do not create a serious social problem.⁷⁷

Before discussing whether we should require corporations and their directors to bear "social responsibility," it is worthwhile to con-

⁷⁴ ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (Edwin Cannan ed., The Modern Library 1937) (1776).

⁷⁵ ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 69 (1932).

⁷⁶ See MIWA, *supra* note 6, at 210.

⁷⁷ See *id.* Although my analysis focuses on large firms such as those listed on the Japanese stock exchanges, the same logic also applies to both large and small unlisted firms:

What would happen if an owner of a large unlisted firm, where the body of employees is the controlling group, made a decision against the interests of this group, for instance suggesting selling the organization to some other firm in ten years? Such a firm can neither attract young talent nor induce employees to invest in organization-specific skill formation, resulting in the firm's poor performance. Thus an owner-manager chooses to be friendly to the body of employees, and the non-separation, or non-dispersion, of ownership does not affect the firm's basic decisions. The same holds true for small businesses. In order to survive and grow, even an owner-manager of a small business has to follow the same path.

sider four possible mechanisms for enforcing such a rule. First, we could encourage directors to make socially conscious decisions. However, a corporate "social responsibility" regime that relies on mere persuasion and voluntary assumption of this obligation by business leaders would have only a limited effect. Moreover, if some firms were to take "social responsibility" but others did not, then this enforcement mechanism would disadvantage those who acted responsibly and confer a significant market advantage on those who did not. Thus, a system that relied exclusively on persuasion to enforce corporate "social responsibility" could never succeed.

Second, the law could mandate that corporate directors make specific socially conscious decisions, such as donating a certain percentage of a firm's income to charity. This enforcement mechanism, however, lacks any logical means by which the legislature can define the parameters of such a legal requirement. For example, should it require firms to contribute to educational, academic, or religious organizations? In addition, society might benefit more if the government were to collect and then distribute a social tax instead of leaving allocation decisions to the discretion of self-selected private individuals. As one commentator has asked, "Is it tolerable that these public functions of taxation, expenditure, and control be exercised by the people who happen at the moment to be in charge of particular enterprises, chosen for those posts by strictly private groups?"⁷⁸

Third, the law could prohibit shareholders from filing derivative suits that challenge decisions directors make with "social responsibility" in mind. This alternative, however, also raises several troubling questions. For instance, which challenges would we eliminate? Would we modify the business judgment rule? Could shareholders contract around this prohibition?⁷⁹ Moreover, even if we could resolve these problems, given that shareholders set the directors' compensation and can remove them, directors rarely will take action that is contrary to the shareholders' interest.

⁷⁸ FRIEDMAN, *supra* note 1, at 134.

⁷⁹ See Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1599-1601 (1989). Professor Romano notes:

The rules that are identified as "mandatory" in practice have very little in common with the ordinary understanding of that term. They are either easily—and legally—side stepped, or they pose nonbinding constraints because there is no burning demand to deviate from them.

....

The history of corporation codes suggests that when a mandatory rule's constraint becomes binding (that is, when a sufficient number of firms desire to deviate from the rule), then the code is invariably revamped in the direction of less restrictive (more optional) terms.

Id. at 1599-1601 (footnote omitted).

Finally, the law could curtail shareholder discretion in the election of directors by restricting the pool of candidates. Such a measure, however, would reduce the anticipated rate of return of an investment in a firm, which in turn would discourage investments in companies and distort the allocation of resources in the economy.⁸⁰

A general concern with "social responsibility" is that all four of these enforcement mechanisms would create an economic distortion if enforcement targets firms in the public spotlight, such as public utility, telecommunication, transportation, distribution, and financial companies. Inconsistent enforcement would enable smaller firms not under public scrutiny to act less responsibly, giving them a market advantage over larger, more prominent firms that face greater pressure to act in a socially conscious manner.

