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I. Introduction

The purpose of this paper is to highlight the differences between the United States ("U.S.") and Japan's corporate governance system. A majority of this report's analysis will focus on financial regulations and Japan's *Keiretsu* system—a system of corporate entities with formal and informal relationships, held together through multiple cross-holdings of each other, often centered around a financial entity.[1]

Different ideals heavily influence each economy differently. A rigid system of corporate formality bolsters the U.S. system, crusading against conflicts of interest, holding a belief in strong antitrust laws. The Japanese system, on the other hand, is one dependent on relationship interests to provide support for one another.

The U.S. and Japan's respective laws and actions reflect the difference between the two systems. However, as Japan adapts to new global realities, it continues to place itself in the awkward position of clinging onto old systems while simultaneously trying to instill modern reforms.

1. Randall Morck, Masao Nakamura & Avil Shivdasani, *Banks, Ownership Structure, and Firm Value in Japan*, 73 J. BUS. 539, 542 (2000).

II. Legal Realities Between the Two Systems

A. Underlying U.S. Financial Regulation and Laws

> Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete—to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster.
>
> -Supreme Court Justice Thurgood Marshall.[2]

The U.S. economy is built on an economic system of free enterprise that opposes conflicts of interest. There are few areas of the U.S. economy where this is more prevalent than in the financial industry. Despite the many critiques against the industry, one cannot deny that finance remains one of the most regulated industries in the U.S.

During the presidency of Franklin D. Roosevelt, as a part of the New Deal Era, Congress passed the U.S.A Banking Act of 1933, commonly known as Glass-Steagall.[3] This legislation was in response to three successive, debilitating financial crises starting in the late nineteenth century—the Great Depression in the 1930s being especially traumatic.

Glass-Steagall's explicit intent was "[t]o provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes."[4] In doing so, Glass-Steagall separated investment banking from commercial banking, prevented commercial banks from investing in stock or equity, and created the Federal Deposit Insurance Corporation, more commonly known as FDIC.

Nearly 70 years later, in 1999 during a period of financial deregulation, Congress passed the Gramm-Leach-Bliley Act (also known as the Financial Services Modernization Act of 1999), which repealed parts of Glass-Steagall but still kept several vital provisions. Today, financial holding companies are allowed to hold both investment and commercial banks (indirectly

2. *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610, (1972). *See also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 651 (1985).

3. The Banking Act of 1933, Pub. L. No. 73-89, 48 Stat. 162.

4. *Id.*

marrying the two types of banks together again).[5] Nevertheless, the statute stating a "bank holding company or a subsidiary may not engage in, or acquire or control, directly or indirectly, voting securities or assets of a company," remains intact as a core value of today's financial sector.[6] Under specific circumstances—often in connection with bankruptcy—U.S. banks are occasionally allowed to hold securities but only temporarily.[7] In all, despite financial deregulation, the U.S. government still believes the interest of banks must be separated from the activities of other companies.

B. Underlying Japanese Financial Regulations

1. Formal Legal Standards

In direct conflict with the U.S. system, Japan allows commercial banks to own equity in other firms.[8] This system has roots in the *Zaibatsu* organizations from the Meiji Era. *Zaibatsu* organizations were created by influential families who operated large banks as control centers to manage the family's closely held corporations.[9] *Zaibatsu* banks then took the form of holding companies, similar to the *Chaebol* organizations seen in South Korea today—which include conglomerates such as Samsung, Hyundai, HK, and LG.[10] Today, Japan's *Zaibatsu* legacy lives on through the financial environment as *Keiretsu* style groups. Different from the *Zaibatsu*, *Keiretsu* corporate groups are made up of companies related through a complex web of intercorporate ownership centered around banks, but often lacking a central holding company as seen in the *Zaibatsu*.[11]

Unlike the U.S., which has prohibited banks from holding equity stakes in other firms, Japanese laws allowed banks to own up to 10% of a firm's outstanding shares until 1977.[12] In 1977, Japan passed the Japanese Anti-Monopoly Act, which lowered the equity ownership of banks to 5% of another firm's stock, but many corporate traditions and trends remained

5. Gramm–Leach–Bliley Financial Modernization Act, Pub. L. No. 106–102, § 113, 5 Stat. 1338 (1999).

6. 12 C.F.R. § 225.21 (1984).

7. Morck *supra* note 1.

8. Morck *supra* note 1.

9. *Zaibatsu*, ENCYC. BRITANNICA (Sept. 27, 2019), https://www.britannica.com/topic/zaibatsu.

10. Peter Pae, *South Korea's Chaebol*, BLOOMBERG (Aug. 29, 2019), https://www.bloomberg.com/quicktake/republic-samsung.

11. Keigo Tajima, *Keiretsu*, ENCYC. BRITANNICA (Sept. 9, 2019), https://www.britannica.com/topic/keiretsu.

12. Morck *supra* note 1.

unchanged (additionally, there still exist exceptions that allow some institutions to hold more than 5%).[13]

2. Informal Financial Regulatory Standards

While the U.S. system emphasizes a system of formal safety nets, Japan's financial sector has historically relied on informal relationships and implicit promises between governmental agencies and private banking institutions. Although Japan does have safety nets such as deposit insurance in place—similar to FDIC—Japan's financial sector relies on the public's confidence in the Ministry of Finance and the Bank of Japan to prevent any significant instability from occurring in the first place.[14]

To maintain confidence, the Japanese government's policy has been to keep the monetary environment at a level where small players can survive, and large players can thrive. Moreover, the government refuses to allow banks to fail, unless through a merger with a stronger entity.[15]

To keep small banks out of distress, the Bank of Japan has typically kept interbank interest rates low. Overall, interest rates need to be at least 0.6%-0.7% to cover the operational costs of bank branches.[16] Up until 2012, even after Japan's asset bubble burst in the 1990s, the Bank of Japan has managed to keep short-term interest rates at around 1%.[17]

In return for keeping interest rates healthy, there is an expectation that private banking institutions will take responsibility for projects they invest in. In times of distress, the Bank of Japan expects financial institutions to monitor and rescue distressed firms, even if there is no legal requirement to do so.[18] Banks are expected to provide financial support and capital to struggling businesses. In this capacity, Japanese banks take on a duty similar to *noblesse oblige*—an inferred duty of the privileged to act generously and fulfill social responsibilities towards those less privileged.

Through this social contract, private banks take on an exceptional amount of risk in both equity and debt through junior-debt, preferred shares distributions, common stock distributions, or debt for equity swaps. These

13. *Id.*

14. Curtis J. Milhaupt, *Japan's Experience with Deposit Insurance and Failing Banks: Implications for 14 Financial Regulatory Design?*, 77 WASH. U. L.Q. 399 (1999), *available at* http://openscholarship.wustl.edu/law_lawreview/vol77/iss2/4.

15. *Id.*

16. Mitsuru Obe, *Shrinking to Survive: Japan's Banks Face a Quiet Crisis*, NIKKEI ASIAN REVIEW, Feb. 21, 2018, https://asia.nikkei.com/Spotlight/Cover-Story/Shrinking-to-survive-Japan-s-banks-face-a-quiet-crisis.

