

Krasnow: Corporate Interdependence: The Debt and Equity Financing of Japan  
**CORPORATE INTERDEPENDENCE: THE DEBT AND EQUITY  
FINANCING OF JAPANESE COMPANIES**

MELISSA J. KRASNOW\*

I. INTRODUCTION

Corporate interdependence . . . is the fabric of industrial Japan and is manifest in the constant interaction between government authorities and business organizations, among companies, and within companies themselves.<sup>1</sup>

The interdependence between the actors in the Japanese corporate system is important in the financing of Japanese companies.<sup>2</sup> When Japanese companies need to obtain capital, these companies work together with other Japanese companies, with Japanese banks, and with the Japanese government in securing financing. Corporate interdependence is reflected in the financial relationships among Japanese companies, between Japanese companies and Japanese banks which are members of business groups, and between members of the business groups and the Japanese government.

The goal of this article is to show how Japanese companies are financed with debt and equity and how corporate interdependence facilitates the financing process. In order to discuss the context in which the financing process developed, Section II of this article describes the legal and political evolution of Japanese business groups during the twentieth century. Section III discusses how Japanese companies are financed with debt domestically, with emphasis on bank loans. Loans from Japanese banks to companies in the business groups, which are covered by loans from the Japanese government, illustrate the interdependence within business groups and between business groups and the government. Section IV explores the equity financing of Japanese companies, including the issuance of stock by Japanese companies

---

\* Member, California and Illinois bars. J.D., Northwestern University School of Law, 1992; A.B., Wellesley College, 1989. This article was prepared under the Senior Research Program at Northwestern University School of Law. The author wishes to thank Supervising Professor Philip Martin, also of Mayer, Brown & Platt in Chicago, for his excellent guidance and Professor Kenneth Abbott for his helpful comments. The author also is grateful to Mr. Katsuhiko Tsutsumi of the Tsutsumi Law Office in Fukuoka, Japan for his support and encouragement.

1. ROBERT BALLON & IWAO TOMITA, *THE FINANCIAL BEHAVIOR OF JAPANESE CORPORATIONS* 3 (1988).

2. "Japanese companies" will be used in article to refer only to *kabushiki kaisha*, which are comparable to typical public U.S. corporations. This article focuses on Japanese companies, which the Japanese Commercial Code provides for in Chapter IV of Book II. In addition to Japanese companies, Book II of the Japanese Commercial Code describes provisions for different types of Japanese partnerships—commercial partnerships (*gomei kaisha*) and limited partnerships (*goshi kaisha*) which will not be discussed in this article. Shoho, [The Commercial Code of Japan], No. 48, March 9, 1899 *translated in* 2 EIBUN HOREI SHA, E.H.S. LAW BULLETIN SERIES, JA as amended [hereinafter COMMERCIAL CODE, 2 EHSJA].

and the ownership of these shares. Reciprocal ownership of shares between Japanese companies, a significant source of equity finance, reflects the interdependence among companies.

## II. EVOLUTION OF JAPANESE BUSINESS GROUPS, 1899-1990

This section traces the legal and political evolution of business groups in Japan, from the legal beginning of the Japanese company at the beginning of this century to the present industrial groupings of Japanese companies. Tracing this evolution encompasses the growth of the Japanese economy and the recent restructuring of industry, financial liberalization, internationalization, and decline in Tokyo Stock Exchange share prices.

### A. *The Zaibatsu, 1899-1945*

The Japanese Commercial Code, enacted in 1899, legally defined the Japanese version of Western stock companies (*kaishiki kaisha*).<sup>3</sup> When combined into a single business group, these Japanese companies were known collectively as *zaibatsu*. "*Zaibatsu*" specifically refers to the large, oligopolistic business groups encompassing banks and insurance, manufacturing, and trading companies which dominated the Japanese economy until the end of World War II.<sup>4</sup>

The *zaibatsu* were hierarchical groups which depended on the many vertical and horizontal linkages between component companies for their structure.<sup>5</sup> *Zaibatsu* structural linkages consisted of a wealthy family controlling the top holding company (*honsha*), which controlled the principal operating subsidiaries of the top holding company.<sup>6</sup> The principal operating subsidiaries of the top holding company, in turn, controlled other companies through interlocking directorates or shareholdings.<sup>7</sup>

Other linkages within the *zaibatsu* included the shipping and financial institutions providing capital to the operating companies; the manufacturing companies trading among themselves; and the trading companies procuring raw materials for the manufacturing companies and selling the goods

3. The original Japanese Commercial Code was based mainly on the German code. THOMAS A. BISSON, *ZAIBATSU DISSOLUTION IN JAPAN* 29 (1954). The present Japanese Commercial Code was heavily influenced by U.S. corporation law, which was introduced during the Allied Occupation after World War II. BALLON & TOMITA, *supra* note 1, at 9.

4. RICHARD E. CAVES & MASU UEKUSA, *INDUSTRIAL ORGANIZATION IN JAPAN* 60 (1976); *See infra* note 11.

5. These characteristics of hierarchy, status, and group cooperation reflect the Japanese ideal of *oyabun-kobun*, the relationship between a leader and followers (e.g., a lord-to-vassals relationship). BISSON, *supra* note 3, at 32.

6. "Top holding company" will be in this article to refer to the *honsha*.

7. CAVES & UEKUSA, *supra* note 4. That these principal operating subsidiaries of the top holding company controlled other subsidiaries and therefore were holding companies had consequences for dissolution after World War II. To have adequate dissolution, the dissolution proceedings needed to extend to these top subsidiaries. BISSON, *supra* note 3, at 25.

produced by them on a global basis. The most important external linkages were the close links between the *zaibatsu* and the Japanese government.<sup>8</sup> The Japanese government enacted laws and employed “administrative guidance” (*gyosei shido*) to direct the *zaibatsu* in addition to giving them preferential economic treatment.<sup>9</sup> For example, the Japanese government designated certain companies as “national policy” or “special” (e.g., the Bank of Japan) and helped to vest them with capital.<sup>10</sup>

### B. Postwar Dissolution of the *Zaibatsu*, 1945-1952

Through World War II, the overall growth of the Japanese economy was due in large part to the *zaibatsu*, which dominated the economy.<sup>11</sup> However, after Japan’s defeat by the Allied Powers in World War II, industrial production was curtailed drastically by the destruction of most of Japan’s industrial base. After the war, the U.S. sought to democratize the Japanese economy and eliminate the great concentration of economic power therein by dissolving the *zaibatsu*.

