

Common Ownership: The Paradox in Japan's Corporate Governance

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13. Common Ownership: The Paradox in Japan's Corporate Governance

Steven Van Uytsel

1. INTRODUCTION¹

Japan's corporate governance model, one that could rely on strong mutual ties between companies in various industries and sectors—also known as *keiretsu*²—has long been considered the driving force behind Japan's economic success.³ It was only after Japan entered an economic downturn, in the aftermath of the asset price bubble burst in 1991, that the corporate

¹ An earlier version of this paper was presented at the Kyushu University Workshop on Japanese Corporate Governance (December 8, 2022) and the ZEW–Leibniz Centre for European Economic Research in Mannheim Workshop (March 27–28, 2023). The author would like to thank the participants for their comments. The author would also like to thank Pieter Siebens, Conducting Officer Compliance, ExCo Member, RC and MLRO at MUFG Lux Management Company S.A., and Takatoshi Kondo, legal office at Daikin Industries Ltd, for discussing some of the issues raised in this paper. All mistakes remain the author's. This research has received funding from the Grants-in-Aid for Scientific Research (B) No. 21H00666.

² Časlav Pejović, 'Japanese Corporate Governance: Behind Legal Norms' (2011) 29(3) Penn. State International Law Review 483, 489 fn 16. The author states that "[t]here is a general consensus in the literature that the main bank, *keiretsu* and lifetime employment are the three central features of Japan's post-war system of corporate governance". However, two of the most prominent Japanese corporate governance scholars, Yoshiro Miwa and Mark Ramseyer, have recently published numerous articles and a book which suggest that all of the central features of Japanese corporate governance are "academic myths" (i.e., they do not exist). See Yoshiro Miwa & J. Mark Ramseyer, *The Fable of the Keiretsu* (U. Chi. Press 2006); Yoshiro Miwa & J. Mark Ramseyer, 'The Myth of the Main Bank: Japan and Comparative Corporate Governance' (2002) 27 Law & Soc. Inquiry 401. For a critique of Miwa and Ramseyer's contrarian research, which also supports the general view taken in this paper that the central features of Japanese corporate governance do indeed exist, see Dan W. Puchniak, 'A Skeptic's Guide to Miwa and Ramseyer's "The Fable of the Keiretsu"' (2007) 12 J. Japanese Law 273; Dan W. Puchniak, 'Perverse Main Bank Rescue in the Lost Decade: Proof that Unique Institutional Incentives Drive Japanese Corporate Governance' (2007) 16 Pac. Rim L. & Pol'y 13.

³ See Mitsuhiro Iyoda, *Postwar Japanese Economy: Lessons of Economic Growth and the Bubble Economy* (Springer 2010).

governance model was questioned.⁴ Especially cross-shareholding,⁵ a characteristic of the *keiretsu* corporate governance model whereby companies that perceived themselves as closely related owned shares in one another, was under scrutiny.⁶ This form of shareholding was said to be one of the reasons why managers in Japanese companies tend to take fewer risks or be less innovative and thus preventing the restoration of the economy.⁷ Corporate governance reforms, explicitly limiting cross-shareholding or reforming accounting rules in relation to shares, diminished cross-shareholding.⁸ Institutional investors bought many of the freed-up shares and were thus able to enter the corporate governance spectrum.⁹ Being less intertwined with the investee companies, it was expected that the institutional investors would substantially contribute to alleviating the economic decline by enticing the corporate managers to be more competition oriented.

Institutional investors as shareholders may, however, not be without problems. There is growing literature investigating the effect of institutional investors each holding a minor stake in several competing companies, even in cases whereby the aggregate of these minor stakes is still not providing them a *de jure* controlling stake.¹⁰ Several studies have held that this phenomenon, also known as common ownership, could lead to higher prices or fewer product choices.¹¹ It is still debated why this kind of ownership triggers such an effect. One view is

⁴ Ibid 69–94. The period of stagnation was originally dubbed the Lost Decade. See Guillaume Vandembroucke, ‘Comparing Japan’s Lost Decade with the U.S. Great Recession’ (2018) 3 Economic Synopses 1; Luke R. Nottage and Leon T. Wolff, ‘Corporate Governance and Law Reform in Japan: From the Lost Decade to the End of History?’ (2005) Comparative Research in Law & Political Economy. Research Paper No. 3/2005 1. The Lost Decade became Lost Decades as economic stagnation prolonged. See Yoichi Funabashi and Barak Kushner (eds), *Examining Japan’s Lost Decades* (Routledge 2015), Introduction.

⁵ See Gen Goto, ‘The Japanese Stewardship Code: Its Resemblance and Non-resemblance to the UK Code’ in Dionysia Katelouzou and Dan W. Puchniak (eds), *Global Shareholder Stewardship* (Cambridge University Press 2022), 224; Gen Goto, ‘Legally “Strong” Shareholders of Japan’ (2014) 3(2) Michigan Journal of Private Equity & Venture Capital Law 125; Časlav Pejović, ‘Reforms of Japanese Corporate Governance: Convergence in the Eye of the Beholder’ (2013) 35 Journal of Japanese Law 107.

⁶ Paul Sheard, ‘*Keiretsu*, Competition and Market Access’ in Edward M. Graham and J. David Richardson (eds), *Global Competition Policy* (Institute for International Economics 1997), 506.

⁷ Takeo Hoshi and Anil Kashyap, *Corporate Financing and Governance in Japan: The Road to the Future* (MIT Press 2004) 200 and 202–203.

⁸ Ulrike Schaede, *Choose and Focus: Japanese Business Strategies for the 21st Century* (Cornell University Press 2008).

⁹ Ibid.

¹⁰ See, for an overview of a substantial part of the debate, Martin Schmalz, ‘Recent Studies on Common Ownership, Firm Behavior, and Market Outcomes’ (2021) 66(1) Antitrust Bulletin 12. It may be that as a group, the common owners have a *de facto* controlling stake. See Anna Tzanaki, ‘Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy’ (2022) 18(1) Journal of Competition Law & Economics 168, 183.

¹¹ José Azar, Martin Schmalz and Isabel Tecu, ‘The Anticompetitive Effects of Common Ownership’ (2018) 73(4) Journal of Finance 1513; Mohammad Torshizi and Jennifer Clapp, ‘Price Effects of Common Ownership in the Seed Sector’ (2021) 66(1) Antitrust Bulletin 39; Ioannis Lianos and others, ‘Financialisation of the Food Value Chain, Common Ownership and Competition Law’ (2019) UCL Centre for Law, Economics and Society - Research Paper Series: 4/2019; José Azar,

that the mere presence of institutional investors could create an environment in which managers are inclined to compete less or to act, consciously or unconsciously, in the interest of their common investors.¹²

By detailing the inclination of institutional investors in Japan towards common ownership, this chapter will posit that Japan's corporate governance might be entering a paradoxical phase. If the presence of institutional investors holding a common ownership position diverts the focus of management away from pursuing strategies that are optimal for the company, then they are potentially exacerbating the challenges associated with cross-shareholding rather than solving them.

Section 2 explains the start of the paradox by introducing how Japan embraced a corporate ownership structure characterized by cross-shareholding. Section 3 then shows that the non-applicability of competition rules to cross-shareholding made the Japanese legislator shift to financial and corporate law reforms to address the fallacies of cross-shareholding. Section 4 shows that the reforms changed the corporate ownership structure by introducing institutional investors and how these investors became common owners of competing companies. Section 5 explains how this common ownership may introduce new problems into Japan's corporate governance and thus elucidates the paradox. Section 6 concludes that cross-shareholding reforms have potentially led to another problem, i.e., common ownership.

2. THE POSTWAR GROWTH OF CORPORATE ECONOMIC NETWORKS IN JAPAN: *KEIRETSU*

2.1 *Keiretsu*, its Emergence, and Configuration

Before World War II, Japan's big companies were organized as conglomerates, with a holding company, a wholly-owned bank and several industrial subsidiaries. These were known as *zaibatsu*.¹³ Because the perception grew that the *zaibatsu* contributed to the war effort

Sahil Raina, and Martin C. Schmalz, 'Ultimate Ownership and Bank Competition' (2022) 51(1) *Financial Management* 227. In the pharmaceutical sector, common ownership has likely delayed the marketing of generic brands. See Melissa Newham, Jo Seldeslachts, and Albert Banal-Estañol, 'Common Ownership and Market Entry: Evidence from Pharmaceutical Industry' (2017) DIW Berlin Discussion Paper No. 1738.