Thus, any requirement that corporate leaders bear "social responsibility" would diminish society's aggregate wealth in proportion to the intensity of enforcement: the stricter and broader the enforcement efforts, the greater the decrease in overall wealth. Moreover, even if corporate "social responsibility" did not alter corporate behavior, the resulting atmosphere steadily would undermine the foundations of our free market. The entire social system would lose its stability, and Japan would return to the atmosphere that existed before and during World War II. Section VI addresses this potential outcome and illustrates why it could develop in any society.

VI

CAN A CORPORATE SOCIAL RESPONSIBILITY REGIME EVEN ACHIEVE ITS GOALS?

Even if we were to agree that the law should require corporate officers to behave in a socially responsible way and that this obligation should trump their duty to maximize shareholders' interests, many questions would remain unresolved. For example, precisely how should corporate officials fulfill this duty? Who should define the precise requirements? How should society implement and enforce these requirements? How, and by whom, should a failure to fulfill this obligation be punished? In addition, society would have to bear the potentially great economic costs associated with imposing a social duty on corporate officials.

⁸⁰ See JOHN KAY, *THE BUSINESS OF ECONOMICS* 118 (1996). Kay notes: Any governance structure—political or corporate, democratic or authoritarian, American or Japanese—has a natural tendency to embrace those who share the basic values of those who currently operate it, and to reject those who do not. Moreover, such behaviour is easy to defend; is it not better to confine involvement to those who understand the business?

The anticipated benefits that society would derive from a socially conscious corporate regime simply do not justify our acceptance of these drawbacks. Corporate social responsibility could have a potentially negative impact on the efficient allocation of resources. Whether consciously or unconsciously, consumers in a free market direct their resources toward firms that they regard as the best places to spend their money. Therefore, the controlling group of firms must deliver rewards that are large enough to attract investors. Market forces require the controlling group to act with the interests of every other resource owner in mind. It is as if, as Adam Smith wrote, the controlling group is "led by an invisible hand to promote an end which was no part of [its] . . . intention."⁸¹

Even if imposing a social duty on corporate officials strengthened the relative status of the controlling group, no apparent justification for strengthening their status exists. Consider the reason that other stakeholders usually support the firm's employees as the controlling group.⁸² To survive and expand, a firm must accumulate a stock of human capital, a process that requires time and some measure of confidence that the firm's human capital will not devalue drastically in the foreseeable future.⁸³ The resulting stability enables employees to maximize the use of their resources.⁸⁴ Japanese firms always have performed this accumulation process without any explicit emphasis on social responsibility or governmental intervention.

The prevailing view, however, is that Japanese corporate law should decrease rather than elevate the status of employees. Many commentators argue that directors who are former employees are so successful at winning the support of the *antei-kabunushi* that shareholder meetings have become *keigaika*, or only ceremonial (a mere shell). In addition, commentators accuse management of according the interests of shareholders too little weight.⁸⁵ Another popular view is that because Japanese firms in the 1990s suffer from over-stability, they should restructure themselves to increase their flexibility and mobility.⁸⁶

⁸¹ SMITH, *supra* note 74, at 421. Note that minority shareholders do not vote for the decisions at shareholder meetings. Moreover, some shareholders vote only because it is the best choice given the constraints under the majority's decision-making power.

⁸² See *supra* Part III.

⁸³ See MIRWA, *supra* note 6, at 205-06 (discussing the process that Japanese companies use to accumulate human capital).

⁸⁴ See *id.* at 206.

⁸⁵ See *id.* at 199-200. This popular argument is not peculiar to Japan. For a discussion on the internationally widespread demand for greater shareholder rights, see the many articles in CORPORATE GOVERNANCE TODAY (The Sloan Project on Corporate Governance at Columbia Law School, May 1998).

⁸⁶ See, e.g., Jonathan R. Macey & Geoffrey P. Miller, *Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States*, 48 STAN. L.