In theory, dissolution was to entail the relinquishing of securities and the liquidating of assets held by the *zaibatsu*.<sup>12</sup> However, while 257 industrial firms and 68 distribution firms were targeted for reorganization initially, only 18 of these firms actually were subject to any dissolution action.<sup>13</sup> One example of such action was the dissolving of all the holding companies of the four leading *zaibatsu*—Mitsui, Mitsubishi, Sumitomo, and Yasuda. The control exercised by wealthy families over these *zaibatsu* ceased because their share and equity holdings in the holding companies were eliminated. In addition, certain financial linkages and shareholding linkages between

8. These links were both political and personal. As for political links, many representatives of the *zaibatsu* occupied positions in the upper echelons of the Japanese government (e.g., *zaibatsu* executives in the Ministry of Finance). As for personal links, there were marriages involving the families of top *zaibatsu* executives and top government officials (e.g., the marriage between a Mitsubishi executive’s son and the daughter of a Ministry of Finance official).

9. *Id.* at 13. Administrative guidance (*gyosei shido*) refers to actions by the Japanese government which are neither based on explicit law nor illegal. Such actions include the issuance of directives, requests, warnings, suggestions, and encouragements to business groups under the jurisdiction of a given ministry. Though administrative guidance was not discussed publicly until the 1960s, the Japanese government was employing it to handle the *zaibatsu* during the 1930s. JOHNSON, MITI AND THE JAPANESE MIRACLE 110, 265-66 (1982).

10. *See supra* note 8. The Japanese government gave subsidies to the *zaibatsu* in order to spur industrialization and economic development.

11. Laws promulgated during the 1930s to promote military buildup further concentrated economic power in the *zaibatsu*. HIROSHI ODA & R. GEOFFREY GRICE, JAPANESE BANKING, SECURITIES AND ANTI-MONOPOLY LAW 113 (1988). In addition, the *zaibatsu* worked with the Japanese government to run the wartime economy. At the end of World War II, the four leading *zaibatsu*—Mitsui, Mitsubishi, Sumitomo, and Yasuda—controlled approximately 25 percent of the paid-in capital of businesses incorporated in Japan. CAVES & UEKUSA, *supra* note 4, at 86.

12. T.F.M. ADAMS & IWAO HOSHII, A FINANCIAL HISTORY OF THE NEW JAPAN 23 (1972).

13. CAVES & UEKUSA, *supra* note 4, at 62.

*zaibatsu* companies were eliminated.<sup>14</sup>

In order to prevent the reemergence of a similar concentration of economic power, the Antimonopoly Law was passed in 1947.<sup>15</sup> This law, influenced largely by U.S. antitrust law, aims to promote and maintain free and fair competition and trade in the marketplace. To achieve this goal, the Antimonopoly Law covers private monopolization, unreasonable restrictions on trade, and unfair methods of trading. The Fair Trade Commission (FTC), an agency connected with the Prime Minister's office, is responsible for implementing this law.

### *C. Emergence of the Keiretsu, 1952-1957*

In spite of the Antimonopoly Law and the FTC, economic power remains concentrated among large interdependent groupings known as *sogo shosha* and *keiretsu*. After the Allied Occupation of Japan ended in 1952, some of the former *zaibatsu* trading companies started to rebuild themselves without the top holding companies. The trading companies which emerged from this rebuilding are referred to as the *sogo shosha*.<sup>16</sup> In addition, the *sogo shosha* extended their reach to exercise "quasi-control" over small and medium-sized companies by offering them assistance in finance and management.<sup>17</sup> The *sogo shosha* have multiple functions, including procuring equipment, technology, and raw material, financing trade transactions, and exporting. One of the most distinctive and important characteristics of the *sogo shosha* is that they have a global network of offices and trading contacts which make them essential players in transactions with outside business entities.<sup>18</sup> The six largest *sogo shosha* include Mitsubishi Corporation, Mitsui & Company, Sumitomo Corporation, Marubeni Corporation, C. Itoh & Company, and Nissho-Iwai.<sup>19</sup>

Furthermore, industrial groups known as *keiretsu* developed around the nucleus of a *sogo shosha* and a principal bank.<sup>20</sup> The six major *keiretsu* (with *sogo shosha* and principal bank listed in parentheses) are the Mitsubishi (Mitsubishi Corporation and Mitsubishi Bank), Mitsui (Mitsui & Company and Sakura Bank, formerly Mitsui Taiyo Kobe Bank), Sumitomo (Sumitomo Corporation and Sumitomo Bank), Fuyo (Marubeni Corporation and Fuji Bank), Dai-Ichi Kangyo (C. Itoh & Company and Dai-Ichi Kangyo Bank),

---

14. *Id.* at 63-64.

15. The Antimonopoly Law has since been amended twice—in 1953 and in 1977. Antimonopoly Law, Law No. 54, July 20, 1947, as amended [hereinafter Antimonopoly Law].

16. The organizational roots of the *sogo shosha* can be traced back to the diversified trading companies of the nineteenth century (e.g., Mitsui Bussan). Because the predominant English translation of *sogo shosha* as being a comprehensive trading firm fails to describe its many functions, the Japanese term *sogo shosha* instead will be used throughout this article.

17. M.Y. YOSHINO & THOMAS B. LIFSON, *THE INVISIBLE LINK* 29 (1986).

18. *Id.* at 22, 28, 244, 261.