¹² See Einer Elhauge, 'New Evidence, Proofs, and Legal Theories on Horizontal Shareholding' (2018) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3096812 accessed 15 September 2022, 28–29 (stating that "reduction in pressure itself will likely have anticompetitive effects"); Azar, Raina and Schmalz (n 11) 232–233. For an overview of the different triggers for the anticompetitive effects of common ownership, see Jennifer G. Hill, 'The Conundrum of Common Ownership' (2021) 53(3) *Vanderbilt Journal of Transnational Law* 881, 896–897.

¹³ *Zaibatsu* literally translates as 'wealthy clique'. Eleanor M. Hadley, *Antitrust in Japan* (Princeton University Press 1970) 20–60. See also Alex Y. Seita and Jiro Tamura, 'The Historical Background of Japan's Antimonopoly Law' (1994) *University of Illinois Law Review* 115, 130–135 and 138–145.

of Japan,¹⁴ the US, through the Supreme Command of the Allied Powers (SCAP),¹⁵ envisioned that these conglomerates had to be dismantled and prevented from rising again.¹⁶ Two pieces of legislation were central to this objective: the *Act on the Elimination of Excessive Concentration of Economic Power*¹⁷ (Deconcentration Act) and the *Act on the Prohibition of Private Monopolization and Maintenance of Fair Trade*¹⁸ (AMA).¹⁹ Whereas the former aimed at dissolving the *zaibatsu*, the latter aimed to prevent these prewar conglomerates' resurrection²⁰ by incorporating provisions regulating corporate ownership in the AMA. The 1947 AMA forbade holding companies,²¹ regulated shareholding among companies,²² and limited persons from being directors in competing companies.²³

Despite this original intent, geopolitical changes, such as the rise of communism and the war on the Korean peninsula, forced SCAP to reconsider its economic goals for Japan. SCAP shifted its policy from democratizing the economy to achieving swift economic growth.²⁴

¹⁴ John O. Haley, *Antitrust in Germany and Japan: The First Fifty Years, 1947–1998* (University of Washington Press 2000) 28; Hadley (n 13) 4 (holding that “[t]he Allied assumption ... was that giant enterprises, benefitted greatly by a policy of foreign aggression, had supported the leadership directing foreign aggression...”). See also Seita and Tamura (n 13) 145 and 148.

¹⁵ Matthew R. Augustine, ‘A Research Guide to Research on the Allied Occupation of Japan’ www.columbia.edu/~hds2/BIB95/02occupation_augustine.htm accessed 15 September 2022.

¹⁶ For a detailed description, see Haley (n 14) 3–64.

¹⁷ Law No. 207 of 1947, *kado keizairyoku shuuchuu haijo hou* [Elimination of Excessive Concentration of Economic Power Law].

¹⁸ Law No. 54 of 1974, *shitteki dokusen no kinshi oyobi kousei torihiki no kakuho ni kan suru houritsu* [Law Concerning the Prohibition of Private Monopolies and the Assurance of Fair Trade].

¹⁹ Haley (n 14) 32.

²⁰ Seita and Tamura (n 13) 165.

²¹ The outright ban on holding companies was inscribed in Article 9 of the 1947 AMA. This ban can be explained as a direct reaction against *zaibatsu*, all characterized by a holding company structure. This provision banned setting up a company that had as its primary goal to control the business activities of a company or companies through shareholding. To prevent this article from extending to a parent-subsidiary relationship, the original Article 9 of the AMA did not apply to a company that had spun-off parts of its activities into subsidiaries. Masahiro Shimotani, ‘Japanese Holding Companies: Past and Present’ (2012) 29 *Japanese Research in Business History* 11, 14–15.

²² Shareholding not amounting to a holding company was also regulated by the AMA in 1947. The then adopted Article 10 of the AMA banned any shareholding of nonfinancial companies in companies. Article 14 of the AMA extended this prohibition to any other person. The situation regarding shareholding was slightly different for financial companies. Financial companies (i.e., banking or insurance companies) could never hold shares of competing financial companies. Regarding other companies, Article 11 of the AMA of 1947 allowed financial companies to hold up to five percent of voting rights. See Michiko Ariga and Luvern V. Rieke, ‘The Antimonopoly Law of Japan and its Enforcement’ (1964) 39 *Washington Law Review* 437, 462.

²³ Article 13 of the 1947 AMA forbade a natural person from being a director in competing companies and from being a director in more than four companies. Ariga and Rieke (n 22).

²⁴ See Simon Vande Walle, ‘Competition and Competition Law in Japan: Between Skepticism and Embrace’ in Michael W. Dowdle, John Gillespie, and Imelda Maher (eds) *Asian Capitalism and the Regulation of Competition: Towards a Regulatory Geography of Global Competition Law* (Cambridge University Press 2013) 123–124; Haley (n 14) 39; Seita and Tamura (n 13) 116–117. To achieve this, the United States, already in 1949, approved the relaxation of some of the AMA’s

This new policy goal retracted the importance of the Deconcentration Act and allowed amending the stringent provisions of the AMA prohibiting companies from holding shares in each other.²⁵ In the 1960s, when foreign capital was allowed to enter Japan,²⁶ these AMA reforms gave the business community a chance to reconnect companies to corporate networks.²⁷ This reconnection resulted in the postwar phenomenon called *keiretsu*, a business conglomerate active in various industries and sectors and created through non-controlling cross-shareholding among financial and non-financial companies²⁸ and interlocking directorates.²⁹

provisions preventing companies from establishing formal ties with each other. The business community clarified that these provisions were a handicap in sustaining economic growth. See Haley (n 14) 53.

²⁵ The first revisions of the AMA happened in 1949. The revised Article 10 of the AMA allowed nonfinancial companies to hold shares in other companies on the condition that there would be no substantial restraint of competition. Article 13 of the AMA was revised to only prohibit interlocking directorates in cases where the companies were competitors. Ariga and Rieke (n 22). Other changes were implemented after Japan regained its sovereignty in 1952. The stake financial companies could hold in companies was increased to 10 percent of the voting rights. In 1977, it was decided to bring the level back to 5 percent for banking companies. Insurance companies could retain their level at 10 percent. Banking companies received a grace period of ten years until 1987 to reduce their shareholding. The decision to set the level of shareholding back at 5 percent was made after a JFTC study revealed that banks were among the top three shareholders in the major companies listed on the Tokyo Stock Exchange. Hiroshi Iyori and Akinori Uesugi, *The Antimonopoly Laws and Policies of Japan* (Federal Legal Publications 1994) 177–186. The ban on holding companies was only revised in 1997, despite the argument of the business community that the ban on holding companies “was a ‘legal anomaly’ on an international scale” and the claim that it “was a ‘leftover GHQ policy’ from the occupation.” Shimotani (n 21) 13.

²⁶ Hadley (n 13) 205–256.

²⁷ The original version of the AMA originally forbade this cross-shareholding. In fact, in 1947, the AMA forbade all companies, except financial ones, from holding shares in other companies. The idea was to spread the shares that belonged to the prewar block shareholders, the *zaibatsu* families, and holding companies among individual shareholders. Iyori and Uesugi (n 25) 177–186. To achieve this, SCAP established a Holding Company Liquidation Commission (HCLC), which, together with Japanese government agencies, bought up shares from designated companies to resell them to employees and the public (ibid 14–15). A person already owning 1 percent or more was excluded from any further purchase. Equally, a person could not purchase more than one percent of a company's total shares. Ariga and Rieke (n 22) 462–463. This resulted in the dispersed ownership of companies immediately after the war. The aim to democratize the economy soon became problematic. In a country scattered by the war effort, the public and employees did not have the financial means to meet the need for capital. Seita and Tamura (n 13) 153. Hideaki Miyajima and Fumiaki Kuroki point out that this reform in 1964 was used to seek protection for companies against the pressures of the stock market, prompting the management of *ex-zaibatsu* companies to purchase shares in previously related companies. Furthermore, the government urged life insurance companies to actively buy shares. Hideaki Miyajima and Fumiaki Kuroki, ‘The Unwinding of Cross-shareholding: Causes, Effects, and Implications’, in Masahiko Aoki, Gregory Jackson and Hideaki Miyajima (eds), *Corporate Governance in Japan: Institutional Change and Organizational Diversity* (Oxford University Press 2007), 85.