17. *Id.*

18. Milhaupt, *supra* note 14, at 410.

methods essentially subordinate the bank's interest below other creditors in cases of liquidation. This is only possible in Japan because banks can take on equity stakes, and it increasingly promotes the bank's relationship as a shareholder over that of a typical creditor.

Finally, because there is (1) an expectation that private banks will bail out companies they invested in, and (2) the banks themselves will not be allowed to fail, there also exists an expectation that the government is responsible for rescuing distressed banking organizations.[19] Attempting to avoid bank failure, the Ministry of Finance has previously directed big banks to absorb or merge with distressed ones, provided government loans, and placed government officials onto the boards of troubled banks to take monitoring roles.[20] Through this informal quid-pro-quo, the Japanese government has not depended on deposit insurance as a safety net to provide financial stability (like in the U.S.). Instead, the government strives to instill financial stability by supporting the image that Japanese financial institutions are stable and too big to fail.

3. Comparative Analysis of the Japanese Regulatory System

a. U.S. Response to Financial Crisis

Japan's informal regulatory process differs significantly from the U.S. system in many ways in actual practice. During the 2008 financial crisis, the U.S. system was especially pronounced. Though the U.S. prefers major institutions not to fail—in early 2008, U.S. regulators made a deal with the U.S. Federal Reserve Bank and JP Morgan to bail out the investment banks Bear Stearns—the U.S. is ultimately willing to allow a pillar of institutional banking fail.[21] In September 2008, after failed attempts to form a rescue deal of Lehman Brothers—negotiating with Bank of America, Barclays, and Warren Buffett's Berkshire Hathaway—the U.S. allowed the fourth-largest U.S. investment bank to file for bankruptcy.[22]

In response to the financial panic that resulted from the Lehman collapse, the U.S. opted to strengthen the financial sector's safety net:

19. Garrett L. Brodeur, *Shareholders As Stakeholders: A Future Paradigm for Institutional Activism in Japan*, 27 DUKE J. COMP. & INT'L L. 291, 297 (2017).

20. Milhaupt, *supra* note 14, at 414.

21. *Bear Stearns Gets Bailout from the Federal Reserve*, CNBC, Mar. 14, 2008, https://www.cnbc.com/id/23630235.

22. Larry Elliott & Jill Treanor, *Lehman's fall to earth: the last hours of a Wall Street giant*, GUARDIAN, Sept. 3, 2009, https://www.theguardian.com/business/2009/sep/03/lehman-brothers-rescue-bid.

FDIC.[23] To ensure financial stability, the government temporarily increased FDIC insurance to cover $250,000 from $100,000 and changed coverage to include some investment products such as Money Market Funds, and Certificates of Deposit.[24] In 2010, the U.S. government made the FDIC changes permanent when President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[25]

b. Japanese Response to Financial Crisis

In a financial crisis, Japan would have likely acted differently from the U.S. Rather than allowing large institutions to fail and falling back on financial safety nets, in the past Japan has instead directed, negotiated, and coerced deals to merge distressed institutions with healthy ones. In emergencies, the government would have likely opted to pay for a bailout package itself. By showing the public that banks could never fail, Japan's government ensures a level of financial stability without depending on safety nets.

For example, in the mid-1990s, following the burst asset bubble and a weakened economy, many banks were in distress, and the previously dependable relationship between the banks and government was at risk.[26] As the economist Paul Krugman noted, the cozy relationship and expectation of bail-outs by the government had created significant "moral hazard" conflicts between the banks and the government.[27] It was around this time when the government started flexing its regulatory muscle.

In the mid-1990s, seventeen major banks remained in Japan.[28] In 1999, to shore up confidence, the Financial Supervisory Agency' ("FSA") directed several of Japan's major banks to consolidate in order to clean up and stabilize their balance sheets.[29] Such mergers included one between Chuo Trust and Mitsui Trust and another merger between Sanwa Bank and Toyo Trust.[30] The mergers upheld public confidence and prevented panic, even

23. *See* Press Release, Federal Deposit Insurance Corporation, Basic FDIC Insurance Coverage Permanently Increased to $250,000 Per Depositor (July 21, 2010), https://www.fdic.gov/news/news/press/2010/pr10161.html.

24. *Id.*

25. *Id.*

26. Brodeur, *supra* note 19, at 297.

27. *Id.*

28. *Japanese Banking: Loud and Clear*, ECONOMIST (Jan. 21, 1999), https://www.economist.com/finance-and-28economics/1999/01/21/loud-and-clear.

29. *Id.*

30. *Id.*

though Chuo, Mitsui, Sanwa, and Toyo were individually all in financial straits.

Furthermore, when it was not in the best interest of a distressed bank to merge with another, the FSA occasionally nationalized the weakened bank—as it did with Long-Term Credit Bank and Nippon Credit Bank—or it coerced banks into taking injections of public funds to stabilize its balance sheet.[31] Such forceful tactics from the government also encouraged weaker banks to find partners to merge with on their own initiative—aware that failure to act risked significant government intervention.

Fulfilling its goal to prevent a failed bank at all costs, the FSA continued to press banks to stabilize their balance sheets through the 2000s.[32] As late as 2004, the FSA's policies managed to push Mitsubishi Tokyo Financial Group and UFJ (a bank created from the merger of Sanwa Bank, Tokai Bank, and Toyo Trust & Banking) into another merger. The resulting Mitsubishi UFJ Financial Group ("MUFG") created the world's largest bank at the time—a financial giant that was once five separate banks only two decades before.[33]

c. Japan's Old System in Trouble

In recent events, the Japanese government has had issues keeping interest rates at healthy levels. In 2012, as a part of the Abenomics reforms, Prime Minister Shinzo Abe's government instructed the Bank of Japan to lower interest rates to levels below the 0.6%-0.7% level required for bank branches to remain operational.[34] In 2016, interest rates went negative.[35] Luckily, due to the banking consolidation in the 1990s and 2000s, the few remaining banks had been financially stable enough to handle the low-interest environment. However, if the current environment continues, it is unknown how long the banks will last.

The Bank of Japan has also made other uncharacteristic moves that have signaled an eroding relationship between the government and banks. While there have been some public arguments between Haruhiko Kuroda (the governor of the Bank of Japan) and MUFG President Nobuyuki Hirano, the

31. ECONOMIST, *supra* note 28.

32. *Japan's Banks: Swallow Hard*, ECONOMIST (July 15, 2004), https://www.economist.com/finance-and-economics/2004/07/15/swallow-hard.