The corporate social responsibility argument raises similarly troubling conclusions with regard to trading partners. Trading partners are stakeholders that often profit from imposing greater corporate social responsibility. Contrary to the misinformed conventional wisdom about trade relationships,⁸⁷ trade relationships in Japan are generally not exclusive. They are, however, generally long-term. A social-responsibility regime apparently would elevate the status of trade partners and strengthen the stability of the trade relationships that some critics, calling them *keiretsu*, regard as overly stable. The prevailing view in Japan favors decreased stability of trading partners. The arguments that proponents of corporate social accountability offer to bolster their position lack detail and reflect only general opposition to the free market. Because many other publications have thoroughly criticized the social responsibility position,⁸⁸ it is unnecessary to discuss this point in greater detail. The next Part returns to the Japanese experience.

VII

REWARDS TO THE SHAREHOLDERS AS THE RESIDUAL CLAIMANTS

Proponents of corporate social responsibility insist that it is inequitable to give shareholders sole authority to elect corporate directors. Despite the potential efficiency of this present structure, opponents argue that it confers an unfair privilege on the shareholders.⁸⁹ My discussion of the Japanese shareholders' experience begins with a simple observation that symbolizes their status: although shareholders can vote to liquidate the firm and divide its residual value among

REV. 73, 100 (1995) ("[T]he core purpose of the . . . Japanese corporate governance system[] has been to produce stability But there is growing evidence that this kind of stability is not a virtue today, with global competition and rapid technological innovation placing a far higher premium on . . . flexibility . . ."). Note that I express no opinion with respect to labor-managed firms. Cf. MIWA, *supra* note 6, at 212 ("Employees are a collection of different groups of workers, and one group of workers or a collection of groups of workers form the controlling group."). I do not mean to suggest "that employees in a firm are strongly united and form the controlling group as a whole." *Id.*

⁸⁷ For example, *keiretsu* often is poorly defined. See MIWA, *supra* note 6, at 33.

⁸⁸ See, e.g., FRIEDMAN, *supra* note 1, at 133-36; Macey & Miller, *supra* note 3, at 401-05; see also Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 173-76 (arguing that "the private contracting process" better fortifies nonshareholder constituencies than governmental regulation).

⁸⁹ See, e.g., David Millen, *New Directions in Corporate Law Communications, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1384 (1993). In Japan, observers who emphasize "fairness" and "equity" often challenge the majority's decision-making power at shareholder meetings. But investors, lenders, trade partners, and workers have very different incentives and goals. To ignore these differences and request the equal treatment of these resource suppliers surely undermines the foundation of Japanese society. Whether this point applies to countries other than Japan is another question entirely.

themselves, not one company listed on a Japanese stock exchange, to my knowledge, has ever distributed positive dividends in this way.⁹⁰ As I have noted previously,

[L]arge firms usually do not increase dividend payment even when there are large profits. Instead, firms expand retained earnings and reinvest this profit into the organization mainly for the employees' benefit. Over a long periods of boom and depression, other stakeholders have stayed friendly unless circumstances change. For instance, with stable dividend payment of only 5 yen a year per share, many shareholders remain friendly. Banks which are sure to recover their loan principal and promised interest payments will continue to support existing management. Once-prosperous firms, such as Toyobo, Toray, Mitsubishi Heavy Industries and Nippon Steel, are the notable examples. For instance, Toray earned large profits in the 1960s when it enjoyed a monopoly in nylon production and was one of the pioneering suppliers of polyester. However, Toray's dividends increased slowly, reaching their peak at 8 yen per share per annum in FY 1969. Dividends soon decreased to around 5 yen per year.⁹¹

During prosperous periods, many large Japanese firms plan for future economic stagnation by diversifying and spending large amounts of retained profits to recruit desirable employees.⁹² Most firms avoid mergers and acquisitions as a means of diversifying because they want to expand the employee's workplace, not only generate profits.⁹³ Besides diversification, some large firms also pay additional salary to employees who technically remain employees but in fact no longer work at the firm.⁹⁴ Although these employees find work at other firms, they usually face pay cuts because their organization-specific skills are essentially useless outside of their home companies.⁹⁵ Former employers, however, must compensate their employees for the lost compensation.⁹⁶ As a result, relatively few layoffs in large firms followed the recent period of serious economic decline in Japan.⁹⁷ Thus, even in times of economic hardship,

⁹⁰ Arguably, because Japanese corporate law assigns the residual claim to shareholders, it is shareholders who control the firm. As Ryutaro Komiya has argued, however, "[i]rrespective of legal definitions of rights and responsibilities, ownership of the firm, in an economic sense, is not easily defined. 'Ownership' is not a black-and-white affair" RYUTARO KOMIYA, *THE JAPANESE ECONOMY: TRADE, INDUSTRY, AND GOVERNMENT* 168-69 (1990).