19. *Id.* at 2-3.

20. CLYDE PRESTOWITZ, *TRADING PLACES* 157 (1988).

and Sanwa (Nissho-Iwai and Sanwa Bank) groups.<sup>21</sup> Each *keiretsu* also encompasses a variety of service and manufacturing firms. Service firms generally comprise insurance and shipping companies, while manufacturing firms include steel, chemical, petroleum, electrical, machinery, mining, and construction companies.<sup>22</sup>

The *keiretsu* retain such important internal linkages as business reciprocity among member companies, financial linkages, interlocking directorates, and cross-shareholdings.<sup>23</sup> While the *keiretsu* lack the “tight discipline and strict central coordination” and “degree of power and control in the Japanese economy” of the prewar *zaibatsu*, they still represent a significant concentration of economic power among larger business groups.<sup>24</sup>

Despite the concentration of economic power and the extent of cooperation within a *keiretsu*, competition among the *keiretsu* has been fierce. After World War II, tremendous opportunities for growth existed. As a result, the *keiretsu* actively pursued growth and diversification under the “one-set” policy of building a group of diversified commercial and industrial operations while excluding competitors from this group.<sup>25</sup>

#### D. Recovery and Growth of the Economy, 1950-early 1970s

Economic recovery began in 1950s. In 1950, the Korean War and the subsequent U.S. demand for military goods and services increased Japanese exports, thereby stimulating the economy. Furthermore, during the 1950s, the Japanese government promoted the development of such capital-intensive heavy industries as steel, chemicals, petroleum, and machinery by providing them with protection and incentives.<sup>26</sup>

---

21. *Id.*; Brian W. Semkow, *Japanese Banking Law: Current Deregulation and Liberalization of Domestic and External Financial Transactions*, 17 LAW & POL'Y IN INT'L BUS. 99 n.151 (1985); STEPHEN BRONTE, JAPANESE FINANCE: MARKETS AND INSTITUTIONS 252-57 (1982). Mitsui Taiyo Kobe Bank changed its name to Sakura Bank on April 1, 1992. T.R. Reid, *In Japan, Banking on a New Image*, WASH. POST, Apr. 2, 1992, at B10.

22. W. CARL KESTER, JAPANESE TAKEOVERS 54-56 (1991).

23. Through these internal linkages, companies within a *keiretsu* help each other. For example, through business reciprocity and financial linkages, these companies transact business with each other regularly and provide financing for other companies, especially those in financial trouble. *Id.* at 53, 70-71. Interlocking directorates will be discussed in Section III. *See infra* note 65. Cross-shareholding will be defined in Section IV.

24. YOSHINO & LIFSON, *supra* note 17, at 31.

25. *Id.* at 33; BALLON & TOMITA, *supra* note 1 at 9, 58.

26. In particular, the Ministry of International Trade and Industry (MITI), which devises and implements Japanese industrial and trade policies, oversaw the economic recovery and growth of postwar Japan. YOSHI TSURUMI, JAPANESE BUSINESS 63 (1978). MITI's goals for economic development during the 1950s and 1960s included encouraging the channeling of resources toward specific favored industries and promoting larger business groups in certain industries to achieve economies of scale.

One way that the target industries have pursued these goals is through mergers in which

Active government promotion resulted in tremendous capital investment in these industries. During the period between 1952 and 1973, Japanese industries periodically absorbed large amounts of capital, resulting in average annual increases in real gross domestic investment of 13 percent.<sup>27</sup> Most of this investment capital was provided by commercial banks, which, in turn, relied on the Bank of Japan (BOJ) for loans.<sup>28</sup> To a lesser extent, issues of new stock and bonds during the early 1950s helped to raise capital for Japanese industries.<sup>29</sup> By the mid-1950s, Japan's economic recovery was complete, since output in all major industries except mining was much greater than before World War II.<sup>30</sup>

During the 1950s and 1960s, the Japanese government adopted the policy goal of liberalizing foreign trade and capital transfers.<sup>31</sup> These measures led to the dramatic acceleration of Japan's export growth during the 1960s: Japanese exports quadrupled, increasing at twice the rate of world trade as a whole.<sup>32</sup> As a result, at the beginning of the 1970s, Japan had a substantial trading surplus and had one of the strongest currencies in the world.

### *E. Industrial Restructuring and Internationalization, 1970s*

The 1970s were characterized by the restructuring of Japanese industry,

---

one company absorbs another. According to Japan's Federal Trade Commission (FTC), mergers decrease domestic competition between business groups so that they can better compete against foreign business groups. CAVES & UEKUSA, *supra* note 4, at 29, 149. Competition against foreign business entities became increasingly important as restrictions on foreign business in Japan were being relaxed during the 1960s and early 1970s. PAUL NORBURY & GEOFFREY BOWNAS, *BUSINESS IN JAPAN* 39 (1974).

27. YOSHINO & LIFSON, *supra* note 17, at 25. As a result of this tremendous capital investment, Japan's gross national product (GNP) rose, on average, 10.5 percent between 1950 to 1973. Alan S. Gutterman, *Japan and Korea: Contrasts and Comparisons in Regulatory Policies of Cooperative Growth Economies*, 8 INT'L TAX & BUS. LAW. 267 (1990).

28. 80 percent of new capital was provided by commercial banks. GEORGE ALLEN, *A SHORT ECONOMIC HISTORY OF MODERN JAPAN* 191 (1972); BRONTE, *supra* note 21, at 143.

29. As for the issues of new stock, the Tokyo Stock Exchange (TSE) reopened in 1949. Japanese industries applied the funds gained from the issuance of new stock towards equipment, working capital, and the repayment of loans. ADAMS & HOSHII, *supra* note 12, at 71-72.