33. *Id.*

34. Obe, *supra* note 16.

35. Jonathan Soble, *Japan's Negative Interest Rates Explained*, N.Y. TIMES (Sept. 21, 2016), www.nytimes.com/2016/09/21/business/international/japan-boj-negative-interest-rates.html.

relationship was clearly in turmoil when the Bank of Japan sidelined Hirano from being considered for a post in the Central Bank.[36]

Sidelining Hirano broke a historical tradition, leaving the Bank of Japan without a governor from a private bank for the first time. Traditionally, the Bank of Japan would alternate at least one representative between the three megabanks—MUFG, Sumitomo Mitsui Banking Corporation, and Mizuho Bank—on their Board of Governors. In prior years, Makoto Usami—the former president of MUFG—and three other Mitsubishi bank alumni served as governors for the Bank of Japan.[37]

4. Recent Regulatory Trends on Securities Regulation

Apart from banking, Japanese securities laws have also begun to change into those more reminiscent to the U.K. and the U.S. Specifically, the regulatory framework for hostile takeovers have evolved. Before this, Japan's regulatory board was very protective of its domestic industries. As outlined in the Foreign Exchange and Foreign Trade Act, "any foreign investor intending to make an 'inward and direct investment' in a Japanese corporation must notify in advance and receive permission from the Minister of Finance and any other ministry with jurisdiction over the target corporation."[38] In the act, "inward and direct investment" included any acquisition of shares in a Japanese listed corporation in which, "at least ten percent of the corporation's shares will be held by a nonresident individual after completion of the acquisition."[39] Essentially, the Japanese government put large amounts of red tape to prevent the foreign acquisition of domestic companies—making the regulatory changes in the 1990s and early 2000s particularly exciting to foreign investors.

In 1990, Japan reformed the Securities and Exchange Act, patterned after U.K. legislation to spur foreign investment.[40] Regardless, the Foreign Exchange and Foreign Trade Act has not significantly changed, and the government can still intervene in any acquisitions of 10% or above. The government's power to block deals was utilized as recently in 2008 when the government prevented a British hedge fund from taking 20% in Electric

36. Kosuke Takami, *BOJ vs. Mitsubishi: Detente, or maybe not?* NIKKEI ASIAN REVIEW (Jan. 1, 2018), https://asia.nikkei.com/Economy/BOJ-vs-Mitsubishi-Detente-or-maybe-not.

37. *Id.*

38. Brodeur, *supra* note 19, at 299.

39. *Id.*

40. Dan W. Puchniak & Masafumi Nakahigashi, *The Enigma of Hostile Takeovers in Japan: Bidder Beware*, 15 BERKELEY BUS. L.J. 4, 6 (2018).

Power Development Co.[41] Fifteen years after the 1990 reforms, in 2005, the Japanese government again became more protective, issuing additional takeover guidelines that substantially incorporated Delaware jurisprudence concerning takeover defenses—notably the "poison pill."[42]

Nonetheless, with the implementation of new measures in the 1990s, there was speculation that previously protected Japanese firms would be open to hostile takeovers in a frenzy similar to that of the U.S. in the 1980s.[43] Commentators saw large amounts of value in the Japanese takeover market; as one article from the *Economist* noted, "there [were] pots of gold hidden everywhere."[44] The article cited several analysts who believed 10% of listed public companies in Japan had break-up values more than twice the current market value at the time.[45]

Furthermore, many believed that hostile takeovers would bring in other expected benefits. Such benefits included lowered shareholder-manager agency costs and the implementation of efficient corporate restructuring.[46]

However, despite overall foreign ownership of Japanese stocks increasing from 4.7% in 1990 to 29.8% in 2015,[47] Japan's "takeover-friendly" environment did not produce any significant hostile takeovers.[48] In the end, many scholars believe takeover activism to have peaked in 2008—though such activism has not yet come to a complete end.[49]

C. Understanding the Keiretsu Organizational System

1. Organization and Makeup of the Keiretsu Group

As noted before, the *Keiretsu* is a corporate group characterized by a complex web of intercorporate ownership centered around a bank.[50] It should be emphasized that despite having the same name, many *Keiretsu* related companies are independent corporate entities, not partially or wholly owned subsidiaries of each other (unlike the *Zaibatsu* or *Chaebol* model where a central holding company consolidates equity of all related companies). However, despite this fragmentation, at its height, the Tokyo

41. *Id.* at 299.
42. Brodeur, *supra* note 19, at 299.
43. Puchniak, *supra* note 40, at 13.
44. *Id.* at 6.
45. *Id.*
46. *Id.* at 11.
47. Brodeur, *supra* note 19, at 298.
48. Puchniak, *supra* note 40, at 8.
49. Brodeur, *supra* note 19, at 303.
50. Encyclopaedia Britannica, *supra* note 9.

Stock Exchange estimated that *Keiretsu* groups held 43% of the exchange's shares through cross-holdings.[51]

An example of a *Keiretsu* is the Mitsubishi group. Today, the overarching Mitsubishi name includes over 25 corporate entities that include: Mitsubishi Corp ("MC"), Mitsubishi Heavy Industries ("MHI"), MUFG, Meiji Yasuda Life Insurance Co. ("Meiji Ins."), Tokio Marine Holdings (insurance), Kirin Holdings (beer), Nikon (cameras), as well as Mitsubishi Motors ("MMC"), Chemicals, Electric, Materials, Energy, etc.[52] But despite being entirely separate entities, they each own small equity holdings of one another. For instance, approximately 12% of MHI is held between MC, MUFG, Meiji Ins., Tokyo Marine Holdings, and Mitsubishi Electric Corp—MUFG being the most significant equity holder.[53] Throughout this report, the focus will primarily concentrate on the Mitsubishi *Keiretsu*, because it is one of the most robust corporate groups, and because it has experienced many situations typically seen as a result of the *Keiretsu* system.

2. *The Keiretsu's Historical Similarities to U.S.*

The chief legal barriers separating the U.S. and Japan are the ability of banks to hold equity ownership in other firms regularly. On another note, most cross-holdings seen in Japan would be considered too insignificant and small to trigger a U.S. Williams Act's 5% disclosure requirement. The Williams Act, passed in the U.S. in the 1960s, was in response to a wave of unannounced hostile takeovers. The Act requires disclosure from anyone who holds more than 5% of outstanding shares of a corporation, an amount the U.S. government considers to be a significant level of ownership.[54]

Referring back to MHI's ownership example, the 12% stake of Mitsubishi's *Keiretsu* ownership in MHI included Meiji Ins., MC, Mitsubishi Electric, and Tokio Marine each holding 2.37%, 1.58%, 1.13%, and 0.97% respectively—all amounts the U.S. system would consider insignificant.[55] Although Japan only allows banks a maximum holding of

51. Brodeur, *supra* note 19, at 298.

52. *See* Brian Twomey, *Understanding Japanese Keiretsu*, INVESTOPEDIA (Mar. 9, 2018), https://www.investopedia.com/articles/economics/09/japanese-keiretsu.asp; *The Mitsubishi Group: All in the Family*, ECONOMIST (May. 27, 2004), https://www.economist.com/business/2004/05/27/all-in-the-family.

53. *Mitsubishi Heavy Industries Ltd*, BLOOMBERG LAW, https://www.bloomberglaw.com/company/holdings/7011 JP Equity (last visited Dec. 25, 2018).

54. James Chen, *Williams Act*, INVESTOPEDIA (Mar. 31, 2018), https://www.investopedia.com/terms/w/williamsact.asp.

55. *Mitsubishi Heavy Industries Ltd*, *supra* note 51.

5% of equity ownership, bank ownership, in conjunction with the multiplicity of cross-holdings, has drastically separated the corporate environment in Japan from the U.S.[56]

On a historical note, the difference between the U.S. and Japan has not always been so stark. In the late nineteenth century, both the U.S. and Japan were forming similar corporate groups tethered together by financial organizations. Similar to the *Zaibatsu* system, the U.S. developed groups known as "trusts," when significant U.S. banking organizations began to expand outside of finance and banking.