⁹¹ *Miwa*, *supra* note 6, at 211.

⁹² *See id.*

⁹³ *See id.*

⁹⁴ *See id.*

⁹⁵ *See id.*

⁹⁶ *See id.*

⁹⁷ *See id.*

employers are not sacrificing employee interests to satisfy shareholders.

Consider, for example, the experience of Nippon Steel, Japan's largest steel manufacturer. In 1993, more than 15,000 employees, or approximately thirty percent of the firm's total workforce, worked outside of the firm.⁹⁸ Nippon Steel must compensate these "outside" employees until they reach the retirement age of sixty;⁹⁹ yet despite this economic burden and the company's battle with serious debt, Nippon Steel continued to pay its shareholders annual dividends of 2.5 yen per share.¹⁰⁰ Even some of the largest debt-ridden steel manufacturers that have stopped paying dividends have continued to pay the additional salary to their employees who work outside the firm.¹⁰¹ These examples illustrate the relatively weak position that shareholders occupy in the Japanese corporate structure. They are powerless against directors who compensate "outside" employees, even when those additional salary payments lead the firm to withhold dividend payments.

The experience of NKK, Japan's second largest steel manufacturer, provides another example of the position of shareholders in Japan. On September 3, 1998, NKK announced its plan to liquidate a subsidiary, Toa Steel, that employed 1400 workers and reported annual sales of 130 billion yen at the end of March 1999.¹⁰² NKK stated that it would create a receiving company that would assume all of the subsidiary's assets, debts, and employees.¹⁰³ By the end of March 1998, NKK held 51.58% of Toa, a debt-ridden firm that had not paid dividends to its shareholders.¹⁰⁴ In February 1998, when the price of Toa's shares had reached more than one hundred yen per share, NKK made a capital contribution of 5.2 billion yen that increased its equity holding share by 36.54% to the current level.¹⁰⁵ According to some reports, NKK will acquire from Toa a total of 250 billion yen in debt.¹⁰⁶ Although NKK shareholders recently received annual dividends of 2.5 yen per share, the firm authorized those payments only after an extended period with no dividend payments. Toa's shareholders lost their entire investments as a result of the liquidation.

⁹⁸ See *id.* This figure exceeded 10,000 from 1989 until recently. See *id.*

⁹⁹ See *id.*

¹⁰⁰ See *id.*

¹⁰¹ See *id.*

¹⁰² See *Toa Steel Out of Options, To Liquidate Itself March 31*, JIJI PRESS TICKER SERVICE, Sept. 3, 1998.

¹⁰³ See *NKK Confirms, Toa Steel To Go into Liquidation*, AFX NEWS, Sept. 3, 1998.

¹⁰⁴ See Sandra Sugawara, *In Japan, New Trouble Signs: Toa Steel Co. Becomes Historic Failure: Hitachi Predicts \$1.8 Billion Annual Loss*, WASH. POST, Sept. 4, 1998, at E1; *Debt-Ridden Japan's Toa Steel Facing Liquidation*, ASIA PULSE, Sept. 3, 1998.

¹⁰⁵ See Sugawara, *supra* note 104.

¹⁰⁶ See *Toa Steel Out of Options, To Liquidate Itself March 31*, *supra* note 102.

VIII

ASSESSING THE SOCIAL RESPONSIBILITY ARGUMENT IN LIGHT
OF THE JAPANESE EXPERIENCE

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.¹⁰⁷ Marxist theory influenced academics in a wide range of disciplines as well as journalists, politicians, lawyers, and bureaucrats.¹⁰⁸ 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. The popularity of this position has provided the greatest obstacle to the deregulation that recently began to accelerate in Japan.¹⁰⁹ Much like a dormant volcano that threatens to erupt at any moment, the widespread support for this outdated view is dangerous.

