HASTINGS LAW JOURNAL
VOIR DIRE

Sustainable Capitalism: Revelations from the Japanese Model

JOEL SLAWOTSKY*

INTRODUCTION

Over the last several years, questions have been raised regarding the capitalist economic model of corporate governance in the United States. Critics of America's shareholder-centric model allege that it is archaic and a failure, and they believe that the American version of capitalism must undergo a dramatic shift toward a stakeholder-based model emulating other nations.[1] According to opponents of the shareholder-centric model, the United States must replace the motif of "shareholder profits" with "sustainable capitalism." Proponents of sustainable capitalism allege that the focus on shareholder profits leads to (1) financial scandal, (2) income inequality, (3) financial market problems, and (4) a failed economy.[2] They believe that shareholder value must yield to a sustainable capitalism which requires the interests of shareholders to yield to other stakeholder interests.[3] President Obama recently echoed the "sustainable capitalism" theme by calling for major changes that would enhance the interests of other stakeholders in order to construct an economy "built to last."[4]

---

* Former law clerk to the Honorable Charles H. Tenney of the U.S. District Court for the Southern District of New York. AV-rated attorney at Sonnenschein Nath & Rosenthal LLP (now SNR Denton). Lecturer at the IDC Radzyner Law School in Herzilya, Israel; Haim Striks Law School and College of Management Business School in Rishon L'Zion, Israel; and the Academic Center of Law and Business in Ramat Gan, Israel.

1. *See, e.g.*, Al Gore & David Blood, *A Manifesto for Sustainable Capitalism*, WALL ST. J., Dec. 14, 2011, at A21 ("Before the crisis and since, we and others have called for a more responsible form of capitalism, what we call sustainable capitalism: a framework that seeks to maximize long-term economic value by reforming markets to address real needs while integrating environmental, social and governance (ESG) metrics throughout the decision-making process.").

2. *See id.* ("We are once again facing one of those rare turning points in history when dangerous challenges and limitless opportunities cry out for clear, long-term thinking. The disruptive threats now facing the planet are extraordinary . . . poverty, . . . growing income inequality, . . . massive economic volatility and more.").

3. *See id.*

4. Carol E. Lee & Laura Meckler, *Obama Makes Populist Pitch*, WALL ST. J., Jan. 25, 2012, at A1.

The question this Essay will address is whether the economic issues blamed on the shareholder value model are unique to the U.S. brand of capitalism. Replacing America's shareholder-profits-based capitalism for a stakeholder-based model would constitute a dramatic shift in U.S. corporate governance and would emulate the governance systems found in many EU nations and Japan. However, the stakeholder model—which elevates the interests of stakeholders over shareholder profits—as practiced in many EU nations and Japan, does not inspire great confidence in its superiority.

This Essay will utilize the Japanese governance model as it provides a useful comparative illustration.[5] Unlike the United States, the Japanese model engages in a stakeholder value system wherein the interest of shareholder profits lies at the bottom.[6] As will be seen below, while the United States has its share of corporate scandal, such corporate abuse is not solely relegated to the United States but exists in Japan as well. Moreover, notwithstanding claims that a shareholder model results in income inequality, according to the Organisation for Economic Co-operation and Development, while the United States has the fifth highest household disposable income gap, Japan is close behind in sixth place.[7] In addition, despite the global economic slowdown and market volatility, the U.S. stock indexes are just slightly below record highs, while in contrast, Japan's major index is down about 80% since peaking in 1989.[8] Finally, a review of macroeconomic statistics reveals that in contrast to an ever growing—albeit at a slow pace—U.S. economy, Japan's economy has been shrinking, and its overall economic standing has slipped.[9]

Based upon the performance of equity markets as well as macroeconomic indicators, it appears that the resiliency of the U.S. economy and share prices is caused, at least in part, by superior corporate governance. In light of the calls for reforming corporate governance in the United States, attention should be focused on whether the U.S. model needs fixing or whether it continues to deliver unparalleled performance. Given that restructuring the economy to

---

5. Given the space limitations inherent in this venue, I have selected Japan to represent the stakeholder or "sustainable capitalism" model.