²⁸ See section 2.2 Cross-shareholding as a crucial link between *keiretsu* companies.

²⁹ Pejović (n 2) 489 fn 16.

The early *keiretsu* grew from the old *zaibatsu*. Companies that used to belong to the same *zaibatsu* started to hold shares in each other. Shareholding is often grouped around a bank, a trading company and other member companies.³⁰ As the economy developed, more company networks that did not have a history in the *zaibatsu* were established. Some of the new *keiretsu* grouped companies in a manufacturing-supplier relationship, others clustered distribution companies around major manufacturers, and others developed around department stores.³¹ While the *zaibatsu*-linked *keiretsu* are generally termed horizontal or financial *keiretsu*,³² there is less uniformity in naming the others. Generally, they are referred to as vertical *keiretsu*,³³ but supplier-centered *keiretsu* carry names such as industrial, manufacturing, or supplier *keiretsu*,³⁴ and distribution-oriented *keiretsu* is often named a distribution *keiretsu*.³⁵

Horizontal *keiretsu* unite firms active in various industries with a single bank in the middle of the network, the main bank, which orchestrates “the activities of the member firms through its lending, equity, and board connections.”³⁶ The other companies in this type of *keiretsu* often include industries like “cars, electronics, food and beverages, industrial equipment, insurance, and international trade.”³⁷ There were initially six horizontal *keiretsu*: Mitsui, Mitsubishi, Sumitomo, Fuyo, Sanwa, and Dai-Ichi Kangyo.³⁸ The first four *keiretsu* are said to have counterparts in pre-World War II, the *zaibatsu*.³⁹ The latter two developed in the 1950s and 1960s, a period of fast economic growth, around two banks: Sanwa Bank and Dai-Ichi Kangyo Bank.⁴⁰ The so-called presidents’ council or *sacho-kai*, “a regularly convening association of the presidents (*shacho*) of member firms,”⁴¹ was typical for the horizontal *keiretsu*.

³⁰ Sheard (n 6) 506.

³¹ James R. Lincoln and Masahiro Shimotani, ‘Business Networks in Post-War Japan: Whither the Keiretsu?’ in Asli M. Colpan, James R. Lincoln, and Takashi Hikino (eds), *The Oxford Handbook of Business Groups* (Oxford University Press 2010) 151.

³² See Mitsuo Matsushita, ‘The Antimonopoly Law of Japan’ in Edward M. Graham and J. David Richardson (eds), *Global Competition Policy* (Institute for International Economics 1997) 191; Sheard (n 6) 508.

³³ Ely Razin, ‘Are the Keiretsu Anticompetitive – A Look to the Law’ (1992) 18 North Carolina Journal of International Law 351, 368–373.

³⁴ See Matsushita (n 32) 191; Sheard (n 6) 508. Note that some emphasize the manufacturing stage and call this the industrial *keiretsu*. See Artur F. Tomeczek, ‘The Evolution of Japanese Keiretsu Networks: A Review and Text Network Analysis of Their Perceptions in Economics’ (2022) 62 Japan & The World Economy 1, 3.

³⁵ See Matsushita (n 32) 191; Sheard (n 6) 508.

³⁶ Lincoln and Shimotani (n 31) 130.

³⁷ Razin (n 33) 368.

³⁸ See Tomeczek (n 34) 3; Iyori and Uesugi (n 25) 323; Hadley (n 13) 257–290.

³⁹ See Sheard (n 6) 506. Mitsui, Mitsubishi, and Sumitomo, as *keiretsu*, carried the same name as when they were *zaibatsu*. Fuyo, as *keiretsu*, is seen as a direct successor of the Yasuda *zaibatsu*. See Hadley (n 13) 258–259. The composition of the Fuyo *keiretsu* also allows us to say that they had parts of the Asano and Okura *zaibatsu* incorporated into their structure. See Albrecht Rothacher, *The Japanese Power Elite* (Palgrave Macmillan 2016) 201.

⁴⁰ Sheard (n 6) 506. Compare Hadley (n 13) 258 and 262 (indicating that even the Fuyo and Dai-ichi Kangyo may find their origins in the prewar *zaibatsu*. The Fuji Bank was said to be connected to the Yasuda *zaibatsu*, while the Dai-ichi Bank stems from the Shibusawa *zaibatsu*, but the *keiretsu* as such equally had links with the Furukawa *zaibatsu* and the Kobe Kawasaki *zaibatsu*).

⁴¹ Lincoln and Shimotani (n 31) 130.

While the information on the membership of the presidents' council is publicly available, internal deliberations remain veiled in secrecy.⁴²

The vertical *keiretsu*, whether it is the supplier or distribution *keiretsu*, does not stretch over various industries. This *keiretsu* is organized among firms in a supply chain or distribution relationship with each other. More specifically, vertical *keiretsu* relates to firms "engaged in the production of component products, the assembly of principal products, and the distribution of *keiretsu* output."⁴³ Eminent vertical *keiretsu* include Canon, Daihatsu, Hitachi, Honda, Nissan, Toshiba, and Toyota.⁴⁴ Unlike the horizontal variant, the vertical *keiretsu* did not develop the presidents' council. The cooperative association or *kyoryoku-kai* is said to play a similar role.⁴⁵

The above description may give the impression that the *keiretsu* were well-delineated company networks; however, some horizontal and vertical *keiretsu* were intertwined and overlapping.⁴⁶ For example, Toyota aligned with Mitsui and had observer status within the Mitsui presidents' council, the Nimo-kai.⁴⁷ Daihatsu, affiliated with Toyota, actually belonged to the Sanwa *keiretsu*.⁴⁸ Hitachi was special as it was a member of the presidents' councils of the Fuyo, Dai-ichi Kangyo, and the Sanwa *keiretsu*.⁴⁹ Matsushita, not belonging to any of the presidents' councils, leaned toward the Sumitomo *keiretsu*.⁵⁰ It is now evident that these *keiretsu* are part of a continuum. The lines between the *keiretsu* were fundamentally redrawn at the end of the 1990s and the early 2000s when major bank consolidations occurred. Several *keiretsu*-related banks, "long[ing] the institutional leadership and public face of the horizontal *keiretsu*,"⁵¹ merged to form new financial institutions.

2.2 Cross-Shareholding as a Crucial Link Between *Keiretsu* Companies

Whether we talk about horizontal or vertical *keiretsu*, both types are characterized by close ties between companies. These ties are formalized through "cross-shareholding, personnel transfers, and preferential lending and trade."⁵² Cross-shareholding (in Japanese, referred to as *kabushiki mochiai* or, in short, *mochiai*)⁵³ implies that *keiretsu* related companies hold shares in one another.⁵⁴ Thus, the corporate networks could grow.⁵⁵ Some companies would take a

⁴² Pejović (n 2) 504.

⁴³ Razin (n 33) 373.

⁴⁴ Tomeczek (n 34) 3.

⁴⁵ Lincoln and Shimotani (n 31) 130.

⁴⁶ Hadley (n 13) 300.

⁴⁷ Lincoln and Shimotani (n 31) 136–137.

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ Ibid.

⁵¹ Ibid 147.

⁵² Ibid 136.

⁵³ Goto, 'The Japanese Stewardship Code' (n 5) 224. See also Pejović (n 5) 111 fn 12.

⁵⁴ The cross-shareholding in a Japanese corporate governance context is, in principle, between companies that belong to different industries and sectors. Although not excluded, this kind of cross-shareholding does not focus on the holding of shareholdings in competing companies.