As I have observed elsewhere, "it is only recently that many economists have begun to talk about the Japanese economy using the standard principles of economics" and have applied them to explain the "dominant patterns of the Japanese economic phenomena."¹¹⁰ Because of the dominance of Marxist theory, until very recently, support for open and free competition led by an invisible hand has been weak in Japan. Those who subscribed to such theories failed to recognize that the economic phenomena could have occurred as a result of exchange by agreement, not by coercion.¹¹¹ Marxian theories permeated not only academia and various fields of social science, but also politics, the legal profession, government, and the media.¹¹² Business leaders also espoused Marxist views when they discussed the overall Japanese economy.¹¹³ Indeed, "Marxian theories have become so ingrained [in Japanese society] that they still permeate the conventional view of the Japanese economy,"¹¹⁴ leaving little room for support of free competition.¹¹⁵

Not only did much of the public distrust the free market and fear unfettered competition, but Japan experienced intermittent revivals of Marxist ideology. Bolstered by these fears, the Japanese govern-

107 See MIWA, *supra* note 6, at 2.

108 See *id.*

109 See YOSHIRO MIWA, KISEI KANWA HA AKUMU DESUKA? [IS DEREGULATION A NIGHTMARE?] 22-68 (1997).

110 MIWA, *supra* note 6, at 2.

111 See *id.*

112 See *id.*

113 See *id.*

114 *Id.*

115 See *id.*

ment has imposed strict regulations on large sections of the economy, including the energy, finance, telecommunications, and transportation sectors.¹¹⁶ Because the remarkable postwar industrial success in Japan was the product of free and open competition, however, public support of Marxist theory gradually has eroded in recent years.¹¹⁷ Nevertheless, Marxist economic thought is so deeply embedded in Japanese society that the slightest stimulus could trigger an explosive resurgence.

In this light, the open debate over the value of corporate social responsibility remains both dangerous and potentially useful. On the one hand, it is dangerous and harmful because even a slight stimulus could disrupt the current stability and increase the popularity of the social-responsibility view. On the other hand, as long as the economy remains stable, the debate provides a valuable opportunity to educate the public on the drawbacks of a social-responsibility regime. In addition, the debate serves as an outlet for the energy that feeds on the distrust and criticism of the free market. Therefore, the social-responsibility debate is beneficial as long as both camps conclude that corporate directors owe a fiduciary duty only to the shareholders.

Japan experienced the greatest proliferation of Marxist ideology when the nation was under governmental control before and during World War II. Beginning with *sangyo gohrika undo* (the industrial rationalization movement), which was symbolized by the establishment of *Rinji Sangyo Gohri-kyoku* (the temporary industrial rationalization agency),¹¹⁸ the government gradually expanded its involvement in the

¹¹⁶ See *id.* at 14 (stating that "government influence is strong in regulated industries like energy, transport, communications, financial intermediations and agriculture").

¹¹⁷ Some readers might share Paul Krugman's erroneous belief that "before the early 1970s the Japanese system was heavily directed from the top, with MITI and the Ministry of Finance influencing the allocation of credit and foreign exchange in an effort to push the economy where they liked." PAUL KRUGMAN, *THE AGE OF DIMINISHED EXPECTATIONS: U.S. ECONOMIC POLICY IN THE 1990s* 142 (rev. & updated ed. 1994). Many Japanese also agree that the Industry Stabilization Act of 1978 and the Structural Improvement Act of 1983, both policies for "competition control" and "planned resource allocation," were what the government inherited from the wartime plan-and-control system. The postwar industrial policy differs from the wartime control in two regards. First, the objective is economic independence and economic growth rather than wartime mobilization. Second, the policy implementation system is a decentralized inducing system with diversified soft-type methods rather than a command-control system, making excessive competition visible. See Tetsuji Okazaki & Masashiro Okuno-Fujiwara, *gendai nihon no keizai shisutemu to sono genryu* [*Economic System in Today's Japan and the Historical Origin*], in *GENDAI NIHON KEIZAI SHISUTEMU NO GENRYU* [THE ORIGIN OF ECONOMIC SYSTEM IN TODAY'S JAPAN] 1, 12 (Tetsuji Okazaki & Masashiro Okuno-Fujiwara eds., 1993). These views are clearly mistaken. See YOSHIRO MIWA, *SEIFU NO NORYOKU* [THE COMPETENCE OF THE STATE] 117-217 (1998). The government could not and did not achieve very much through intervention in private business, either during wartime control or in the postwar Japan before the early 1970s.