An example of U.S. trusts, the banker J.P. Morgan (founder of the now JP Morgan Chase) was instrumental in forming General Electric Co. and U.S. Steel.[57] The original Mellon Bank (now BNY Mellon) founded and managed what is now Alcoa (Aluminum), Gulf Oil (Chevron-Texaco), and manufacturer Westinghouse.[58] While Mellon would eventually become the U.S. Secretary of the Treasury and become ex-officio chairman of the original Federal Reserve Act, Morgan was often the target of public criticism and congressional investigations.

Following the financial crises in 1895 and 1907, Congress passed the Clayton Antitrust Act of 1914.[59] Following the Great Depression in 1929, Congress enacted Glass-Steagall in 1933.[60] The legislation passed by Congress in this period forced many trusts to break up, leading to the current U.S. economic environment today. Under this model, General Douglas MacArthur of the U.S. Army tore apart Japan's *Zaibatsu* groups in hopes of creating a similar U.S. system after WWII, forcing Japanese corporations to transition to the *Keiretsu* system to keep former corporate relationships intact.[61]

3. Personal Ties Within the Keiretsu

Despite the formal corporate relationships tethered together by cross-holdings of one another, one cannot understand the K*eiretsu* system from a

56. Morck, *supra* note 1, at 542.

57. *J.P. Morgan*, HISTORY.COM (Nov. 9, 2009), https://www.history.com/topics/19th-century/john-pierpont-morgan (last visited Dec. 25, 2018).

58. *See* Abram Brown & Alex Morrell, *175 Years Later, The Mellons Have Never Been Richer. How'd They Do It?,* FORBES (July 8, 2014), https://www.forbes.com/sites/abrambrown/2014/07/08/175-years-later-the-mellons-have-never-been-richer-howd-they-do-it/#79e815e67489; *Andrew W. Mellon*, FEDERAL RESERVE HISTORY, https://www.federalreservehistory.org/people/andrew_w_mellon (last visited Dec. 25, 2018).

59. 15 U.S.C. § 12 (2012).

60. 12 U.S.C. § 227 (1935).

61. *Yes, General*, ECONOMIST (Dec. 23, 1999), https://www.economist.com/business/1999/12/23/yes-general.

strict ownership perspective, as that is only half the story. After all, other non-Mitsubishi *Keiretsu* groups partially own MHI, and yet, ten out of its eleven board of directors are still directly related to MHI, MC, MMC, MUFG, and Tokio Marine Ins. Corp.[62] In fact, it is the informal and personal—near family-like—relationships between the executives that cement the bonds of the *Keiretsu*.

For instance, executives from different Mitsubishi corporations reportedly get together on the second Friday of every month to solidify social ties among themselves.[63] Back in 1995, when Mitsubishi Bank and Bank of Tokyo announced they were to merge into MUFG, Tsuneo Wakai, the president of Mitsubishi Bank at the time, told reporters that different bank presidents often got together in various social and drinking events.[64] It was at these events where the two bank presidents became good friends—a relationship that led both men to endorse the merger as soon as talks began.[65]

Within *Keiretsu* groups, personal ties between the executives of the related companies had guided executives and employees alike to prefer products from their own *Keiretsu* groups. Within Mitsubishi, this preference ranged from Mitsubishi steel for cars and Kirin beer at bars. While today, corporate loyalty is not as strict as it once was—for instance, in 2003, MHI's Nagasaki plant previously restricted garage spaces exclusively to Mitsubishi cars—corporate loyalties remain strong to one another.[66] Absent those personal relationships, some Japanese partnered groups or alliances have witnessed spectacular ends (discussed below in Nissan-Renault-Mitsubishi Alliance).

4. Stable Shareholders

In addition to the *Keiretsu* organizations, there is also an overarching classification known as "stable shareholders." Similar to *Keiretsu* relationships, these shareholders generally consist of, "banks, insurance companies or other nonfinancial Japanese companies that are 'typically engaged in some sort of business transaction with the issuer corporation.'"[67] Stable shareholders and *Keiretsu* ownership are not mutually exclusive, and

62. *Mitsubishi Heavy Industries Ltd*, *supra* note 51.

63. ECONOMIST, *supra* note 52.

64. Sheryl WuDunn, *International Business; Merger to Create New Japan Bank, World's Largest*, N.Y. TIMES (Mar. 29, 1995), https://www.nytimes.com/1995/03/29/us/international-business-merger-to-create-new-japan-bank-world-s-largest.html.

65. *Id.*

66. *The Mitsubishi Group: All in the Family*, *supra* note 53.

67. Puchniak, *supra* note 40, at 17.

many recognize *Keiretsu* relationships as a sub-classification of stable shareholders.

Non-*Keiretsu* stable shareholders typically hold less than 5% of outstanding shares, and the primary purpose of that ownership is to reinforce or establish a long-term relationship between the firms' management and not necessarily as an investment.[68] In doing so, when an issuing firm is under threat of a hostile takeover, the share-holding firm is more inclined to protect the current management. The protection is not merely loyalty bias, but protecting the current management is seen as being beneficial to protect current contracts and deals. Although most takeover offers hold a hefty premium, protection of current business between the two firms seems to be preferred.

In the takeover bid of an iconic Japanese brand commonly known as Bulldog sauce ("Bulldog"), the solidarity of the stable shareholders was seen in practice.[69] In 2007, a U.S. hedge fund, Steel Partners, held approximately 11% of Bulldog's shares and attempted a hostile takeover. In response, Bulldog's board set forth a vote to allow poison pill procedures to protect themselves.[70] Practically, all shareholders except for the insurgent party voted for the measures, gaining over 85% of the vote.[71] Despite the hefty premium offered, a majority of stockholders rallied around Bulldog's current management—a majority of these shareholders believed to be stable shareholders of the brand.[72]

5. Benefits of the Keiretsu System

While there are several advantages seen in the *Keiretsu* system, many of these benefits are double-edged.[73] The original purpose of the *Keiretsu* was as a defense against hostile takeovers.[74] Following the U.S. occupation and breakup of the *Zaibatsu* organizations, high-profile takeovers plagued Japan in the 50s and 60s.[75] By allowing banks to own equity in other companies, banks recreated their former *Zaibatsu* groups and directed other members to form the complex web of cross-holdings seen today. This

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. Mizuki Hayashi, *Corporate Ownership and Governance Reforms in Japan: Influence of Globalization and U.S. Practice*, 26 COLUM. J. ASIAN L. 315, 343 (2013).

74. Morck, *supra* note 1 at 541-42.

75. *Id.*

intricate web effectively protected managers from outside threats. While this is considered beneficial for the protection of corporate managers, it precludes the "shareholder-first" mentality seen in the U.S. that protects managers at the cost of proper decision-making.