⁵⁵ It is not possible to call it a group. Lincoln and Shimotani (n 31) 128.

higher stake than others, but none would hold a controlling share in other companies;⁵⁶ however, combined, mutually held shares usually constitute a controlling portion of a company's shares.⁵⁷

It can further be said that the cross-shareholding could also be stable shareholding or *antei kabunushi*,⁵⁸ which means that the shares were held for a long time.⁵⁹ Referring to a study of the Nihon Life Institute, Ulrike Schaede cautions that not all stable shareholding can be reduced to cross-shareholding. A substantial amount of the stable shareholding was held unilaterally.⁶⁰

Data shows that cross-shareholding was at 23.6 percent in 1950, 36.8 percent in 1955, 47.4 percent in 1965, and 62.2 percent in 1974.⁶¹ Cross-shareholding almost stabilized at around 63 percent until the early 1990s, when the shareholding of financial institutions gradually decreased, and foreign shareholding increased.⁶² Data also discloses that financial companies have held the highest portion of cross-shareholding.⁶³

The following figure (Figure 13.1⁶⁴) visualizes cross-shareholding information between 1970 and 1995 with a 5-year interval. The two highest lines in Figure 13.1 illustrate the extent of the cross-shareholding. Aggregating the percentages of these lines shows that, until 1995, cross-shareholding was above 60 percent.

⁵⁶ Goto, 'The Japanese Stewardship Code' (n 5) 224.

⁵⁷ Pejović (n 5) 112. See also Goto, 'The Japanese Stewardship Code' (n 5) 224.

⁵⁸ Goto, 'The Japanese Stewardship Code' (n 5) 224.

⁵⁹ Ulrike Schaede, 'The Strategic Logic of Japanese Keiretsu, Main Banks and Cross-Shareholdings, Revisited' (2011) Columbia Business School, Center on Japanese Economy and Business Working Paper 247.

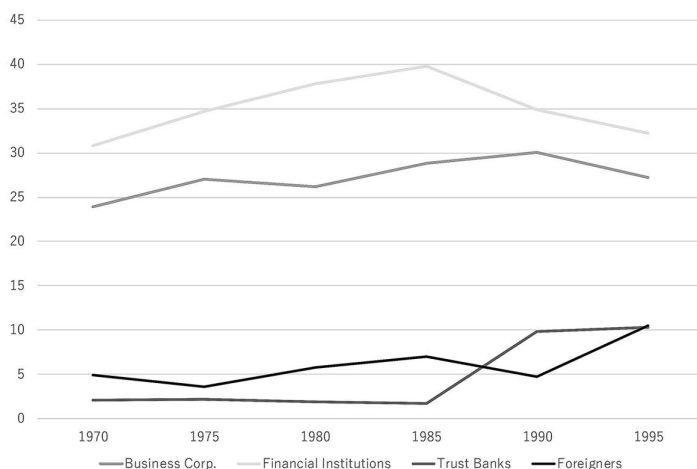
⁶⁰ *Ibid.*

⁶¹ Miyajima and Kuroki (n 27) 85.

⁶² *Ibid.* 86.

⁶³ *Ibid.* Two reasons can explain why financial companies have been able to secure that position. When SCAP drew its plans for postwar Japan, the aim was to break up the *zaibatsu*, including the attached banks. To guide this process, the Deconcentration Act was adopted. The law required SCAP to designate the companies that had to be dismantled. The plan was to identify such companies in four sectors: industrial, distributive and service, insurance, and banking. While the Holding Company Liquidation Commission (HCLC) was able to designate companies in the two former sectors, a change in the position of SCAP toward its plans with Japan due to geopolitical reasons meant that the deconcentration policy toward banks was forfeited. In 1948, the HCLC declared that banks would not be subject to designation, allowing them to keep the dominant position they had acquired in the prewar and wartime periods. Furthermore, the law allowed these financial companies to use their influence. The AMA explicitly stated that these companies could hold up to 5 percent, at certain times even 10 percent, of the other company's shares. Seita and Tamura (n 13) 156–157; Pejović (n 5) 113 (indicating that this was remarkable because the United States did not allow banks to hold shares in other banks).

⁶⁴ Japan Exchange Group, '2021 Shareownership Survey' (2023) <https://www.jpx.co.jp/english/markets/statistics-equities/examination/01.html> accessed 15 September 2022.



Source: The data for the figure were obtained from the Japan Exchange Group, 2021 Shareownership Survey. Financial institutions include City and Regional Banks, Trust Banks, and all insurance companies.

Figure 13.1 Distribution percent of market value owned by type of shareholders

3. *KEIRETSU*: FROM COMPETITION LAW TO A CORPORATE GOVERNANCE ISSUE

3.1 Questioning Cross-Shareholding From a Competition Law Perspective

The presence of cross-shareholding, and by extension *keiretsu*, within the Japanese economy has been unquestioned for a relatively long time. Industrial organization literature even lauded the *keiretsu* structure and its cross-shareholding because it enabled management to focus on the company's growth. The *keiretsu* model guaranteed economic security through continued business transactions, making companies less dependent on high dividends. Any profits could be redirected to the further expansion of the companies.⁶⁵ Furthermore, financial companies could overcome the information gap between borrowers and lenders in a system with a high dependency on bank loans and cross-shareholding, often combined with board representatives of bank personnel or other personnel placements. It also allowed the banks to step in and sanitize companies that had run into trouble.

The first signs of criticism toward the *keiretsu*, particularly the cross-shareholding, came from the US when there was a tremendous trade imbalance with Japan at the end of the

⁶⁵ Ulrike Schaefer, 'Competition for Corporate Control: Institutional Investors, Investment Funds, and Hostile Takeovers in Japan' (2006) Columbia Business School, Center for Japanese Economy and Business, Working Paper No. 248, 30.

1980s. In the framework of the Structural Impediments Initiative, the negotiations aiming at eradicating elements causing the trade deficit, the US trade negotiators argued that *keiretsu* could induce anticompetitive results due to the structural weakening of the AMA.⁶⁶ US trade representatives argued that Japan had to take more rigorous enforcement measures against these *keiretsu* based on the AMA's remaining provisions on shareholding.⁶⁷ The US call was met with an investigation by the Japan Fair Trade Commission (JFTC) into the phenomenon of *keiretsu*.⁶⁸

The JFTC took a narrow view and limited its investigation to the horizontal *keiretsu*, drawing the following conclusions. Each *keiretsu* had a substantial number of shares controlled by its member companies. The top shareholders belonged to the same *keiretsu*. Most shareholders were considered stable; they did not dispose of their shares for a long time. Furthermore, financial companies were found to be shareholders across different *keiretsu*. None of these findings, however, allowed for the conclusion that the provisions on shareholding in the AMA were infringed.⁶⁹

The exclusionary effect that intragroup transactions may have had on outsiders, whether foreign or domestic, was another argument to call upon the JFTC for more control of the *keiretsu*. In this regard, the JFTC surveyed the intragroup transactions of the six big horizontal *keiretsu* at two different points in time. The general conclusion was that intragroup transactions were in decline. Another finding was that foreign companies without any relation to the *keiretsu* were barely among the top 30 trading partners. On the contrary, non-related domestic and related foreign firms were relatively well represented among the top 30 trading partners. The poor representation of foreign firms led to the question of whether any intragroup transactions represented anticompetitive conduct under the AMA's provisions on vertical agreements. More specifically, the question was raised whether these transactions hindered new market entry or excluded existing competitors from the market.

The JFTC acknowledged that longstanding transactional relationships could produce such anticompetitive outcomes; however, as is widely shared in the literature, this would

⁶⁶ On Structural Impediments Initiative (SII), see Mark K. Morita, 'Structural Impediments Initiative: Is it an Effective Correction of Japan's Antimonopoly Policy' (1991) 12 *University of Pennsylvania Journal of International Law* 742; Norio Naka, *Predicting Outcomes in United States-Japan Trade Negotiations: The Political Process of the Structural Impediments Initiative* (Quorum Books 1996) 18–19; Jonathan E. Johnson III, 'Keiretsu: Their Effect on Business and How American Government and Business Can Confront Them' (1992) *Brigham Young University Law Review* 1155, 1164, and 1166.

⁶⁷ See United States Senate, Committee on Finance, 'United States-Japan Structural Impediments Initiative Hearing before the Sub-Committee on International Trade' (1990) 102 <https://www.finance.senate.gov/imo/media/doc/hrg101-5943.pdf> accessed 15 September 2022; Matsushita (n 32) 155; Naka (n 66) 22 (where the author indicates that the commitments of Japan toward *keiretsu* were mainly directed toward stricter enforcement of the AMA).

⁶⁸ Two scholars refer to the fact that the Japan Fair Trade Commission monitored large business groups, to be understood as *keiretsu*. See Schaede (n 8) 90 (also indicating that the last survey on *keiretsu* was in 2001); Iyori and Uesugi (n 25) 320–340.