30. YOSHINO & LIFSON, *supra* note 17, at 25.

31. ADAMS & HOSHII, *supra* note 12, at 249. Japan took the following steps to implement this policy goal. In 1952, Japan joined the International Monetary Fund (IMF). In 1955, Japan joined the General Agreement on Tariffs and Trade (GATT). In 1959, IMF and GATT demanded that Japan have freely convertible currency and open its domestic market to foreign goods. In 1960, the Japanese government responded to these demands by adopting the "Plan for the Liberalization of Trade and Exchange." This plan laid the basis for the revised Foreign Exchange Law, which was enacted by the Diet in 1979. JOHNSON, *supra* note 9, at 220, 238; *See infra* note 36. In 1964, Japan became a member of the Organization for Economic Cooperation and Development (OECD). The OECD is composed of advanced industrialized nations "committed to not only trade liberalization but also to the removal of controls on capital transactions." JOHNSON, *supra* note 9, at 263. The IMF, GATT, and OECD all were established to advance the doctrine of free trade. PRESTOWITZ, *supra* note 20, at 230.

32. ALLEN, *supra* note 28, at 182, 201. The majority of these exports were products of heavy industry, which was dominated by the *keiretsu*. YOSHINO & LIFSON, *supra* note 17, at 28.

slower economic growth, and internationalization through the easing of restraints on foreign capital and investment. By the mid-1970s, annual economic growth in Japan slowed to 3 to 5 percent as a result of the recessions caused by two "oil shocks."<sup>33</sup> In 1974, the Ministry of International Trade and Industry (MITI) responded to this slowdown with the publication of its initial "long-term vision" of the restructuring of Japanese industry from capital-intensive heavy industries to knowledge-intensive industries.<sup>34</sup>

In addition, MITI's vision called for Japan to "internationalize" for its own sake.<sup>35</sup> This call for "internationalization" (*kokusaika*) was in response to new economic competition from such newly industrialized countries (NICs) as South Korea and laid the basis for financial liberalization in the 1980s. The most significant sign of internationalization was the Diet's enactment in 1979 of the revised Foreign Exchange Law. The Foreign Exchange Law promotes free foreign exchange and investment transactions and capital flows into and out of Japan and mandates government control over these transactions only in exceptional situations.<sup>36</sup>

#### *F. Financial Liberalization and Internationalization, 1980s*

Despite the slower annual economic growth during the 1970s, the Japanese economy finally caught up with the leading Western economies at the beginning of the 1980s. By 1980, Japan's per capita gross national product (GNP) was equivalent to that of other advanced industrial democracies (e.g., the United States and Germany).<sup>37</sup> By 1987, Japan's per capita GNP exceeded that of the United States.<sup>38</sup>

During the 1980s, the Japanese government continued to emphasize the development of knowledge-intensive industries and internationalization through the easing of restraints on foreign capital and exchange. The revised Foreign Exchange Law went into effect in 1980. In addition, the Japanese government began to emphasize the policy goal of financial liberalization by

---

33. ODA & GRICE, *supra* note 11, at 4. "Oil shocks" refers to the sudden increases in energy costs in Japan. There increases were due to the decreased supply of oil available in the world market associated with the wars in the Middle East. JOHNSON, *supra* note 9, at 297.

34. JOHNSON, *supra* note 9, at 301. Examples of knowledge-intensive industries include high-technology, computers, and other industries with high value-added potential. MITSUO MATSUSHITA & THOMAS J. SCHOENBAUM, JAPANESE INTERNATIONAL TRADE AND INVESTMENT LAW 27 (1989).

35. JOHNSON, *supra* note 9, at 301.

36. This revised law amalgamated and superseded the Foreign Exchange and Foreign Trade Law of 1949 and the Law Concerning Foreign Investment of 1950, both of which prohibited, with few exceptions, free foreign exchange and investment transactions and capital flows into and out of Japan. BRONTE, *supra* note 21, at 226.

37. JOHNSON, *supra* note 9, at 304.

38. Gutterman, *supra* note 27, at 268.

taking steps to deregulate financial markets and to internationalize the yen.<sup>39</sup> As a result of these measures, capital transactions into and out of Japan increased dramatically during the decade.<sup>40</sup>

Three steps in the 1984 Yen-Dollar Accord furthered financial liberalization—domestic interest rate deregulation, Euro-yen market deregulation, and yen internationalization.<sup>41</sup> The Yen-Dollar Accord, reached between Japan and the United States, promoted “open and liberalized capital markets and free movement of capital.”<sup>42</sup>

First, Japan agreed to deregulate interest rates domestically. The Bank of Japan deregulated the interest rate ceiling on large denomination deposits in 1985. By 1987, the minimum large denomination deposit amount exempted from interest rate regulations had been reduced from ¥1 billion to ¥100 million.<sup>43</sup> Prior to this deregulation, the Ministry of Finance kept domestic interest rates artificially low, which made the cost of raising capital relatively inexpensive for Japanese banks.<sup>44</sup> This is significant because Japanese bank loans account for the largest percentage of working and investment capital to Japanese companies.<sup>45</sup> One effect of interest rate deregulation, the increased cost of raising capital, caused stock prices to decline.<sup>46</sup>

Second, Japan agreed to deregulate Euro-yen transactions to a great extent. Specific deregulation measures included permitting both Japanese and non-Japanese banks to make Euro-yen loans to non-Japanese borrowers without restrictions and allowing both Japanese and non-Japanese companies to issue Euro-yen bonds.<sup>47</sup> Such deregulation spurred growth in the Euro-yen market.

Third, Japan agreed to internationalize the yen. The growth in the Euro-

39. KAREL VAN WOLFEREN, *THE ENIGMA OF JAPANESE POWER* 401 (1989). The aim of financial market deregulation was to transform Japan into an important global financial power by increasing the efficiency of Japan's capital markets and opening them to non-Japanese. Harold Baum, *Japanese Capital Markets: New Legislation*, 22 *LAW IN JAPAN* 1 (1989). One commentator notes: “Japan is thus following the worldwide trend . . . the so-called globalization of financial markets, toward commonality in market systems. This by no means signifies that de facto unification of laws has already been achieved. Yet one can expect that this trend will continue. . . .” *Id.* at 25.