6. Justin Wood, *Director Duties and Creditor Protections in the Zone of Insolvency: A Comparison of the United States, Germany, and Japan*, 26 PENN ST. INT'L L. REV. 139, 160 (2007).

7. *See* ORG. FOR ECON. CO-OPERATION & DEV., ECONOMIC POLICY REFORMS: GOING FOR GROWTH 2012, at 187 fig.5.4 (2012).

8. Compare the U.S. Dow Jones Industrial Average, which peaked in 2007 at slightly over 14,000 and which stood in February 2012 at nearly 13,000 (down approximately 7% from its record high), with the Japanese Nikkei, which peaked in 1989 at almost 39,000 points and stood in February 2012—over twenty years later—at less than 10,000 points (down approximately 80%). *Dow Jones Industrial Average*, YAHOO! FIN., http://finance.yahoo.com/q/bc?s=%5EDJI&t=5y (last visited May 11, 2012); *Japanese Nikkei*, YAHOO! FIN., http://finance.yahoo.com/q/bc?s=%5EN225+Basic+Chart&t=my (last visited May 11, 2012).

9. *See infra* note 43 and accompanying text.

make it "built to last" requires lowering the value of shareholder interests, it is useful to examine whether diminishing shareholder value will improve the economy. Because Japanese corporate culture places shareholders below most or all other stakeholders, Japan serves as an excellent exemplar.

I. Japanese Corporate Governance in General

Japanese governance is marked by several qualities that corroborate and reinforce the disregard for outside shareholders.[10] Traditionally, Japanese corporate governance has been characterized by shareholder meetings that are ritualistic and devoid of meaningful discussion of the company's affairs, a reluctance to employ outside directors and an affinity towards the employment of former government regulators as directors upon retirement from governmental service, great deference to senior managers, and a reluctance to criticize other affiliated companies.[11] While many of these practices have been reduced, their existence remains and continues to impact corporate Japan.

An important characteristic of Japanese corporate governance is the existence of the Keiretsu—a system of interlocking affiliated companies whose members own shares in one another and transact business together.[12] While less extensive than in the past, the system remains a significant factor in corporate Japan. The difference manifests itself in various ways. One is reduced trading and volatility as a high percentage of shares are held by long-term investors rather than those looking for profits.[13] These long-term-oriented investors serve to entrench senior management, as a majority of equity is held in "friendly" hands.[14] The predominance of long-term investors also leads companies to prioritize their long-term interests over short-term performance, as these friendly shareholders are considered stable, long-term investors not searching for "mere profit." Of course, the system also reinforces the disregard for

---

10. Outside shareholders are owners who are not aligned with an "ally" company and who therefore are outside the group of important stakeholders, such as members of the Keiretsu group, creditors, and so forth. Caslav Pejovic, *Japanese Corporate Governance: Behind Legal Norms*, 29 Penn. St. Int'l L. Rev. 483, 490 (2011).

11. *See id.* at 495–98; *see also* Carlo Osi, *Board Reforms with a Japanese Twist: Reviewing the Japanese Board of Directors with a Delaware Lens*, 3 Brook. J. Corp. Fin. & Com. L. 325, 336, 352 (2009) ("In post-war corporate Japan, corporations are primarily managed for the stakeholders. This includes employees, banks, suppliers, customers, business partners, the community and, in some respect, shareholders. This stakeholder-oriented model is quite different from the shareholder primacy model advocated in the United States."); *Former Olympus Boss Woodford Blows Whistle on Company*, BBC News (Nov. 15, 2011), http://www.bbc.co.uk/news/15742048 ("But it's a culture of deference and sycophants and yes men. I mean in Japan people respect the position without questioning the person who takes and assumes that position.").

12. Pejovic, *supra* note 10, at 490.

13. *Id.* at 490–93.