Furthermore, *Keiretsu* organizations support each other to promote confidence in affiliated corporations. Essential to this support network is the banking organization. The support of the banking arm is necessary because they act as both a shareholder and creditor—which is why even a 5% ownership substantially separates the U.S. and Japanese corporate system.[76]

a. The U.S. Perspective on Creditor and Shareholder Rights

In the U.S., shareholders and creditors are two separate groups with different rights and different priorities. A shareholder will look at a company in a long-term view and may be willing to forgo today's earnings for brighter prospects in the future. A creditor, on the other hand, has a set timeframe, limited by the term set in the loan. Furthermore, a creditor only cares if earnings are plentiful and stable enough to cover the loan and interest, and therefore dislikes risky business and is willing to pursue aggressive liquidation of assets in bankruptcy or financial distress.

The U.S. tries to keep creditor and shareholder interests completely separate, preventing U.S. commercial banks from owning equity in other companies. Historically, attempts in the U.S. to blur this line have been struck down by the U.S. court system. In the 1958 case, *Costello v. Fazio*, two of three business partners, attempted to switch their equity positions into creditor positions within their failing business.[77] Using a process known as equitable insubordination, the court rearranged the debt-equity structure in bankruptcy to ensure all three business partners were liable.[78] Among other things, this case showed the court's insistence on keeping creditors and shareholders separate.

b. Japan's System of Intertwining of Creditors and Shareholders

Overall, the *Keiretsu* bank ownership system flips the U.S. system's logic on its head. By having a bank act as both a creditor and shareholder, many of the conflicts of interest between the two classes are subdued. This intertwined interest leads to several beneficial arrangements. For example, non-financial members of a *Keiretsu* sometimes have beneficial loan

76. Morck, *supra* note 1.

77. *Costello v. Fazio*, 256 F.2d 903, 910 (9th Cir. 1958).

78. *Id.*

agreements compared to that of independent businesses. While informal loyalty influences some of these benefits, there are more practical reasons why shareholding banks are willing to lend to *Keiretsu* members.

One reason for this is the greater transparency between the two corporations. Because the bank acts as both a creditor and a shareholder, the loan-taking firm is more willing to reveal the internal workings and financial information to the bank—resolving the issue of information asymmetry. Utilizing the *Keiretsu* relationship, non-banking corporations will rarely be underfinanced or undercapitalized as the *Keiretsu* bank will be willing to provide capital for a majority of reasonable projects. Thanks to this access, *Keiretsu* organizations will usually recover faster in times of economic downturns.[79] However, in the long-run, after a quick recovery, the *Keiretsu* firms' stock prices tend to stall and keep track with the overall Japanese economy.[80]

Furthermore, acting as a shareholder, banks will often choose not to pursue liquidation in troubled financial times aggressively—and, in fact, will often entrench themselves more as shareholders. In the U.S., if a company is in distress, creditors may demand the company to liquidate, even if there are promising prospects for that firm. The *Keiretsu* system will alternatively choose to provide the indebted company additional support when in financial straits, assisting in refinancing instead of liquidating.

As well as supporting internal *Keiretsu* financing, the banking organization lowers the cost of outside financing as well. When in need of financing, the *Keiretsu* bank will often act as the leading bank to create syndicates for debt financing and will act as the lead underwriter to bring in capital. Additionally, during times of financial distress, the bank will also serve as a guarantor to other creditors in order to keep interest rates subdued.[81]

For their assistance, the *Keiretsu* banks also benefit from the relationship. With increased financial transparency, banks use more accessible and reliable information to make better investment decisions. Additionally, as both a creditor and shareholder, banking institutions tend to proportionally have a more considerable influence on corporate decisions than what their limited 5% equity interest would typically imply.[82] Banks, therefore, take a more significant monitoring role of the affiliated firms, and in times of financial distress, will appoint their managers or direct other

79. Morck, *supra* note 1.

80. *MSBHF Mitsubishi Corp Stock Quote Price*, MORNINGSTAR, https://www.morningstar.com/stocks/pinx/msbhf/quote.html (last visited Dec. 25, 2018).

81. Morck, *supra* note 1, at 540.

82. Morck, *supra* note 1.

Keiretsu affiliated managers to top executive roles in the troubled firms to shift corporate strategy.

6. Downsides to the Keiretsu System

a. Corporate Entrenchment

As noted above, many of the benefits of the *Keiretsu* system can end up being a liability. One of these detriments includes overly entrenched management. The *Keiretsu* system, as an anti-takeover defense, works almost a little too well. The managers of the companies are never really under external threat and tend not to react quickly to threats compared to U.S. companies. When there is a foreign joint venture or alliance, it is more likely due to a Japanese *Keiretsu* group letting others in, instead of someone forcing themselves in from the outside.

In the U.S., one of the most effective and common takeover defenses has been the poison pill. The overall result of a poison pill defense will prevent a hostile acquisition from taking place unless the merger offer is genuinely attractive to the shareholders. Unlike *Keiretsu* solidarity—which acts as a near-absolute bar from hostile takeovers—the poison pill on its own raises the cost of the acquisitions, but it does not ultimate rule out the possibility of an acquisition or merger. Such corporate indifference to outside threats has generally been linked to lower performance.

Another example of indifferent management plaguing the old guard of the Japanese banking industry today revolves around their inability to react quickly or begin reform efforts. Failing to act earlier, large Japanese megabanks have only recently started to implement reforms in digitization and the cutting of low-performing branches.[83]

Large commercial *Keiretsu* banks, such as MUFG, Sumitomo Mitsui Banking Corporation, and Mizuho Bank, have been particularly bad in digitization. Smaller E-banks in Japan have been performing much better. In 2017, MUFG, Sumitomo and Mizuho have had approximately a 5%-7% growth in deposits, however, popular E-banks such as SBI Sumishin Net Bank (an old spun off venture between Soft Bank and Sumitomo Mitsui) and Rakuten Bank (an E-commerce company) have had growth rates of 14% and 28% respectively.[84] Furthermore, those small E-banks have been opening accounts at a rate of about 9%-12% a year.[85] These smaller banks have been able to increase their market share by keeping costs low (for instance, by not having physical branches). In doing so, the smaller banks like SBI Sumishin

83. Obe, *supra* note 16.

84. *Id.*

85. *Id.*

Net Bank have been offering fixed mortgages at rates of 1.17% while the other major banks have only been able to offer 1.28%.[86]

In another sign of the slow adaptation, we look at the closing rate of Japanese bank branches. Since 2009, the U.S. has downsized its physical branch presence, closing nearly 10,000 branches from its peak.[87] In the U.K., banks have closed physical branches at an average of 300 branches a year since the late 1980s.[88] Japan, on the other hand, in the nine years from 2007 to 2016, actually increased the number of branches and the number of employees.[89]

In 2017, the three leading Japanese banks announced plans to begin downsizing branches and cutting a total of 32,000 positions; it comes about ten years after the U.S. began doing so.[90] Furthermore, this delay in responding has come at a cost: in 2016, the return on assets ("ROA") from Japanese banks was around 0.3%, whereas the banks in "shareholder-first" regions (mostly former British dominions) such as the U.S., U.K., Australia, Hong Kong, and Singapore have had ROAs of 1.0%, 0.8%, 0.7%, 1.1%, and 0.9% respectively.[91]

b. Keiretsu Corporate Loyalty Bias

Corporate loyalty is also a positive and negative aspect of the *Keiretsu* system. Such loyalty often prevents corporations from picking the most rational or economical solution, preferring related firms instead. While all organizations around the world tend to have some level of loyalty biases, it is especially prevalent in the *Keiretsu* groups. As noted before, in the past, some Mitsubishi manufacturing plants only allowed Mitsubishi cars to park in the garage, Mitsubishi brand materials were preferred over cheaper or better alternatives, and employees were pressured into only drinking Kirin beer.[92]

Despite historically strong loyalty biases at Mitsubishi in particular, recently, these loyalties have started to wane. On a corporate level, MHI has increasingly purchased computer equipment from outsiders such as Hitachi and Toshiba over Mitsubishi Electric, individual employees no longer feel

86. *Id.*

87. *The closing of American bank branches*, ECONOMIST (July 27, 2017), https://www.economist.com/finance-and-economics/2017/07/27/the-closing-of-american-bank-branches.