⁶⁹ This can be deduced from the conclusion that the AMA is difficult to apply to *keiretsu*. See Matsushita (n 32) 191 (indicating that *keiretsu* often depend on informal arrangements). Another source for this conclusion is the continuous data collection by the JFTC on the *keiretsu*, without attaching further enforcement action to it. See Iyori and Uesugi (n 25) 320.

require a case-by-case analysis.⁷⁰ Hence, it cannot be said that a *keiretsu* is *a priori* infringing the AMA, which depends on how the *keiretsu* members conceptualize the transactions. Reciprocal dealings, for example, would likely not infringe the AMA if they were not made exclusive. Equally, refusals to deal would only be problematic if the *keiretsu* had attained market dominance; however, market dominance would be challenging to achieve as there was fierce competition between *keiretsu*.⁷¹

The above led to the general conclusion that a rigid application of the AMA is not a solution to problems stemming from *keiretsu*. Traditional competition law instruments did not provide a theory of harm suitable to address such problems if they were to exist.

3.2 One Last Attempt to Expand Competition Law Towards *Keiretsu*

Paul Sheard seems to challenge the suitability of traditional competition law instruments to deal with *keiretsu* and cross-shareholding. After conceding to the above conclusions, Sheard explores whether there needs to be a new theory of harm developed for *keiretsu*.⁷²

Keiretsu relies on long-term transactions between member companies; thus, this is not extraordinary. According to industrial organization literature, companies that have done business with each other have accumulated advantages over companies with no business relations. Therefore, it is normal for long-term transactions to occur within the market; however, the unique characteristic of the *keiretsu*, in which cross-shareholding plays a tremendous role, is that it could create a bias toward long-term transactions.⁷³

Sheard does not elaborate on the formation of bias. On the one hand, he reverts to the industrial organization literature, stating that the decision to work with related companies reflects a mere rational decision. The cost of dealing with *keiretsu* member companies is considered inexpensive; thus, it is hard to consider this decision as a bias that would be an anticompetitive or unfair practice. On the other hand, Sheard opines that the impact on market foreclosure is minimal.⁷⁴

Despite these two reflections, when alluding to the bias, Sheard includes one sentence on how cross-shareholding and bank financing protect the management from hostile takeovers.⁷⁵ However, he does not investigate the impact of this protection mechanism on the formation of the above-mentioned bias, which the competition law literature has neglected for a long time. This lack of research means that the competition law literature has neglected to link the *keiretsu* with the theory of a “quiet life” developed by finance and corporate law scholars.

The theory of a quiet life is an old theory that Sir John R. Hicks developed in 1935 to qualify the behavior of managers of monopoly companies. Hicks purported that managers of a monopoly company were not adequately prompted to perform their managerial duties. The monopoly situation insulates managers from the product market, so they do not have to make

⁷⁰ See, e.g., Iyori and Uesugi (n 25) 320–340; Razin (n 33) 379–405; Matsushita (n 32) 184–195.

⁷¹ Razin (n 33).

⁷² Sheard (n 6) 526.

⁷³ *Ibid.*

⁷⁴ *Ibid.*

⁷⁵ *Ibid.*

difficult decisions.⁷⁶ However, managers are not necessarily shielded from the product market in the context of *keiretsu*. They are shielded from the control of the capital market,⁷⁷ which could have allowed them to make choices that were not necessarily pro-competitive.

3.3 Cross-Shareholding in Decline After Corporate Governance Reforms

The *keiretsu* stronghold—cross-shareholding—has been compromised from the 1990s onwards. Legal reform caused banks to retreat as one of the principal shareholders within the *keiretsu* structure. In general, the economic downturn, which started after the real estate bubble burst in 1991, made holding shares among *keiretsu* members less attractive.⁷⁸

Financial companies have been very prominent in holding shares of *keiretsu* members. A survey in 1991 revealed that banks still had about 11 percent of the total stock market capitalization.⁷⁹ Twelve years later, this holding was reduced to 3.6 percent. The economic crisis may have contributed to this reduction. Companies had to deal with nonperforming loans and had to restructure. Furthermore, two legal reforms changed the “institutional leadership and public face”⁸⁰ of the *keiretsu*.

One of the legal reforms was the revision of the financial reporting rules, forcing Japanese firms and banks to report the results of all affiliates they have real control of in consolidated accounts. This kind of change in the accounting rules prevented the practices often employed by *keiretsu* affiliates from hiding liabilities or assets by transferring them to other affiliates. A further change in 2001, which required reporting assets at market value and thus revealing the undercapitalization of many banks, caused a rush to withdraw from cross-shareholding.⁸¹

Schaede described another reason for the reduction of shareholding by banks in her book *Choose and Focus*, in which she also puts a number on the amount of money banks had to withdraw from the stock market:

But the most important trigger of the mass sell-off after 2001 was the new Law Limiting Banks' Stock Ownership. Designed to improve the stability of the banking system, this law limits a bank's total shareholdings to its size, strictly defined as 'own capital.' In fiscal year 2001, the largest four banks alone were estimated to face a shareholding overhang of about ¥ 7 trillion, which created immense pressure to reduce stakes. By way of reference, in March 2001, city banks and other banks (excluding trust banks) held ¥ 35.7 trillion worth of shares at current market value, but this declined to ¥ 18.2 trillion in March 2003.⁸²

There seems to be a consensus that cross-shareholding reduction did not persevere, especially among business corporations.⁸³ The downward trend of cross-shareholding seems to have

⁷⁶ John R. Hicks, 'Annual Survey of Economic Theory: The Theory of Monopoly' (1935) 3(1) *Econometrica* 1, 8.

⁷⁷ Goto, 'The Japanese Stewardship Code' (n 5) 224.

⁷⁸ Scott R. Anderson, 'Are Japan's Corporate Governance Reforms Working?' (2018) *Investment Research* 2, https://www.lazardassetmanagement.com/docs/product/-sp10-/66807/arejapan%E2%80%99scorporategovernancereforms_lazardresearch_en.pdf accessed 15 September 2022.

⁷⁹ See Schaede (n 8) 99.

⁸⁰ Lincoln and Shimotani (n 31) 147.

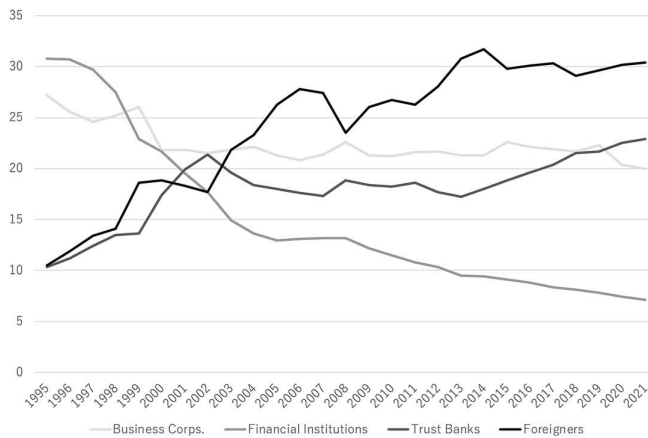
⁸¹ *Ibid* 148.

⁸² Schaede (n 8) 99.

⁸³ Pejović (n 5) 130–131. See also Schaede (n 8) 97–99; Pejović (n 2) 506.

stopped around 2007 and almost stabilized.⁸⁴ Whether or not the cross-shareholding has been sold is not in itself important for the argument of this chapter; however, the reduction in cross-shareholding, opening perspectives for other investors to buy shares, is important. Data shows that foreign and domestic institutional investors (investment trusts and trust banks), foreign and domestic private equity funds, and individuals bought released shares.⁸⁵

The following figure (Figure 13.2⁸⁶) shows the decline of cross-shareholding from 1995 onwards. Business corporations' shareholdings are almost stable, around 20 to 25 percent. The shareholding by financial institutions, including regional and local banks and all types of insurance companies, dropped from above 30 percent to around 7 percent. Trust banks and foreigners, including institutional investors, experienced a steep increase in shareholding.



Source: The data for the figure were obtained from the Japan Exchange Group, 2021 Shareownership Survey. Financial institutions include City and Regional Banks, Trust Banks, and all insurance companies.