40. Baum, *supra* note 39, at 1, 4; George Tavlas & Yuzue Ozeki, *The Internationalization of the Yen*, 28 *FIN. & DEV.* 2 (June 1991).

41. *U.S.-Japan Yen-Dollar Agreement Expected to Strengthen Japan's World Economic Role*, *INT'L TRADE REP.'S U.S. EXPORT WKLY.*, June 5, 1984 at 1012-13 [hereinafter *Yen-Dollar*]. “Euro-yen” refers to yen deposited in and managed by banks outside of Japan. Semkow, *supra* note 16, at 149.

42. ODA & GRICE, *supra* note 11, at 3.

43. *Id.* at 5. Using the recent exchange rate of ¥150 to \$1, these amounts are equal to \$6,666,666.67 and \$666,666.67, respectively.

44. *Downbeat: A Survey of Japanese Finance*, *THE ECONOMIST*, Dec. 8, 1990, 60, at 3.

45. BALLON & TOMITA, *supra* note 1, at 9. For example, in 1981, bank loans constituted roughly 73 percent of Japanese company financing. Gutterman, *supra* note 27, at 335 n.242.

46. *Downbeat*, *supra* note 44.

47. *Yen-Dollar*, *supra* note 41.



yen market, where international transactions are conducted most actively, reflected the internationalization of the yen during the 1980s. The opening of the Tokyo offshore market in 1986 also helped to increase international use of the yen. In this market, non-Japanese are exempt from certain regulations and taxes as long as they make transactions only with non-Japanese. As of 1988, the volume of this market was over 120 billion dollars.<sup>48</sup> However, despite the increased use of the yen in international transactions, yen internationalization is far from complete: the proportion of international transactions made in yen is much lower than that of currencies from such industrialized nations as the United States.<sup>49</sup>

### G. Decline in Tokyo Stock Exchange Share Prices, 1990

The circumstances which led to the steep decline in Tokyo Stock Exchange (TSE) share prices in 1990 can be traced back to the 1980s. In the 1980s, share prices rose. As Tokyo Stock Exchange share prices rose in the 1980s, assets that Japanese companies held appreciated.<sup>50</sup> Japanese companies borrowed more and more against these rising collateral values in order to purchase stock in other companies.<sup>51</sup> Japanese banks engaged in profiteering by buying and selling stock in Japanese companies as TSE share prices increased. The stock that banks held appreciated; the banks then used the increased value of this stock as collateral to lend against.<sup>52</sup>

The steep decline in Tokyo Stock Exchange share prices resulted from the "lending spree which created enormous liquidity in terms of money supply—exceeding by far the amount needed to finance real economic activity."<sup>53</sup> After soaring to an all-time high at the end of 1989, the Nikkei index of the Tokyo Stock Exchange plunged by 45 percent between February and October 1990.<sup>54</sup>

When Tokyo Stock Exchange share prices fell, the value of the collateral for existing loans was impaired. Moreover, the banks were unable

---

48. ODA & GRICE, *supra* note 11, at 10.

49. For example, in the mid-1980s, 72 percent of world reserves were held in dollars whereas just 4 percent were held in yen. *Downbeat*, *supra* note 44. Further internationalization of the yen will occur when higher proportions of the capital flows into and out of Japan are made in yen. Tavlas & Ozeki, *supra* note 40.

50. Anthony Rowley, *When the Music Stopped*, FAR EASTERN ECONOMIC REVIEW, Dec. 13, 1990, at 43.

51. *Id.*; Marshall Auerback, *Japan Inc.'s Days Are Numbered*, WALL ST. J., Sept. 3, 1991, at A18. This Japanese practice of financial speculation (*zai-teku*) will be discussed in Section IV.

52. BALLON & TOMITA, *supra* note 1, at 141-42; DANIEL BURSTEIN, YEN! 44 (1988); Rowley, *supra* note 50.

53. Rowley, *supra* note 50.

54. Using the recent exchange rate of ¥150 to \$1, this plunge is equal to \$2 billion. See *Downbeat*, *supra* note 44; Rowley, *supra* note 50.

to make further loans due to the decreased value of collateral.<sup>55</sup> In addition, this bank lending situation was aggravated by the increased cost of raising capital due to higher domestic interest rates.<sup>56</sup> In this manner, Japanese banks therefore were adversely affected by the decline in Tokyo Stock Exchange share prices.<sup>57</sup>

Consequently, a contraction in Japanese bank credit occurred. This credit crunch was worldwide because Japan was the largest net creditor nation in the world by 1985.<sup>58</sup> In response to the credit contraction, Japanese banks began to sell their stock in Japanese companies in order to meet Bank for International Settlements (BIS) capital adequacy standards.<sup>59</sup> In addition, Japanese companies started to sell stock which they held in Japanese banks.<sup>60</sup>

### III. DOMESTIC DEBT FINANCE

#### A. *The Position of Banks in the Keiretsu Structure*

The prototypical *keiretsu* structure can be viewed as a concentric enterprise circle which surrounds a core *sogo shosha*.<sup>61</sup> This circle encompasses Japanese companies that traditionally belong to the *keiretsu*, including a principal bank. Within this circle, there are financial linkages between the companies and the principal bank.

The principal bank functions as a source of finance to the companies in the circle and as a potential check upon the management of these companies.<sup>62</sup> The principal member bank engages in the former function by providing a high percentage of the capital of the *keiretsu* and implicitly

55. Auerback, *supra* note 51.

56. See *Downbeat*, *supra* note 44. The higher domestic interest rates resulted from the Bank of Japan's continual raising of interest rates. Scott Miller, *Profits Plunge at Japan's Banks*, AMERICAN BANKER, Nov. 30, 1990, at 1.