88. Obe, *supra* note 16.

89. *Id.*

90. *Id.*

91. *Id.*

92. *The Mitsubishi Group: All in the Family*, *supra* note 61.

required to purchase Mitsubishi related products such as Kirin beer or Nikon cameras, and German DaimlerChrysler was allowed to take a 34% equity stake in Mitsubishi Motors.[93] Furthermore, starting with the merger of Bank of Tokyo and Mitsubishi in the 1990s, the Mitsubishi *Keiretsu's* core business allowed itself to be injected with outsiders.[94] In an increasingly competitive global economy, *Keiretsu* groups have begun to reduce loyalty biases, though not wholly.

c. Groupthink and Other Egregious Issue

Similar to other inefficiencies, cohesive *Keiretsu* ties have also led to excessive groupthink, occasionally leading to scandal and fraud. Though such cohesion allows these corporations to act uniformly, it tends to restrict their ability to evaluate their own decisions.[95] Such insider-thinking was present in the case regarding the Olympus scandal.

In 2011, Olympus appointed its very first foreign President, Michael Woodward, onto the board.[96] Woodward' then discovered several instances of financial reporting fraud regarding purchases of valueless companies and "advisory fees" to the total amount of $1.7 billion in suspicious transactions dating back to the 1990s—possibly involving even the Yakuza.[97] Woodward went to the chairman (Kikukawa), the outside auditors, the board of directors, and even to business journals looking for answers; he brought in his own forensic accountants to find the answers he sought, but to no avail—he received the silent treatment from all informed parties.[98] Six months into the job, Woodward was called into a meeting where he was unanimously sacked by the entire board of directors lead by Kikukawa.[99]

As Woodward soon realized, the board was not the only one in on it. As he went to the press, he noted how docile the politicians and regulators were as the scandal hit the news worldwide, causing the stock to drop by 80%.[100] When Woodward tried to rally stockholders to remove the board of directors, he met resistance from Olympus's *Keiretsu* group, centered around

93. *Id.*

94. *Id.*

95. Hayashi, *supra* note 70, at 334.

96. *Paying a price for doing what's right*, ECONOMIST (Nov. 24, 2012), https://www.economist.com/books-and-arts/2012/11/24/paying-a-price-for-doing-whats-right.

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

the banking giant, the Sumitomo Mitsui Banking Corporation.[101] His attempt failed miserably, and he was forced to leave Olympus.

In the end, Woodard recalls realizing that, "in everyone's eyes Mr. Kikukawa was protecting a great company and its employees without personal gain; this was a victimless accounting fudge; and after spending a decade trying to get rid of the mess, they took the bold step of choosing a foreign boss to put the company back on the right course—only to see their trust betrayed."[102] In the U.S., financial fraud is an especially egregious crime—especially after Enron, WorldCom, and the financial crisis in general—but in the eyes of Japanese managers and politicians, this cover-up was nothing but a simple misunderstanding. As the *Keiretsu* system continues to protect its own from financial distress, corporate takeovers, and even fraud, it is no surprise that outsiders have had difficulty in the Japanese takeover market.

III. Keiretsu Groups and Informal Loyalty Ties in Practice

A. The Entrenchment of Corporate Loyalties: Comparing Nissan's Alliance to Mitsubishi's

Examples of the downside of *Keiretsu* group loyalty ties can be seen in 2000 regarding Mitsubishi Motors Corporation ("MMC"). In 2000, DaimlerChrysler ("Daimler") decided to create an alliance with MMC and eventually held a 37% stake in the company.[103] This decision followed Renault's newly formed alliance with Nissan in 1999.[104]

Due to economic woes in Japan, automakers were struggling and were more willing to open themselves up to foreign alliances and cooperation. Nissan was backed by the Fuyo *Keiretsu*, which was considerably weaker than that of the Mitsubishi *Keiretsu* in terms of influence, strength, and solidarity; a factor that many contribute to Nissan's success in turning itself around, while Mitsubishi's corporate entrenchment would lead itself into a deeper pit a few years later. As a result, the Fuyo *Keiretsu's* weakness allowed Renault to take the lion's share of Nissan ownership but was able to instill painful reforms, managing to bring Nissan back to profitability.[105]

101. *Id.*

102. *Id.*

103. *The Mitsubishi Group: All in the Family*, *supra* note 53.

104. *Renault-Nissan-Mitsubishi has become the world's biggest carmaker*, ECONOMIST (Mar. 17, 2018), https://www.economist.com/business/2018/03/17/renault-nissan-mitsubishi-has-become-the-worlds-biggest-carmaker.

105. *The Mitsubishi Group: All in the Family*, *supra* note 53.

In 1999 when the Nissan-Renault alliance was formed, Nissan had net losses of ¥684 billion, debt of ¥1.3 trillion, and an operating profit margin of 1.4%.[106] However, by the end of 2001, Nissan had ¥372 billion of profit, cut its debt down approximately by two-thirds to ¥432 billion, and their operating margin increased more than five-fold to 7.9%.[107] On the other hand, Mitsubishi Motors in 2000 had a net loss of ¥279 billion,[108] and while there were encouraging signs of a ¥37 billion net profit in 2002,[109] Mitsubishi's net loss fell back down to ¥215 billion in 2003.[110]

Some blamed the Mitsubishi group's entrenchment for the lack of necessary reforms.[111] By the end of 2001 (two years after the establishment of the alliance), Nissan's nine-member board (not including outside auditors) included four non-Japanese members, including Carlos Ghosn, the president, and creator of the Nissan-Renault Alliance—requiring just one of the five Japanese member's support to make a decision.[112] MMC, on the other hand, had three non-Japanese board members out of eight—requiring the support of two of the five Japanese Mitsubishi executives to make decisions.[113]

Later in 2003, when the overall Mitsubishi group bailed out MMC (discussed below), only two out of twelve board members were non-Japanese. To emphasize this rift in relations, in the 2004 MMC annual report, there were no photos of the non-Japanese directors and their names are noticeably separated from the other highlighted Japanese board members.[114] In all, despite DaimlerChrysler holding a significant stake in Mitsubishi Motors, reform attempts were stifled by the presence of other Mitsubishi affiliated members. In contrast to Nissan's case, the lower share of Fuyo affiliated directors provided a lower level of resistance, which increased the chances for Nissan to pull off a successful turnaround.

106. Nissan Motor Co, Ltd., *Annual Report: Year Ended March 31, 2000* (2000), https://www.nissan-global.com/EN/DOCUMENT/PDF/AR/1999/ar1999.pdf.