14. *See id.* at 492–93.

individual "outside" shareholders. But again, the underlying trait is unlike America's shareholder profits model; in Japan, there is a "sustainable" economic system in which many stakeholders cooperate to advance their own interests, as opposed to serving the interest of shareholders.

II. The United States and Japan: The Key Difference Is the Esteem or Disdain for Owners

The key distinction between the U.S. and Japanese models of corporate governance is Japan's low regard for the interests of corporate owners and high regard for other stakeholders. In Japan, the interest of shareholders is at the bottom of the pyramid, while other stakeholders, such as employees, suppliers, creditors, and allied companies, all trump the interests of shareholders.[15] While this disregard for shareholders has diminished over the last several years, it remains a powerful characteristic of corporate Japan.

In Japan, values such as loyalty, honor, and fidelity are also more important than shareholder profits. But these values are applicable mainly to the relationship between the corporation and its senior managers, employees, allied companies, business partners, and other insider stakeholders; they do not apply to outsiders, nonaffiliated businesses, and owners. The corporation's owners are at the bottom of the pyramid. This model of corporate governance, which values shareholders at the lowest level of importance relative to all other stakeholders, is the antithesis of the U.S. model.

In an interview with the BBC, the former president of Olympus made these remarks underscoring the low regard of shareholders in Japan:

> Non-execs are there to hold the executive to account. They are there to look after the interests of the shareholders. Which brings me onto the shareholders. The western shareholders, the American, European, Hong Kong, they are asking me to go back, but the Japanese shareholders have not said anything.
>
> I mean the company has lost 80% of its value since I was dismissed three-and-a-half weeks ago. It has now been put on the watch list by the Tokyo Stock Exchange. It's in a critical position. But the Japanese shareholders haven't said a word—one comment by Nippon Life two weeks ago saying we would like the full facts and clarity. That's tepid. You know, it's meaningless.[16]

In contrast, shareholder performance remains the pinnacle of U.S. corporate governance. Executive pay is often tied to share performance, corporate profitability, or other measures of short-term success. While other stakeholders' interests are considered to some degree, these are subordinate to shareholder value and are tied to the corporation's self-

15. *See id.* at 490.
16. BBC News, *supra* note 11.

interest and that of its senior managers, who may be liable in the event of misconduct or of mistreatment of other stakeholders, such as shareholders, regulators, and employees.[17] Corporate social responsibility is viewed as "protective" business conduct aimed at safeguarding shareholder value. Additionally, stiff competition among companies contrasts with the Japanese Keiretsu cooperative and self-help corporate governance.

Given these differences, does the focus on shareholder performance as opposed to a sustainable stakeholder model lead to the problems pointed out by proponents of shifting the United States to a sustainable capitalism model?

III. Financial Scandal

Advocates of pushing the United States towards a stakeholder-based model believe that U.S. corporate fraud stems in large part from the emphasis on shareholder profits. Yet Japan has also suffered from these corporate misadventures. Several high-profile governance failures have underscored the vulnerability of all corporate governance models.[18] The stunning admission by Olympus that it hid financial losses dating back to the 1990s exemplifies the continued failure of corporate governance in Japan. Olympus stands accused by its former (and fired) president, U.K. national Michael Woodford, of engineering a grandiose accounting fraud by paying exorbitant fees to consultants to cover up the losses.[19] According to Mr. Woodford:

> Olympus had bought a company called Gyrus for $2bn. That was a very expensive acquisition. We paid 100 times the annual profits for that company. But I found we had paid a fee of $700m and that fee had gone through the Cayman Islands. That's 36% of the value of an acquisition. Normally that type of advice if it was legitimate, would cost around 1%. So it was inexplicable.[20]

Immediately following Mr. Woodford's disclosure of the financial irregularities, the Olympus board summarily fired him.[21] Olympus has

17. For example, financial reporting irregularities most often result in the dismissal of senior managers and directors, governmental fines, and shareholder litigation. Corporate bribery and corruption may result in fines and penalties. Lawsuits may result from the production of dangerous products without adequate safety measures for employees or consumers.