Figure 13.2 Distribution percent of market value owned by type of shareholder (excluding individuals and securities firms)

⁸⁴ Tomomi Takada and Katsuhiko Muramiya, 'How Cross-Shareholding Influences Financial Reporting: Evidence from Japan' (2020) 28(5) *Corporate Governance: An International Review* 309, 312. See also Takaya Seki, 'The Japanese Corporation: Community, Purpose, And Strategy' in Thomas Clarke, Justin O'Brien, and Charles R.T. O'Kelly (eds), *The Oxford Handbook of the Corporation* (Oxford University Press 2019) 434.

⁸⁵ Schaede (n 8) 110–125.

⁸⁶ Japan Exchange Group (n 64).

4. NEW SHAREHOLDERS MANIFEST THEMSELVES AS COMMON OWNERS

The corporate governance reforms changed the shareholding structure. The shares that were sold due to these reforms were either bought by a new type of shareholder or by shareholders that were previously not very present in the Japanese stock market.

The *sai-shintaku* (trust of trusts) is one example of a new type of shareholder, which did not exist before 2000. Three of these *sai-shintaku* were initially created: Japan Trustee Services Bank, Trust and Custody Services Bank, and Master Trust Bank of Japan.⁸⁷ The former two formed the Custody Bank of Japan, thus reducing the number of *sai-shintaku* to two.⁸⁸ These two *sai-shintaku* specialize “in securities processing by administering the trust business of two of the four main banking groups.”⁸⁹ The Custody Bank of Japan (CBJ) mainly centers around Mitsui Sumitomo Trust Holdings, Resona Bank, and Mizuho Financial Group.⁹⁰ The Master Trust Bank of Japan (MTBJ) is the specialized trust investor of Mitsubishi UFJ Trust and Banking, Nippon Life Insurance, Meiji Yasuda Life Insurance, and Norinchukin Trust & Banking.⁹¹

Both *sai-shintaku* have become ubiquitous with their shareholding, listed among the major shareholders of almost every publicly listed company. In this sense, they have become common owners of competing companies. If we look at the first-tier companies in the construction industry in 2022, CBJ and MTBJ are among the principal shareholders of Taisei (5.4 percent and 16.1 percent, respectively), Obayashi (8.1 percent and 16.9 percent, respectively), Shimizu (4.1 percent and 14.7 percent, respectively), and Kajima (5.1 percent and 16.0 percent, respectively).⁹² Equally, this kind of shareholding is noticeable in the food industry, and more specifically, the beverages industry: Asahi Group Holdings (4.7 percent CBJ and 17.1 percent MTBJ), Kirin Holdings (4.6 percent CBJ and 13. percent MTBJ), Suntory Beverage and Food (2.1 percent CBJ and 6.8 percent MTBJ), and Sapporo Holdings (3.6 percent CBJ and 15.3 percent MTBJ).⁹³ The presence is also noticeable in the nonferrous mining industry: Sumiseki Holdings (1.4 percent CBJ and 9.3 percent MTBJ), Nittetsu Mining (2.8 percent CBJ and 10.6 percent MTBJ), and Mitsui Matsushima Holdings (2.2 percent CBJ and 9.5 percent MTBJ).⁹⁴

Common ownership by the *sai-shintaku* also has a vertical dimension. The *sai-shintaku* also hold shares in companies in a supply/distribution relationship. To exemplify this, for

⁸⁷ Ulrike Schaeede, ‘Corporate Governance Reform in Japan’ in Knut Sogner and Andrea Colli (eds), *The Emergence of Corporate Governance: People, Power and Performance* (Routledge 2021) 161; Seki (n 84) 427.

⁸⁸ Custody Bank of Japan, ‘Message from the Management’ (2020) <https://www.custody.jp/english/message/index.html> accessed 15 September 2022.

⁸⁹ Schaeede (n 8) 113.

⁹⁰ Custody Bank of Japan, ‘Corporate Data’ (2020) <https://www.custody.jp/english/corporate/index.html> accessed 15 September 2022 (enumerating the other shareholding banks in this trust); See also Schaeede (n 8) 113.

⁹¹ The Master Trust Bank of Japan, ‘Corporate Overview’ (2022) <https://www.mastertrust.co.jp/english/corporate.html> accessed 15 September 2022. See also Schaeede (n 8) 114 (informing that the last-mentioned trust is the trust arm of the umbrella bank for all agricultural cooperatives).

⁹² Toyo Keizai Inc., *Japan Company Handbook 2022* (Toyo Keizai Shinposha 2022) 124–128.

⁹³ *Ibid* 270–275.

⁹⁴ *Ibid* 102–103.

the year 2022, CBJ has shares in Nissan Motors (1.8 percent), Toyota Motor (5.8 percent), Mitsubishi Motor (0.7 percent), Honda Motor (5.9 percent), Subaru (4.9 percent), and Mazda Motor (4.3 percent). MTBJ has 8.7 percent, 11.7 percent, 6.1 percent, 14.8 percent, 14.6 percent, and 15.8 percent, respectively. Furthermore, the *sai-shintaku* are also shareholders in several car parts manufacturers, such as Akebono Brake Industry (1.9 percent CBJ and 9.4 percent MTBJ), Tachi-S (5. percent CBJ and 5.9 percent MTBJ), or Mikuni (3.7 percent CBJ and 8.1 percent MTBJ).⁹⁵

Yet, *sai-shintaku* are not the only institutional investors that have taken a share from the previous cross-ownership of the financial institutions. The increase in foreign shareholding also results in more shareholding by foreign institutional investors.⁹⁶ In that sense, it is common for firms from the Vanguard or BlackRock family to hold shares in, for example, the construction industry.⁹⁷ For example, the shareholding of the Vanguard family floats around 3 percent in Taisei, around 2.5 percent in Shimizu, around 3.1 percent in Obayashi, and around 2.9 percent in Kajima. The BlackRock family situates around 3.2 percent in Taisei, around 3.3 percent in Shimizu, around 3 percent in Obayashi, and around 2.8 percent in Kajima.

Besides the *sai-shintaku*, there is the Bank of Japan's (BOJ) accumulation of exchange-traded funds (ETFs) tracking the TOPIX Index and the Nikkei 225 Index, making the BOJ an indirect owner of the ETFs' portfolio companies.⁹⁸ This ownership means that the BOJ is a passive owner without voting rights and thus cannot voice its concerns regarding the company's governance. The ownership and voting rights in the portfolio companies (exercised by proxy with the proxy policies being publicized)⁹⁹ lie with the ETF sponsor companies.¹⁰⁰ These sponsoring companies are trust banks and asset management companies.¹⁰¹ The amount

⁹⁵ Ibid 1397–1419.

⁹⁶ Schaeede (n 65) 16.

⁹⁷ See Taisei <https://www.morningstar.com/stocks/xtk/1801/ownership> accessed 15 September 2022; Shimizu <https://www.morningstar.com/stocks/xtk/1803/ownership> accessed 15 September 2022; Obayashi <https://www.morningstar.com/stocks/xstu/oba/ownership> accessed 15 September 2022; Kajima <https://www.morningstar.com/stocks/xngo/1812/ownership> accessed 15 September 2022.

⁹⁸ The literature is mostly disconnected from the concept of *keiretsu*. See Leonardo Cadamuro, 'Had BoJ Intervention Attract ETFs' Private Investment?' (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4184064 accessed 15 September 2022; I Go and Kazuo Yamada, 'Passive Ownership and Accounting Conservatism: Evidence from the BOJ's ETF Purchasing Program' (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4177156 accessed 15 September 2022; Takahiro Hattoria and Jiro Yoshida, 'The Impact of Bank of Japan's Exchange-Traded Fund Purchases' (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3575835 accessed 15 September 2022; Hiroshi Gunji, Kazuki Miura, and Yuan Yuan, 'The Effect of the Bank of Japan's ETF Purchases on Firm Performance' (2021) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3798098 accessed 15 September 2022. Some literature mentions the *keiretsu* when making a reference to these new shareholders. See Masumi Sai and Kazuo Yamada, 'Does Passive Ownership Affect Corporate Governance? Evidence from the Bank of Japan's ETF Purchasing Program' https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3894249 accessed 15 September 2022; Seki (n 84) 427.

⁹⁹ Sai and Yamada (n 98).

¹⁰⁰ Ibid 2.