107. Nissan Motor Co, Ltd., *Annual Report: Year Ended March 31, 2002* (2002), https://www.nissan-global.com/EN/DOCUMENT/PDF/AR/2001/ar2001.pdf.

108. *Id.*

109. Mitsubishi Motor Corporation, *Annual Report 2003: Year Ended March 31, 2003* (2003), https://www.mitsubishi-motors.com/en/corporate/ir/library/pdf/annual2003.pdf.

110. *Mitsubishi Motors Corp*, MORNINGSTAR, http://quicktake.morningstar.com/stocknet/secdocuments.aspx?symbol=7211&country=jpn (last visited Dec 25, 2018).

111. *The Mitsubishi Group: All in the Family*, *supra* note 53.

112. Nissan Motor Co, Ltd., *supra* note 107.

113. Mitsubishi Motor Corporation, *supra* note 109.

114. Mitsubishi Motor Corporation, *Annual Report 2004: Year Ended March 31, 2004* (2004), https://www.marketscreener.com/MITSUBISHI-MOTORS-CORPORA-69740/pdf/191665/Mitsubishi%20Motors%20Corporat_Annual-Report.pdf.

B. Utilization of the Keiretsu Financial Support Network

As an example of both strong *Keiretsu* solidarity but an unfavorable investment, we now look to the Mitsubishi group's bailout of MMC in 2004. After losing ¥215 billion in 2003, Daimler decided to stop supporting the failing MMC.[115] Having nowhere else to ask for assistance, MMC asked Mitsubishi's financial arm for assistance and, utilizing the *Keiretsu* organization, the whole of Mitsubishi was able to provide a support package totaling ¥210 billion. Furthermore, MUFG swapped an additional ¥130 billion of debt for equity, essentially wiping ¥130 billion worth of debt and respective interest payments off of MMC's liabilities.[116]

At this point, MMC was one of—if not the weakest of—the Mitsubishi corporations. Furthermore, many analysts and outsiders had given up on the company and expected MMC to fail. In 2004, MMC sales in the U.S. fell by 25.6%, and 38.8% in Japan. Furthermore, the 2004 sales volume in Japan was 55.4% below the sales volume of 1995, nearly ten years before and was expected to keep falling.[117] Despite the 37% stake it had at the time, Daimler decided that it was time to cut MMC off life support.

By all means, any further investment in MMC was considered a poor investment decision, and yet both a combination of formal and informal *Keiretsu* ties allowed it to survive. However, looking deeper into the underlying relationships, the decision and actions by the Mitsubishi group make much more sense.

First, despite Daimler holding a significant stake in MMC, other Mitsubishi firms still had fairly notable stakes in MMC as well. Before the bailout, MC, MHI, and MUFG held a total of 26% of MMC, with MHI holding the largest share.[118] MUFG, as the principal financing arm of Mitsubishi, took the lead on the bailout deal but did not cover everything itself. Instead, Mitsubishi tapped the existing *Keiretsu* organization for assistance. Though the rescue's share distribution was for ¥210 billion, ¥140 billion was spread between other members of the Mitsubishi groups, with MC, MHI, and MUFG each taking on ¥40 billion respectively. Furthermore, the group was able to tap its informal connections by bringing in Phoenix Capital, a venture fund started by former employees of MUFG and its

115. *The Mitsubishi Group: All in the Family*, *supra* note 53.

116. *Id.*

117. James B. Treece & Yuzo Yamaguchi, Mitsubishi's Japan sales collapse in May, AUTOMOTIVE NEWS (June 14, 2004, 1:00 AM), https://www.autonews.com/article/20040614/SUB/406140732/mitsubishi-s-japan-sales-collapse-in-may.

118. *The Mitsubishi Group: All in the Family*, *supra* note 53.

preceding bank organizations.[119] Despite not holding the formal ownership ties as the other Mitsubishi corporations had, the informal loyalty of previous employees locked in an additional ¥70 billion of capital.[120]

Regarding the form of the rescue, share distributions increased Mitsubishi's overall equity stake, further integrating the separate Mitsubishi members into MMC. These share distributions also pushed out DaimlerChrysler in the process by diluting their shares. Furthermore, not only did this increase Mitsubishi's equity stake, but by subordinating their stakes through share distributions and the utilization of a debt for equity swap, the group was able to relieve MMC's external debt pressures. By selecting this form of financing, Mitsubishi increased its investment risk but was able to provide financial relief without additional debt stress on MMC.

By increasing its equity share, Mitsubishi also began to enforce its monitoring ability, placing ten former Mitsubishi affiliated executives on the board of twelve. By 2004, MMC's board completely changed, led by Yoichiro Okazaki, a former executive of MHI.[121] Okazaki brought nine other executives from Mitsubishi affiliated industrial corporations, though a majority were from MHI.[122] In doing so—despite DaimlerChrysler still having a significant stake—the Mitsubishi group collectively hijacked operations of MMC to carry out its own reforms with the Mitsubishi *Keiretsu* support—support DaimlerChrysler had hoped for in the years before.

Ultimately, the reforms implemented by the general Mitsubishi group produced mixed results. In 2005, Yoichiro Okazaki and a few other executives resigned amid a scandal, and the Mitsubishi group companies needed to inject an additional ¥250 billion of fresh capital into MMC.[123] While the support allowed Mitsubishi to survive, MMC did not return to profitability until 2006. Moreover, while the firm was able to survive and eventually become profitable, the cash provided by the other Mitsubishi corporations could have been used more efficiently on other projects.

In the U.S., it would have been difficult to find firms willing to fund a zombie-like firm such as MMC in the early 2000s. Because U.S. banks have no equity interest, as debtors, they are more likely to ask for liquidation of assets rather than throwing life-lines to failing companies. Furthermore, because creditors and shareholders are commonly separate entities, liquidations are more likely to occur in the U.S. than to Japanese *Keiretsu*

119. *Id.*

120. *Id.*

121. Mitsubishi Motors Corporation, *supra* note 114.

122. *Id*. Mitsubishi Heavy Industries Ltd, *supra* note 53.

123. *MMC's Okazaki, other top execs to resign*, JAPAN TIMES (Jan. 23, 2005), https://www.japantimes.co.jp/news/2005/01/23/national/mmcs-okazaki-other-top-execs-to-resign/.

firms. Retailers such as Toys“R”‘Us, Sears, Sports Authority, and Circuit City are all examples of large corporations who failed to keep up with the times and were forced to liquidate their assets to cover creditor debt.[124] These liquidations have occurred without much complaint from the government and have been supported by the U.S. financial system.