57. The Japanese banks also were hurt by problem loans. It was estimated in late 1990 that problem loans by Japanese banks for U.S. real estate transactions, leveraged buy-outs, and junk bonds totalled 8 billion dollars. Rowley, *supra* note 50, at \_\_\_\_\_. Profits at major Japanese banks decreased by more than 25 percent between April and September 1990. *Id.* These problem loans will be discussed in greater detail in Section III.

58. See Baum, *supra* note 39. Moreover, the U.S. was unable to help Japan since it also suffered a credit contraction in 1990. See *Downbeat*, *supra* note 44.

59. Since late 1987, Bank for International Settlements (BIS) international capital rules have required that banks in industrial countries maintain capital equal to at least 8 percent of total assets by the end of March 1993. See Miller, *supra* note 56.

60. *Inc.'s*, *supra* note 51.

61. This section draws heavily from the following source. NORBURY & BOWNAS, *supra* note 26, at 62-72.

62. According to the Ministry of Finance (MOF), a Japanese company is a '[subsidiary], if more than 50% of issued shares is owned by the registrant (parent), or [affiliate], if 20% or more of issued shares is owned by the registrant and thereby a major part of the business activities is under his control by uninterrupted and close relationship.' BALLON & TOMITA, *supra* note 1, at 39.

insuring against business risk.<sup>63</sup> The most important aspect of the principal member bank's financing function is the favorable treatment accorded to the Japanese companies within a given *keiretsu*. This favorable treatment entails having direct access to a bank of international stature with excellent credit ratings and being able to obtain loans otherwise not available through a variety of financing arrangements with that bank.<sup>64</sup> As for the latter function, present executives of this bank typically are dispatched to work with the management of the companies, and former (i.e., retired) executives often join these companies as presidents and directors to ensure that those in financial trouble use their capital efficiently.<sup>65</sup>

### B. "Payback Analysis" by Japanese Companies

Japanese companies each have a finance department to work with banks to obtain working capital. When the need to obtain capital arises, the capital budgeting analysis which the finance department employs is known as "payback analysis."<sup>66</sup> "Payback analysis" involves determining how many years it will take to pay off with profits the bank's loan at an arbitrarily set 10 percent interest rate.<sup>67</sup>

### C. Debt Finance through Bank Loans

Japanese companies have, on average, a debt-to-equity ratio of 2 to 1; by contrast, public U.S. corporations have, on average, a debt-to-equity ratio

63. One example of such implicit insurance against business risk is that the principal bank will step in to restructure Japanese companies within the *keiretsu* that are on the verge of bankruptcy. J. Mark Ramseyer, *Takeovers in Japan: Opportunism, Ideology and Corporate Control*, 35 UCLA L. REV. 1, 31 (1987). The Bank of Japan (BOJ) acts as a guarantor of principal bank loans to the *keiretsu*: the BOJ "will assist in a rescue if a large company gets in trouble". CAVES & UEKUSA, *supra* note 4, at 39. The Bank of Japan extends to principal banks large loans to cover the principal bank lending. BRONTE, *supra* note 21, at 143; BALLON & TOMITA, *supra* note 1, at 87.

64. One advantage of principal bank lending within a *keiretsu* is that there is an implicit guarantee that other companies in the *keiretsu* will help to rescue a principal bank in financial trouble. *Keiretsu* members mobilize in this manner to provide support for other *keiretsu* members only. BALLOON & TOMITA, *supra* note 1, at 73-74.

It is important to note that a principal bank frequently will engage in lending outside one *keiretsu* of which it is a member and possibly be a member of other *keiretsu*. NORBURY & BOWNAS, *supra* note 26, at 62. Through such diversified lending (i.e., lending inside and outside a given *keiretsu*), the principal bank spreads the risks of loan defaults among different parties. CAVES & UEKUSA, *supra* note 4, at 39.

65. The dispatching of executives from the principal bank to work with the companies is an example of interlocking directorates. BALLON & TOMITA, *supra* note 1, at 68.

66. In comparison, the finance departments of U.S. corporations use a battery of complicated financial techniques such as discounting cash flow and making assumptions about the rate of return on investment for capital budgeting analysis. RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 173 (1988); JAMES C. ABEGGLEN & GERRY STALK, JR., KAISHA, THE JAPANESE CORPORATION 178-79 (1985).

67. ABEGGLEN & STALK, *supra* note 66, at 178-79.

of 0.5 to 1.<sup>68</sup> Japanese companies tend to be highly leveraged. This primarily is because obtaining debt financing either through bank loans or domestic issues of corporate bonds is more convenient and less expensive than equity financing.<sup>69</sup>

Japanese companies can be financed with debt in the form of bank loans. These bank loans comprise the largest percentage of funds that Japanese companies use to meet working capital and investment needs.<sup>70</sup> The loans and banks are of three main types—long-term loans from long-term credit banks, short-term loans from commercial banks, and Bank of Japan loans to commercial banks.

First, there are three long-term credit banks in Japan—the Industrial Bank of Japan, the Long-Term Credit Bank, and the Nippon Credit Bank. Long-term credit banks are governed by the Long-Term Credit Bank Law of 1952.<sup>71</sup> These banks receive 70 percent of their funds from the issuance of

---

68. *Id.* at 150.

The mid-1980s the capital structure of a Japanese company, on average, is shown below:

<u>Liabilities</u>		<u>Net Worth</u>	
Current liabilities		Paid-in capital	6
Accounts payable	18	Capital surplus	4
Short-term borrowing	17	Earned surplus	12
Other	14	===	
Fixed liabilities			22 percent
Long-term borrowing	14		
Bonds	9		
Other	5		
	===		
	77 percent		

BALLON & TOMITA, *supra* note 1, at 83.

69. This is because interest rates have been kept artificially low, and interest income is taxed at a lower rate than dividends. Specifically, due to the different tax rates, dividends cost Japanese companies roughly twice as much as interest. As a result, debt financing has been the traditional method of financing the industrial sector and the growth thereof in postwar Japan. Semkow, *supra* note 21, at 95; BALLON & TOMITA, *supra* note 1, at 89-90.