18. The United States is not immune to financial scandal. For example, Enron and other large U.S. corporations have engaged in financial skullduggery. However, accounting and reporting fraud touches nations worldwide in both shareholder and stakeholder models, illustrating that the stakeholder model does not provide a defense against financial deception.

19. Tomoko Yamazaki et al., *Olympus's Possible Delisting Means "Japan Way" No Longer Acceptable Excuse*, Bloomberg (Nov. 10, 2011, 10:26 AM), http://www.bloomberg.com/news/2011-11-09/olympus-scandal-means-japan-way-no-longer-excuse.html.

20. *See* BBC News, *supra* note 11.

21. Yamazaki et al., *supra* note 19.

confessed to this misconduct and offered its apologies.[22] While the fraud itself is disturbing, even more troubling is the abject failure of the directors and auditors—the entities responsible for ensuring such fraud does not occur, to either discover or report the fraud. As Mr. Woodford noted: "What is the oversight? What are the non-execs doing? . . . So there [are] profound questions about the auditing firms in Japan, and non-executive directors were completely and utterly useless—that comment, his own admission, that he doesn't understand what's going on."[23]

The reasonable implication is that the directors and auditors were either directly participating or were aiding and abetting such conduct, or at a minimum were recklessly indifferent to the fraud's existence. The Olympus exemplar serves to corroborate the disregard for shareholders that is a feature of the Japanese stakeholder model.

Some of these governance problems can have a severe health and safety impact. For example, in the aftermath of the 2011 Japanese earthquake, the Tokyo Electric Corporation was heavily criticized for failing to make honest and timely disclosures regarding the safety of the Fukushima nuclear reactor.[24] Unfortunately, the company's conduct was entirely consistent with prior practice. The company has a history of cover-ups and has been sharply criticized for serious safety violations.[25]

Another trait of Japan's model is the culture of complicity which encourages industries to monitor themselves rather than be supervised by objective monitors which can result in cover-up.[26] One example is the whistle-blower who disclosed the cracked steam dryer at the Fukushima nuclear plant. Regulators disclosed his identity and allowed the plant's owner to oversee the problem.[27] The saga demonstrated the "collusive ties that bind the nation's nuclear power companies, regulators and politicians."[28]

---

22. OLYMPUS CORP., NOTICE CONCERNING PAST ACTIVITIES REGARDING DEFERRAL IN POSTING OF LOSSES (2011), *available at* http://www.olympus-global.com/en/corc/ir/tes/pdf/nr111108.pdf.

23. BBC NEWS, *supra* note 11.

24. *See Scandal-Ridden Energy Company Behind Japan's Nuke Crisis*, CBS NEWS (Mar. 17, 2011, 9:27 AM), http://www.cbsnews.com/stories/2011/03/17/501364/main20044198.shtml.

25. *See Heavy Fallout from Japan Nuclear Scandal*, CNN (Sept. 2, 2002, 7:52 AM), http://archives.cnn.com/2002/BUSINESS/asia/09/02/japan.tepco/index.html ("The Monday announcements came after Tokyo Electric Power Co. (TEPCO) admitted last week that it may have failed to accurately report cracks at its nuclear reactors in the late 1980s and 1990s. The company and the Japanese government are probing whether workers covered up reports of the cracks. TEPCO is suspected of falsifying 29 cases of safety repair records.").

26. *See* Martin Fackler, *Report Finds Japan Underestimated Tsunami Danger*, N.Y. TIMES, June 2, 2011, at A8 ("This seemed to repeat a widely held criticism in Japan that collusive ties between regulators and industry led to weak oversight and a failure to ensure adequate safety levels at the plant.").

27. Norimitsu Onishi & Ken Belson, *Culture of Complicity Tied to Stricken Nuclear Plant*, N.Y. TIMES, Apr. 27, 2011, at A1.