Indeed, during the 1990s, following Japan’s economic bubble, many of the large *Keiretsu* banks were keeping “legions of inefficient industries and ‘zombie firms’ on life support.”[125] Furthermore, it was because of these of *Keiretsu* groups—thought to be poster-child of inefficient corporations—that many pundits believed that the securities reform in the 1990s would usher in an age of hostile corporate takeovers, similar to that in the U.S. in the 1980s.[126] However, as seen in Mitsubishi’s ability to control the board of MMC, this turned out not to be the case. As some have noted, Japan does not need hostile takeovers because the benefits of such takeovers—monitoring, financing, and corporate restructuring—are the same duties *Keiretsu* groups take when saving a distressed member, but in a manner some saw as more efficient.[127]

As noted at the beginning of this paper, Japan’s financial stability is partially based on the expectation that banks would be responsible for their investments and partner groups. Therefore, the government and Japanese society, in general, was not only willing to accept the risky, profitless steps taken by the Mitsubishi group in bailing out MMC, but rather, expected it to do so. In contrast to the U.S.’s shareholder first mentality, such investments would never have happened. Glass-Steagall was intended to “provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes.”[128] Arguably, this is precisely what Mitsubishi and MUFG had done when it invested and supported the weakened MMC.

C.Mistake of Ignoring Japanese Norms of Informal Corporate Ties

Though support from *Keiretsu* groups is considered to be an occasional cause of bad investment, failure to acknowledge the informal system of loyalty and trust is also a mistake in itself. In a separate example, we look

124. Phil Wahba & John Kell, *These Are the 10 Biggest Retail Bankruptcies of the Last Decade*, FORTUNE (Mar. 2, 2016, 10:02 AM), http://fortune.com/2016/03/02/biggest-retail-bankruptcies.

125. Puchniak, *supra* note 40, at 13.

126. *Id.*

127. Puchniak, *supra* note 40, at 11.

128. The Banking Act of 1933, Pub. L. No. 73-89, 48 Stat. 162 (1933).

to the Nissan-Renault-Mitsubishi alliance, nearly twenty years after the establishment of the original Nissan-Renault alliance. With the inclusion of MMC into the alliance in 2018, the group became the largest manufacturer and seller of cars and light vehicles in the world, edging out Volkswagen. Furthermore, by streamlining, the alliance claimed to have produced annual savings of $6.2 billion in total.[129]

Similar to *Keiretsu* style groups, the individual car companies held cross-holdings of each other. Renault owned 43% of Nissan, while Nissan owned 34% of MMC and held a 15% non-voting stake in Renault (the French government also owned 15% of Renault). In a basic sense, the alliance had some of the characteristics of a *Keiretsu*. However, Renault's ignorance of the informal social ties that held the executives of Mitsubishi together would end up putting the Nissan-Renault-Mitsubishi alliance in trouble.

Despite the ownership structure, internal relations between the firms proved to be too toxic. Several years into the Nissan-Renault alliance, it became clear that Nissan was the more successful brand. However, the slanted corporate structure between the two companies (43% stake v. 15% non-voting stake), led to negative sentiment from Nissan. This sentiment was magnified in 2015 when the French government, under the direction of then-finance minister, Emmanuel Macron, increased the French government's stake to 20% and passed a law giving the state increased voting rights.[130] Fear of Paris controlling Nissan fueled the fears of both Nissan and the Japanese government.[131]

Within the company, Nissan employees were also discouraged by the ownership structure. Japanese employees felt discriminated against, claiming they were receiving promotions at a slower rate than the non-Japanese employees.[132] Unfortunately, the alliance did not nurture the informal social ties that typically accompany a Japanese style *Keiretsu*—a system Nissan was ultimately accustomed to.

The alliance was abruptly put into chaos in November 2018 when the Japanese police—in an uncharacteristically bold move—arrested Carlos Ghosn, the former Chairman of Nissan, Chairman of Renault, and the main

129. Renault-Nissan-Mitsubishi has become the world's biggest carmaker, *supra* note 104.

130. *Id*.

131. *Id*.

132. Mark Matousek, *Nissan employees reportedly burst into applause when they learned Carlos Ghosn had been arrested*, BUS. INSIDER (Dec. 17, 2018, 8:21 AM), https://www.businessinsider.com/nissan-employees-applauded-aftercarlos-ghosn-arrest-report-2018-12.

glue holding the entire alliance together.[133] It is believed that disgruntled whistle-blowers within Nissan made the disclosures leading to Ghosn's arrest.[134] Following the arrest, Mitsubishi and Nissan quickly expelled Ghosn from their management hierarchy. Renault's ignorance of informal ties and the lack of solidarity seen in a typical *Keiretsu* is likely an underlying cause of the tension that had been building up. The rift was clearly reflected when Nissan employees were reported to have burst into applause after learning of Ghosn's arrest.[135]

IV. Conclusion and Final Words

Overall, the Japanese economic structure is still influenced by an old system of informal relationships. Furthermore, while the ability of banks to own equity ownership in other corporations seems to be the most significant legal difference between the U.S. and Japanese financial system, the informal ties built from cross-holdings are what set the two economies apart.

However, informal agreements and social contracts between the private banking sector and the government regulatory agencies—once an implicit standard—has come under stress. Continuously low interest rates have put large private banks in an insecure spot, unable to operate the way they always have, and being forced to change. Furthermore, the government's historic policy of support towards the banks is starting to falter. In doing so, private banks may soon no longer have the strength to bail out weak industries—as they have in the past—or Japan may have to begin depending more on formal safety nets such as deposit insurance.

On the other hand, allowing banks to hold equity stakes in *Keiretsu* member corporations have changed the creditor-shareholder relationship. While the U.S. system separates the two—giving each side different priorities during financial distress—Japan's system marries the two interests into one. By merging those interests, banks have a more significant monitoring role, but also puts itself at risk by pooling its capital to rescue the occasional non-performing companies.Most interesting, the informal ties between the government, banking institutions, and *Keiretsu* groups are astounding in strength, importance, and breadth of influence. Previously, the government's accommodating policy towards banking institutions—in return for the banks' duty to monitor and rescue—and the ability of the

133. Marlene Awaad, *Nissan's ex-chairman Ghosn re-arrested, chances of imminent bail dashed: media*, CNBC (Dec. 20, 2018, 9:50 PM), https://www.cnbc.com/2018/12/21/nissans-ex-chairman-carlos-ghosn-re-arrested-media.html.

134. *Id.*

135. *Id.*

Keiretsu banks to pool the collective strength of an entire group shows an astounding level of solidarity and organizational strength.

However, as seen in the Mitsubishi cases, the strength to support weak businesses, and the inability to adapt can lead to financial/investment decisions considered unprofitable or irrational. However, despite the criticisms of the loyalty systems in Japan, they remain integral for success in the Japanese business environment. As seen in the Nissan-Renault-Mitsubishi alliance, a lack of internal solidarity and relationship ties can inversely put an alliance under immense stress.

While the majority of the post-WWII financial regulatory environment and the *Keiretsu* system has brought a certain level of stability and survivability to the business enterprises in Japan, it remains to be seen if this system will remain intact following the economic woes of the financial crisis that started in 2008 which still affects Japan today. As low or negative interest rates and a division of policy complicate the relationship between government regulators and private banking institutions, it threatens to upend the long-established system. As the government reduces its support of large banking institutions, we may begin to see the end of massive *Keiretsu* bailouts similar to that seen in Mitsubishi's rescue of MMC. However, against all the odds—breakups by the U.S. military, economic bubble bursts, banking crises, scandals and the financial crisis of 2008—*Keiretsu* groups have remained resilient, begging the question, is this time really different? Perhaps it is time to stop expecting Japan's corporate culture to change and learn instead to work with it.