¹¹⁸ See MIWA, *supra* note 117, at 147-48. From June 2, 1930 until April 30, 1937, the commerce minister headed the Temporary Industrial Rationalization Agency, which was established to lead and oversee the movement.

private sector as the war progressed.¹¹⁹ The intervention steadily increased until the government strictly controlled nearly every form of business activity. For example, the government dictated entry into the market and investment and denied profit incentives. In response, some business leaders argued that governmental interference in the free market would undermine military production, and they attribute the serious inefficiency and weakness of Japan's wartime economy in part to the poorly organized governmental intervention that discouraged business incentives.¹²⁰

Japan's postwar industrial success reached its pinnacle during the second postwar decade, following ten years of recovery from the wartime destruction. During this prosperity, the government implemented a series of "liberalizations."¹²¹ The most pressing policy issue of the period, known as the industrial-order debate, involved the proper role of the government in the market economy. The controversy peaked when the Ministry of International Trade and Industry proposed the Act on Temporary Measures for the Promotion of Specified Manufacturing Industries to the Diet. Support for the act, which sought to preserve the "industrial order" by authorizing governmental intervention in the private sector, derived from the public's fear of competition, distrust of the market, and faith in the government. After the attempt failed, a long-term trend toward more open and free markets accelerated.¹²² Thus, Japan's remarkable industrial success occurred not because of effective industrial policy set by the government, but because of an open and free market.

At the outset of the 1990s, Japanese business leaders began to stress *kyosei*, or symbiosis, as an ideal for which both society and business should strive.¹²³ Japanese people often attribute the word to the late Akio Morita, a former SONY chairman and vice-chairman of *Keidanren*, or the Federation of Trade Associations in Japan.¹²⁴ As a spokesperson for the Japanese business community, Morita enthusias-

¹¹⁹ See Alex Y. Seito & Jiro Tamura, *The Historical Background of Japan's Antimonopoly Law*, 1994 U. ILL. L. REV. 115, 137 (stating that "Japan's wartime conditions led to greater governmental control of competition—primarily through governmentally enforced cartels—with the principal objective of maximizing military potential").

¹²⁰ Another question is whether better organization could have made the government's wartime intervention in the private sector more effective. For a negative answer to this question, see *Mrwa*, *supra* note 117, at 1-113.

¹²¹ See *Miwa*, *supra* note 6, at 12-13 (describing the Japanese government's 1961 adoption of the Outline of the Plan for Trade and Foreign Exchange Liberalization). Among other things, this plan called for the government to increase the "trade liberalization rate" from 40% in 1961 to 80% by 1963. See *id.*

¹²² See *Miwa*, *supra* note 6, at 151, 156.

¹²³ See Clay Chandler, *Japan Inc. Tries To Push New Credo, but 'Kyosei' Concept Is Lost on Many*, *ASIAN WALL ST. J.*, Aug. 10, 1992, § 1, at 7; Akio Morita, "*nihon-teki keiei*" *ga abunai* [*Danger to the "Japanese Management"*], *BUNGEI SHUNJU*, Feb. 1992, at 94.