28. *See id.* ("Just as in any Japanese village, the like-minded—nuclear industry officials, bureaucrats, politicians and scientists—have prospered by rewarding one another with construction projects, lucrative

IV. Japanese Income Inequality: The Haves and the Never-Will-Haves

According to the Organisation for Economic Co-operation and Development, while the United States has the fifth highest household disposable income gap, Japan is close behind in sixth place.[29] In recent years, the income gap in Japan has been growing at a remarkably high rate, and Japan has been described as a nation of haves and "never-will-haves."[30] Japan is experiencing sharp wealth gaps and income distribution inequalities and an overall reduction of wages. While the wealthy enjoy extremely high incomes, the middle class is not doing well.[31] The number of individuals in low wage jobs is at record high levels.[32] Over two million Japanese are receiving welfare, and the poverty rate in Japan exceeds the rate in the United States.[33] Between 1997 and 2007, wages declined by roughly twenty trillion Yen (200 billion USD).[34] In contrast to the income declines among middle class and lower socioeconomic groups, the number of rich Japanese has increased every year (except for 2008) since 2001.[35] Studies indicate that a relatively small number of Japanese have a very large slice of the wealth.[36]

V. Japanese Financial Market Performance: A Twenty-Year Bear Market

The financial consequences of the failed Japanese governance structure are multiple. One manifestation of failed governance is the extremely poor performance of Japan's equity markets. Already into its third decade of dramatic under performance, the Japanese equity markets have been a dismal performer, particularly in comparison to other large economies.[37] Indeed, notwithstanding various challenges faced in recent years ranging from the subprime mortgage crisis to the EU sovereign debt crisis, the U.S. stock markets have been remarkably resilient.

---

positions, and political, financial and regulatory support. The few openly skeptical of nuclear power's safety become village outcasts, losing out on promotions and backing.").

29. Org. for Econ. Co-operation and Dev., *supra* note 7.

30. *See* Roger Pulvers, *In Disparity-Ridden Japan, Don't Mind the Gaps—Just Get out of Them*, Japan Times (Jan. 29 2012), http://www.japantimes.co.jp/text/fl20120129rp.html.

31. *See, e.g.*, *Luxury Gap: How Japan Turned into a Nation of the Haves and the Have-Nots*, Indep. (U.K.) (Feb. 6, 2008), http://www.independent.co.uk/news/world/asia/luxury-gap-how-japan-turned-into-a-nation-of-the-haves-and-the-havenots-778677.html (describing the opulent lifestyles of a small number of wealthy Japanese, in contrast to a struggling middle class).

32. Mark Schreiber, *Occupy Wall Street Resonates Within Japan*, Japan Times (Dec. 4, 2011), http://www.japantimes.co.jp/text/fd20111204bj.html.

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *See Japanese Nikkei*, *supra* note 8.

In contrast, after peaking in 1989, Japan's stock market is down by an astounding percentage. The dismal performance of the Japanese equity markets is astonishing. The Nikkei index peaked at approximately 40,000 in 1989.[38] In February 2012, it stood below 10,000.[39] This is a loss of about 80% over the long-term. While exceptions exist, generally speaking, anyone who held Japanese shares since 1989 has suffered incredible losses. In contrast, the U.S. equity markets are far above their 1989 levels.[40] Moreover, while the Japanese Nikkei is down approximately 80% from its all-time peak, the Dow Jones Industrial Average is trading about 7% below its all-time high reached in 2007.[41]

VI. JAPAN'S FAILED ECONOMY

For roughly two decades the Japanese economy has been an underperformer. Japan's macroeconomic financial performance has been lackluster and more competitive economies are racing to a higher ranking. Once hailed as the world's second largest economy with sights set on the United States, Japan has slipped behind China and is very close to slipping below India.[42] By 2001, China had overtaken Japan which fell to third-place.[43] India stands ready to overtake Japan as the Indian economy is within 5% of Japan's.[44] The Japanese real estate markets (both commercial and residential) have similarly been hard hit since peaking in 1989.[45]

Japan's macroeconomic performance has been marked by deflation, lower wages, lower corporate profits, and a low growth rate. A review of Japanese government reports demonstrates that for most of the 1990s and 2000s, Japan either experienced very low growth or an actual decline in the output of goods and services.[46] For example, Japan's GDP in 2010

---

38. *Id.*

39. *Id.*

40. *See supra* note 8.