70. BALLON & TOMITA, *supra* note 1, at 87-88; *see supra* note 45. By the mid-1980s, while bank loans made to large Japanese companies decreased, bank loans made to small and medium Japanese companies increased. Large companies accumulated tremendous amounts of surplus funds (e.g., retained earnings) and turned to alternative sources for financing, particularly the domestic and international issuance of securities. Semkow, *supra* note 21, at 95. As large companies began to utilize these alternative sources of finance, banks increased lending to small and medium companies. BALLON & TOMITA, *supra* note 1, at 91.

71. NORBURY & BOWNAS, *supra* note 26, at 52; ODA & GRICE, *supra* note 11, at 18. During the early 1900s, the Japanese government targeted certain sectors of the economy and created government banks to provide these sectors with long-term financing in order to promote economic growth. After World War II, the U.S. sought to prevent in postwar Japan the great concentrations of economic power characteristic of prewar Japan by encouraging Japanese companies to obtain long-term financing from the capital markets. However, because the securities markets were neither large enough nor sufficiently developed to provide long-term financing for many companies, the shift towards the capital markets and away from bank loans failed to materialize. Long-term credit banks continued to make long-term loans to Japanese companies. The Long-Term Credit Bank Law, enacted in 1952, recognized formally the existing situation of long-term finance primarily by long-term credit bank long-term loans. Long-Term Credit Bank Law, Law No. 187 of 1952. However, this situation appears to be changing

bank bonds and 5 percent from total deposits.<sup>72</sup> Long-term credit banks provide long-term loans ranging from 5 to 10 years directly to Japanese companies.<sup>73</sup> These loans often provide funds to Japanese companies in the industrial sector.<sup>74</sup>

Second, there are the commercial banks, which are composed of the 11 city banks based in large metropolitan areas and the 64 local banks located

---

gradually. Short-term loans from commercial banks are continually renewed for long-term finance. In addition, since the financial liberalization and internationalization of the 1980s, Japanese companies have been looking more than previously towards domestic and international capital markets for long-term finance. Semkow, *supra* note 21, at 107.

72. Semkow, *supra* note 21, at 102; BALLON & TOMITA, *supra* note 1, at 87.

73. Such long-term loans constitute approximately 17 percent of the financing of Japanese companies. BALLON & TOMITA, *supra* note 1, at 92-93, 102.

74. Semkow, *supra* note 21, at 102-103. Together, the Ministry of International Trade and Industry, the Ministry of Finance, the Bank of Japan, and the long-term credit banks influence the allocation of credit to Japanese companies in certain industries. MITI emphasizes the development of particular industries (e.g., knowledge-intensive industries) and facilitates this development. For example, MITI uses administrative guidance to grant tax incentives to the industries that it targets. Moreover, the long-term credit banks encourage companies in such industries to borrow funds in order to finance growth. BALLON & TOMITA, *supra* note 1, at 29. Ministry of International Trade and Industry officials also influence the industries with which they have worked closely through *amakudari* (literally translated as "descent from heaven") by working in companies in these industries after retiring from MITI. JOHNSON, *supra* note 9, at 301.

The Ministry of Finance is one of the most important ministries because of its control over the Japanese budget. Through its Budget Bureau and Financial Bureau, the Ministry of Finance controls the three yearly budgets of the Japanese executive branch—the general account, the special account, and the government investment budgets. *Id.* at 75; BALLON & TOMITA, *supra* note 1, at 33-36. In particular, the Budget Bureau determines the general account budget. The Budget Bureau receives budget requests from the various government ministries and agencies. In general, the MOF treats budget requests from the more powerful (i.e., well-connected in Japanese government and society) ministries such as MITI more favorably than those from other ministries. BRONTE, *supra* note 21, at 132. The Trust Fund Bureau of the MOF provides funds to the industrial sector through the Fiscal Investment and Loan Program (FILP). FILP receives these funds through postal deposits, pension payments, and insurance premiums. The importance of such public financial support is that it "primes" private lenders to lend since FILP funds are directed to sectors of the economy where the return on investment is expected to be high. BALLON & TOMITA, *supra* note 1, at 36-37.

In addition, the Banking Bureau of the MOF regulates most Japanese banks, including the long-term credit banks and the Bank of Japan, by monitoring the funds used by these banks. *Id.* at 129. To quote one commentator, "[The function of the Banking Bureau is comparable] to that of a franchiser. The banks . . . serve as franchisees. . . . The system endures, because the central motivation is to protect the banks' profits." VAN WOLFEREN, *supra* note 39, at 121. Furthermore, the MOF influences the long-term credit banks through *amakudari*: former MOF officials work for the long-term credit banks. BRONTE, *supra* note 21, at 137.

The BOJ influences the long-term credit banks through its determination of interest rates and its purchase of long-term credit bank bonds. Though not formally part of the Japanese government, the Bank of Japan is influenced to a great extent by the government, which owns 55 percent of the stock of the BOJ. Moreover, through *amakudari*, former MOF officials work for the Bank of Japan. *Id.* at 137, 142-43, 146.

in regional areas.<sup>75</sup> Commercial banks are governed by the Banking Law.<sup>76</sup> These banks receive more than 70 percent of their funds from yen deposits.<sup>77</sup> Commercial banks typically make short-term loans directly to Japanese companies.<sup>78</sup> These short-term loans range from 60 to 180 days.<sup>79</sup> There is an implied or express understanding between commercial banks and Japanese companies that these loans will continue to be renewed. Japanese companies continually renew these short-term loans and in effect use them for long-term finance (i.e., short-term credit rolls over into long-term credit).<sup>80</sup> These short-term commercial bank loans to Japanese companies frequently are applied toward such operational expenses as bills, wages, and taxes.<sup>81</sup>

Third, the Bank of Japan, Japan's central bank, functions "as guarantor to the commercial banks."<sup>82</sup> The Bank of Japan engages in the practice of "overloan" by providing commercial banks with "a volume of loans larger than would have been considered prudent by a private bank."<sup>83</sup> As a result

---

75. In addition to the Bank of Tokyo, the other city banks include Mitsubishi Bank, Sakura Bank, Sumitomo Bank, Fuji Bank, Dai-Ichi Kangyo Bank, Sanwa Bank, Tokai Bank, Daiwa Bank, Asahi Bank (Kyowa Bank merged with Saitama Bank to establish Kyowa Saitama Bank on April 1, 1991, which subsequently changed its name to Asahi Bank), and Hokkaido Takushoku Bank. Semkow, *supra* note 21; *Graduates Take Rites of Passage into Japanese Corporate Life*, Financial Times, April 8, 1991 at 4.