¹⁰¹ Cadamuro (n 98) Table 3.

of ownership administered by these banks and companies is known to the portfolio companies.¹⁰² It has been reported that the Government Pension Investment Fund, which manages the Japanese government's pension plans, is undertaking similar investments through trust banks and asset management companies, thus making it also an indirect owner.¹⁰³

The literature does not link indirect ownership with common ownership, which may have to do with the fact that the investment is hidden. The use of ETFs makes it difficult to provide exact data on whether there is any common ownership. However, the BOJ is said to be a top ten shareholder in 90 percent of the Nikkei 225 Index listed companies through the ETFs it bought.¹⁰⁴ The Nikkei Index overview shows that many of the companies included in the Nikkei 225 Index are in direct competition with each other, as it groups companies per sector.¹⁰⁵ Regarding the competition in the blue-chip sector, the media claims, for example, that the BOJ is the “major owner of more Japanese blue-chips than both BlackRock Inc., the world's largest money manager, and Vanguard Group, which oversees more than \$3 trillion.”¹⁰⁶

In an academic paper, I Go and Kazuo Yamada stress that “[t]he voting rights of ETF sponsor companies have dramatically increased.”¹⁰⁷ They further reveal that one of the sponsor companies is Nomura Asset Management, of which the “NEXT FUNDS 225” is the largest Nikkei 225 ETF.¹⁰⁸ Exploring this further in several databases, it is indeed noticeable that Nomura Asset Management,¹⁰⁹ joined by several other Japanese asset management companies that manage ETFs, holds shares across the horizontal and vertical spectrum of the market.¹¹⁰

¹⁰² It is not obvious how much is indirectly owned by the BOJ. The BOJ does not disclose the information on its daily purchases, but estimates have been made on how much the BOJ indirectly owns. Hiroshi Gunji, Kazuki Miura, and Yuan Yuan estimated that in 2014, indirect ownership in some companies rose to six percent of the number of shares issued. See Gunji, Miura, and Yuan (n 98) 1.

¹⁰³ The Asahi Shinbun, ‘2 Public Entities Hold Large Stakes in 84% of Firms Listed on TSE’ (2020) <https://www.asahi.com/ajw/articles/13863217> accessed 15 September 2022. See also Seki (n 84) 427 (indicating that the GPIF is most likely using the *sai-shintaku* to purchase their ETFs).

¹⁰⁴ Anna Kitakana, ‘BOJ Seen Quietly Snapping Up Big Stakes in Japan Inc. via ETFs’ (2016) <https://www.japantimes.co.jp/news/2016/04/25/business/boj-seen-quietly-snapping-big-stakes-japan-inc-via-etfs/> accessed 15 September 2022; Cf Go and Yamada (n 98) 1 n. 4 (showing that 80% of the ETFs is owned by the BOJ).

¹⁰⁵ Nikkei Indexes, ‘Components: Nikkei Stock Average (Nikkei 225)’ <https://indexes.nikkei.co.jp/en/nkave/index/component> accepted 15 September 2022.

¹⁰⁶ Kitakana (n 104).

¹⁰⁷ Go and Yamada (n 98) 12.

¹⁰⁸ Ibid 12–13.

¹⁰⁹ Ibid 13.

¹¹⁰ Among these databases, see Morningstar (<https://www.morningstar.com/>); Market Screener (<https://www.marketscreener.com/>); Financial Times (<https://markets.ft.com/data/equities>). For example, using the latter database, the following picture can be drawn about the shareholding of major Japanese asset management companies in the major construction industry firms: Nomura Asset Management (Taisei 5.7%; Shimizu 3.8%; Obayashi 5%; Kajima 4.95%); Sumitomo Mitsui Asset Management (Taisei 3.3%; Shimizu [missing %?]; Obayashi 3.3%; Kajima 3.3%); Nikko Asset Management (Taisei 1.9%; Shimizu 1.8%; Obayashi 2.1%; Kajima 1.8%); Daiwa Asset Management (Taisei 2.3%; Shimizu 1.7%; Obayashi 2%; Kajima 1.6%).

5. COMMON OWNERSHIP: A PARADOX IN JAPAN'S CORPORATE GOVERNANCE?

In the Japanese corporate governance literature, the described evolution has been largely disregarded. This literature primarily emphasizes the increased prominence of institutional investors within Japan's shareholding structure and elaborates on their potential influence on corporate governance. The focus is on how institutional investors could shift managers' attention from long-term economic growth strategies to short-term profit strategies. It was anticipated that these investors might, without hesitation, voice their concerns or sell their stakes in the company, with the worst-case scenario being a decline in share prices, rendering the company vulnerable to a hostile takeover. In essence, institutional investors were expected to no longer behave as stable shareholders but rather to "increase large firms' sensitivity to profit measures, efficiency, and competitiveness."¹¹¹

There has been ongoing discussion about whether these expectations materialized. The unwinding of cross-shareholding did not reach the extent anticipated. From 2005, it was evident that banks withdrew their shareholdings in keiretsu companies, but this was not necessarily the case for non-financial keiretsu companies. These companies maintained stable cross-shareholding levels.¹¹² Gen Goto acknowledged this evolution but nuanced it. While recognizing a temporary return to cross-shareholding around 2005, he emphasized the need to differentiate between large listed companies and small to medium-sized listed companies.¹¹³ Cross-shareholding remained present in the latter type of companies and thus still significantly influences the corporate governance of those companies. It is common to observe that cross-shareholding companies are inclined to maintain business relationships and support incumbent management.¹¹⁴

Contrastingly, the corporate governance of large listed companies is more impacted by institutional investors. Finance scholars concluded that the higher the share of foreign institutional investors in a company, the greater the return on assets generated.¹¹⁵ Similar conclusions were drawn for the presence of domestic institutional investors.¹¹⁶ Presented with these findings, Goto questioned whether the higher returns resulted from a disciplinary effect on management or if the investors had superior skills in predicting which companies would outperform others. The study found no conclusive evidence for either alternative explanation or any reason to exclude one over the other. Goto suggested that, at least theoretically, it is plausible that institutional investors have a disciplinary effect on management.¹¹⁷ Hidefusa Iida agreed that different answers could be given regarding why companies with foreign institutional investors perform better in terms of return on assets or equity,¹¹⁸ prompting a call

¹¹¹ Schaede (n 8).

¹¹² Pejović (n 5) 130–131.

¹¹³ Gen Goto, 'Legally "Strong" Shareholders of Japan' (n 5) 145.

¹¹⁴ *Ibid* 142.

¹¹⁵ *Ibid* 155.

¹¹⁶ *Ibid* 156.

¹¹⁷ *Ibid*.

¹¹⁸ Hidefusa Iida, 'Foreign Shareholders and Corporate Governance in Japan' (2019) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3346798 accessed 15 September 2022 (clarifying that foreign institutional investors may have a bias toward well-known and large companies but

for further empirical studies. Current empirical studies on institutional investors' impact on the corporate governance of large listed companies have predominantly focused on foreign institutional investors.¹¹⁹ Some have expanded their research scope to include domestic institutional investors, with a particular focus on the investments of one significant investor, the BOJ.¹²⁰

Some studies on the BOJ's investment impact on companies' performance found a decrease in return on assets.¹²¹ Other studies addressing corporate governance effects yielded two noteworthy conclusions.¹²² On the one hand, increased passive ownership led to the removal of antitakeover defenses, the adoption of executive stock options, a higher ratio of outside directors and female board members, a smaller board, and higher payouts.¹²³ On the other hand, it has been suggested that the positive influence on corporate governance resulted from a rule in the 2017 Stewardship Code, imposing transparency duties on passive funds.¹²⁴

The Stewardship Code in Japan was developed by the Financial Services Agency (FSA) to incentivize institutional investors to discipline the management of investee companies. Under the guidance of the FSA-established Council of Experts Concerning the Japanese Version of the Stewardship Code, principles were elaborated in 2014 to improve communication between domestic institutional investors and their investee companies. With these principles deemed insufficient, the Council of Experts mandated disclosure in 2017, requiring domestic institutional investors to reveal how they voted on each agenda item at the annual shareholding meeting.¹²⁵ The 2020 revision imposed a duty to explain the reason for votes in case of a conflict of interest between the institutional investor and investee companies.¹²⁶

equally indicating that the mere presence of these investors does not seem to trigger an improvement in corporate governance. Yet the fear of exit prompts company directors to aim for better performance).