¹²⁴ See Chandler, *supra* note 123.

tically argued that Japanese firms needed to focus less on competition with non-Japanese firms and instead develop novel ways to coexist with them in the world market.¹²⁵ The business community immediately embraced the strategy, even though its substance was quite similar to the traditional cartelization and industry control doctrine. Because it resonated with now-dormant traditional Marxist thought, *kyosei* struck a responsive public chord, especially among older businessmen,¹²⁶ politicians, and journalists;¹²⁷ it became one of the most popular phrases of the era.¹²⁸

The 1990s in Japan essentially has been a period of deregulation. The ongoing recession and financial chaos, however, are fostering a revival of interventionist sentiments. As a result, the dormant volcano of interventionism is beginning to rumble. The public and the mass media increasingly are demanding that the government intervene in the private sector by imposing a social duty on corporate directors, particularly financial institutions. These cries for governmental intervention represent, in substance, a rebirth of the interventionist movement that a similar combination of confidence in the government and distrust of the market triggered in the postwar era.

CONCLUSION

This Article argues that advocates of the corporate social responsibility position have too little confidence in the free market and excessive confidence in the competence of the government. We must question the value of governmental intervention in the market much more critically and thoroughly than the proponents of corporate social responsibility. After observing that "the adoption of a mandatory rule is as likely to do harm as good," Professor Hart warned that "mandatory rules are probably a mistake."¹²⁹ If we apply his admonition to corporate social responsibility, the conclusion is clear: requiring corporate officials to bear social responsibility for their business decisions would be a mistake.

¹²⁵ See Paul Blustein, *Japan Gets a Hard Look from Within; Leaders Talk of Softening Unique Style of Capitalism*, WASH. POST, Oct. 18, 1992, at H1.

¹²⁶ Fujio Mitarai, Canon's President, recently remarked that "whether in Japan or overseas, we want to contribute to society, and also be a good corporate citizen. That's the concept of *kyosei*." *Canon Looking Ahead*, NEW STRAIGHTS TIMES (Malaysia), Sept. 25, 1997, at 26.

¹²⁷ See Ikuya Shigeta, *Economic Perspective*, DAILY YOMIURI, Mar. 9, 1992, at 8 (stating that "the sooner the captains of Japanese industry respond Kaidanren's plea for 'Kyosei,' the better").

¹²⁸ See Morita, *supra* note 123. For a critical analysis of this article, see MIWA, *supra* note 109, at 185-94.

¹²⁹ Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299, 313 (1993).

The risk that markets might fail could lead to "arguments for and against a narrow interpretation of fiduciary duty."¹³⁰ The simple fact that markets sometimes fail, however, does not mean that we should "jump out of the market frying pan."¹³¹ Responding with such a hasty action would be foolish because "we have no basis for predicting whether [we] . . . will land in the fire or a luxurious bed."¹³²

In the 1964 presidential address to the American Economic Association, Professor Stigler characterized Adam Smith's distrust of governmental intervention as a distrust of the state's motives and not as a doubt about its competence.¹³³ Professor Stigler then suggested that Smith had based his views on the unsupported assumption that the government has the ability to achieve undesirable goals with efficiency.¹³⁴ Indeed, Smith dismissed inept governmental conduct and offered no persuasive evidence that the government can accomplish any of its policy objectives. The economic experience of the last decades as well as research that economists have conducted since Stigler delivered his remarks suggest that the public has been too optimistic about the government's ability to intervene effectively in the open market.¹³⁵

Although this analysis focuses on Japanese firms, the conclusions apply to firms around the globe. The underlying premise of my argument—that the fundamental factor that determines the form, character, and operation of any organization is organization-specific human capital found in the body of employees—is technological in nature. Therefore, my analysis is not peculiar to any one country, and any crucial differences that exist between markets are not the product of differences in the basic structure that would render this analysis inapplicable.

130 *Id.*

131 GEORGE J. STIGLER, *THE CITIZEN AND THE STATE* 113 (1975).

132 *Id.*

133 See George J. Stigler, *The Economist and the State*, 55 AM. ECON. REV. 1, 3 (1965).

134 See *id.*

135 For the Japanese experience, see MIWA, *supra* note 117.