41. *See supra* note 8.

42. *Country Comparison: GDP (Purchasing Power Parity)*, CENT. INTELLIGENCE AGENCY, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html (last visited May 11, 2012).

43. *The World FactBook: Japan*, CENT. INTELLIGENCE AGENCY, https://www.cia.gov/library/publications/the-world-factbook/geos/ja.html (last visited May 11, 2012) ("Japan in 2011 stood as the third-largest economy in the world after China, which surpassed Japan in 2001.").

44. *Id.*

45. *See* Sheldon Kasowitz & Ethan Devine, *Is America Going the Way of Japan*?, N.Y. TIMES (Dec. 19, 2011), http://www.nytimes.com/2011/12/20/opinion/is-america-going-the-way-of-japan.html ("Japan's example is chilling: Nominal G.D.P. is lower than it was in 1992, and home prices are down 60 percent from their peak and still falling. Given the size of its bubble, Japan was due a painful deleveraging, but what is truly striking is the country's inability to recover more than 20 years later.").

46. *See Chapter 3 National Accounts*, MINISTRY OF INTERNAL AFF. & COMM., STAT. BUREAU, http://www.stat.go.jp/english/data/chouki/03.htm (last visited May 11, 2012) (offering a collection of data on Japanese GDP).

was less than in 1995.[47] Finally, Japan has not escaped the debt burden facing most of the developed world.[48]

Although the U.S. economy did experience the subprime crisis as well as the effects of the EU monetary predicament, the United States has not suffered from poor economic performance. Indeed, notwithstanding the collapse of Lehman and the near failure of Citigroup and AIG, the U.S. economy has proven resilient. To be sure, real estate values have declined sharply, particularly in previously overbuilt markets, and unemployment levels are higher than average. Overall, however, the United States has avoided deflation and low economic growth. Corporate profits have been soaring and stand at record levels.[49] In dissimilarity to Japan, America's nominal GDP nearly doubled from 1995 to 2010.[50] Moreover, with a single year exception (2009), the GDP of the United States has grown every year since 1950.[51] The deep-rooted paradigm of shareholder profits has served the U.S. economy well.

Conclusion

Despite assertions to the contrary, the American brand of capitalism works. Japan's disdain for shareholder profits may be a proximate cause of the astonishingly poor performance of Japan's overall economy and equity market. Indeed, the unique brand of U.S. corporate governance focusing on shareholder value—in capable hands—is as effective an economic model as can be hoped for. In comparison with the stakeholder model of many EU member states and Japan, the U.S. economy has proven to be resilient and has delivered unrivaled equity returns to investors. In sum, America's economy is not broken and substantive changes should not be made.

---

47. *Id.*

48. Tetsushi Kajimoto et al., *Inside: Japan Slowing Wakes Up to Doomsday Debt Risk*, YAHOO! FIN. (Feb. 17, 2012, 5:23 AM), http://finance.yahoo.com/news/insight-japan-slowly-wakes-doomsday-102346025.html ("Capital flight, soaring borrowing costs, tanking currency and stocks and a central bank forced to pump vast amounts of cash into local banks—that is what Japan may have to contend with if it fails to tackle its snowballing debt.").

49. *National Income and Product Accounts*, U.S. DEP'T OF COM., BUREAU OF ECON. ANALYSIS (Dec. 22, 2011), http://www.bea.gov/newsreleases/national/gdp/2011/gdp3q11_3rd.htm.

50. *Id.*

51. *Id.*

Preferred citation for this Essay:
Joel Slawotsky, *Sustainable Capitalism: Revelations from the Japanese Model*, 2012 HASTINGS L.J. VOIR DIRE 10.