¹¹⁹ Ibid 17.

¹²⁰ Several studies have been conducted. Some earlier studies focused on the stock prices. See Kohei Aonoa, Hiroshi Gunjib, and Hayato Nakata, 'Did the Bank of Japan's Purchases of Exchange-traded Funds Affect Stock Prices? A Synthetic Control Approach' (2021) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3786502 accessed 15 September 2022 and Hattoria and Yoshida (n 98). Subsequent studies focused on firm performance. See Gunji, Miura, and Yuan (n 98). The latest studies also include the impact of this evolution on corporate governance. See Sai and Yamada (n 98); Go and Yamada (n 98).

¹²¹ See Mitsuru Mizuno and Hajime Shimizu, 'The Influence of Institutional Investors on Corporate Governance and Firm Performance: Evidence from Japan' (2015) 3 *Kindai Management Review* 75; Miyajima and Kuroki (n 27).

¹²² See Sai and Yamada (n 98); Cadamuro (n 98); Gunji, Miura, and Yuan (n 98); Go and Yamada (n 98).

¹²³ Sai and Yamada (n 98) 29.

¹²⁴ Ibid 30.

¹²⁵ Go and Yamada (n 98) 2.

¹²⁶ Gen Goto, 'The Logic and Limits of Stewardship Codes: The Case of Japan' (2018) *The University of Tokyo Business Law Working Paper Series No. 2018-E-01*, 37 fn 144, where he states that "[f]or example, Professor Kenjiro Egashira lists the inactivity of domestic institutional investors as one of the basic foundations of the traditional Japanese corporate governance system and claims that the 2014 Reform of the Companies Act introducing the 'comply or explain' rule on the appointment of at least one outside director would fail to change the behavior of Japanese listed companies as long as domestic institutional investors stay the same". See Kenjiro Egashira,

While the Stewardship Code is considered a corporate governance instrument promoting transparency, its efficacy as a solution to the inertia of domestic institutional investors in disciplining investee company managers requires irrefutable evidence. What may be considered evidence of institutional investors encouraging managers to act for the good of the company is also used by some in the common ownership literature to argue that managers give preference to common shareholders' interests.¹²⁷ If this situation were to arise in Japan, the conclusion would be that corporate reforms facilitating institutional investors have substituted one problem with another. Cross-shareholding, identified as a cause of reduced managerial incentives for efficiency and innovative strategies, is evolving into common ownership, increasingly linked to anticompetitive outcomes or inefficient investment environments.¹²⁸

It is still too early to conclude whether the influence exerted by common owners-institutional investors in Japan is having any of the just-described consequences. Due to the lack of exact data on the spread of common ownership, one could speculate in both directions.

The need to keep close attention to common ownership lies in the phenomenon of the *keiretsu* and cross-shareholding. *Keiretsu* have been known for being active in various industries. It was not so that one *keiretsu* network concentrated in one or two industries. Competition between *keiretsu* companies in an industry was said to be fierce. Despite the competition, many of the *keiretsu* occupied industries had developed into oligopolistic markets.¹²⁹ The entry of institutional investors as common owners may aggregate the market power of the companies within the oligopolistic industries. Cross-shareholding has decreased but not vanished. Hence, the stability the existing levels of cross-shareholding offer to the management may be further fortified by the new common owners. If the cross-shareholding makes the management lazy towards competition and innovation, common owners may not induce the management "to pursue bold, long-term, or transformative investments as they are hard to evaluate and might be misperceived by shareholders as inefficient investments."¹³⁰

The relatively little attention paid to common ownership in Japan could equally be explained by characteristics of Japanese corporate governance.¹³¹ It is only recently that executive stock

Kaishaho no kaisei ni yotte nihon no kaisha ha kwaranai [Japanese Companies Would Not Change Regardless of the Companies Act Reform] (2014) 86(11) Horitsu Jiho 59, 60."

¹²⁷ Einer Elhauge, 'The Causal Mechanisms of Horizontal Shareholding' (2021) 82 Ohio State Law Journal 1, 6–23.

¹²⁸ See n 11 above. For inefficient investments, Zohar Goshen and Doron Levit, 'Common Ownership: Shareholders Win and Employees Lose' (2021) ECGI Law Working Paper N° 584/2021 9.

¹²⁹ Julie A. Shepard, 'Using United States Antitrust Laws Against the Keiretsu as a Wedge into the Japanese Market' (1993) 6 Transnat'l Law 345, 363.

¹³⁰ Zohar Goshen and Doron Levit, 'Agents of Inequality: Common Ownership and the Decline of the American Worker' (2022) 72 Duke Law Review 1, 6.

¹³¹ For an overview of the little discussion in Japan, see Noboru Kawahama, 'Kyōtsū kabunushi (common ownership) no kyōsō mondai - kōporētogabanansu to dokusen kinshi-hō no kyōtsū kawai to shite' [Competition Issues of Common Ownership—Common Challenges of Corporate Governance and the Antimonopoly Law], in Yasuhiro Ozaki, Izumi Kawashima, and Yasunobu Wakabayashi (eds), *kōkaikaisha-hō to shihon'ichiba no hōri: Uemura Tatsuo sensei koki linen* [Public Company Law and Legal Theory of Capital Markets: Professor Tatsuo Uemura's 70th Anniversary Commemoration] (Shōji Hōmu 2019) 253; Ryutaro Nakayama, Tatsuya Tsunoda, and Takuma Iwasaki, 'Common ownership o meguru shomondai - kyōsō-hō kōporēto hōsei no

options, even though inscribed in the commercial code since 1997,¹³² are increasingly implemented.¹³³ Moreover, a key element incentivizing managers to shift their attention to common owners, being industry performance executive stock option,¹³⁴ is still rare in Japan. When Hitachi implemented this kind of scheme, the Nikkei Asia reported that only a handful of companies in Japan have such a scheme.¹³⁵

6. CONCLUSION

The existence of common ownership and its potential impact in Japan have not yet been discussed. This chapter aims to be the start. In unraveling Japan's evolution toward common ownership, this chapter can only conclude that it creates a potential paradox within Japan's corporate governance.

The paradox has much to do with how corporate governance has developed in the post-war period. Competition law has long prevented Japanese companies from taking shares in each other. When it became possible, a cap was put on the percentage of shares that could be held. This led to a situation in which companies that considered themselves friendly to each other started taking shares in each other, thus establishing cross-shareholding. When the corporate governance literature considered cross-shareholding to be problematic, the Japanese legislator implemented regulatory reforms to unwind that form of shareholding. The shares that became available on the market were bought up by institutional investors.

The institutional investors do not limit their investment to a group of companies that considered themselves belonging to one network, the *keiretsu*. This results in institutional investors investing in companies that are competing with each other, thereby creating common ownership. Common ownership may not be without problems. There is growing literature suggesting that, in concentrated markets, common ownership could also lead to inefficient managerial decisions. Thus, whereas the problem of cross-shareholding may be addressed by the law reforms in Japan, another problem may have been introduced. Yet, this conclusion should include one caution: more empirical research is required to see whether any of the negative connotations of common ownership have taken root in Japan.

kanten kara' [Issues Surrounding Common Ownership—From the Perspective of Competition and Corporate Law] in Hideki Kanda and Capital Markets Research Institute (eds), *Kigyō hōsei no shōrai tenbō—shihon'ichiba seidō no kaikaku e no teigen* [Future Prospects of Corporate Legislation—Proposals for Reform of Capital Market System] (Shihon Shijō Kenkyūkai 2019) 390.

¹³² See Sadao Nagaoka, 'Determinants of the Introduction of Stock Options by Japanese Firms: Analysis from the Incentive and Selection Perspectives' (2005) 78(6) *The Journal of Business* 2289.

¹³³ Yoichiro Hiroi, 'Hitachi Links Exec Pay to Stock Gains against Siemens, Accenture: Unusual Scheme for Japan Gives Management More Skin in the Game' *Nikkei Asia* (21 June 2023), <https://asia.nikkei.com/Business/Companies/Hitachi-links-exec-pay-to-stock-gains-against-Siemens-Accenture>.

¹³⁴ Miguel Antón et al., 'Common Ownership, Competition, and Top Management Incentives' (2023) 131(5) *Journal of Political Economy* 1294.

¹³⁵ *Ibid.*