The foreign banks operating in Japan, which numbered 74 in 1983, also are considered to be commercial banks. ODA & GRICE, *supra* note 11, at 18. This article, however, focuses on the city and local banks: any reference to "commercial banks" in this article is only to these two types of commercial banks.

76. Banking Law, Law No. 59 of 1981; Semkow, *supra* note 21, at 100.

77. Semkow, *supra* note 21, at 99-100.

78. See *supra* note 74. Both the Ministry of Finance and the Bank of Japan influence commercial bank lending to a great extent. The Banking Bureau of the MOF regulates most Japanese banks, including the commercial banks and the Bank of Japan, by monitoring the funds used by these banks. BRONTE, *supra* note 21, at 129. The MOF also influences the commercial banks through *amakudari*: retired MOF officials work for the commercial banks. *Id.* at 137. The BOJ influences the commercial banks through lending to these banks, since commercial banks rely on loans from the BOJ. *Id.* at 143. In addition, the BOJ determines interest rates, which affects the cost to the commercial banks of raising capital. The cost of raising capital is related to bank lending activity. For example, when interest rates are low, the cost to the banks of raising capital is low, which tends to induce lending. On the other hand, when interest rates are high, the cost to the banks of raising capital is high, which tends to stifle lending. BALLON & TOMITA, *supra* note 1, at 31.

79. Gutterman, *supra* note 27, at 334. Such short-term loans constitute approximately 14 percent of the financing of Japanese companies. BALLON & TOMITA, *supra* note 1, at 93. The majority of the city bank loans are made to large Japanese companies whereas the majority of the local bank loans are made to smaller Japanese companies. *Id.* at 87.

80. Semkow, *supra* note 21, at 100. Such commercial bank loans to Japanese companies have been important in propelling Japan's economic growth, especially the rapid growth which occurred from the 1950s to the early 1970s. Since the financial liberalization and internationalization of the 1980s, Japanese companies have been turning to domestic and international capital markets for long-term finance in addition to commercial bank loans. Gutterman, *supra* note 27, at 334.

81. NORBURY & BOWNAS, *supra* note 26, at 61.

82. BALLON & TOMITA, *supra* note 1, at 87.

83. BRONTE, *supra* note 21, at 143.

of these Bank of Japan loans, commercial banks have been able to meet the demands of Japanese companies for funds without worrying about being rendered insolvent.<sup>84</sup> In fact, no bank has failed in postwar Japan.<sup>85</sup>

#### D. Debt Finance through Bonds

Japanese companies also can be financed with debt in the form of domestic issues of corporate bonds.<sup>86</sup> While government bonds account for the lion's share of the total bond volume on the Tokyo Stock Exchange, the long-term trend is towards expanding the volume of corporate bonds on the TSE.<sup>87</sup>

The two main types of corporate bonds are straight bonds and convertible bonds. At present, straight bonds are declining in issue while convertible bonds are increasing in issue.<sup>88</sup> Convertible bonds can be converted into shares of stock whereas straight bonds cannot be so converted.<sup>89</sup> Since 1933, the Ministry of Finance (MOF) has required issues of both convertible and straight bonds to be secured with collateral.<sup>90</sup> As part of the financial liberalization of the 1980s, the MOF relaxed this requirement. The Ministry of Finance permitted 20 companies to issue unsecured straight bonds in 1983; this number increased six-fold by 1987.<sup>91</sup> In addition, the MOF allowed 100 companies to issue unsecured convertible bonds in 1983.<sup>92</sup>

Since most Japanese companies still may issue straight bonds on a secured basis only and since these companies consider the requirement of collateral to be a hindrance, domestic issues of straight bonds decreased

---

84. NORBURY & BOWNAS, *supra* note 26, at 61-62.

85. However, on many occasions, the Ministry of Finance has had to rescue banks which were in trouble. BALLON & TOMITA, *supra* note 1, at 110.

86. In 1981, corporate bonds constituted roughly 4 percent of Japanese company financing. Gutterman, *supra* note 27, at 335; BALLON & TOMITA, *supra* note 1, at 96.

87. The first government bond issuance in postwar Japan took place in 1966. Following the oil shocks in the 1970s, government bond issuances increased. But since the financial liberalization of the 1980s, overall corporate bond issuances have increased. As of 1988, government bonds made up close to two-thirds of the total bond volume on the Tokyo Stock Exchange. BALLON & TOMITA, *supra* note 1, at 96.

88. Another type of corporate bond which has been increasing in issue, bonds with equity warrants, will not be discussed in this article because they are a very recent financial innovation—all Japanese companies have been allowed to issue these since 1985—and because they are similar in form and in terms of how they are regulated to convertible bonds. ODA & GRICE, *supra* note 11, at 72-74.

89. COMMERCIAL CODE, 2 EHSJA art. 341.7; BALLON & TOMITA, *supra* note 1, at 99.

90. ODA & GRICE, *supra* note 11, at 72. There also are collateral requirements for short-term loans from commercial banks and for long-term loans from long-term credit banks. BALLON & TOMITA, *supra* note 1, at 199; ODA & GRICE, *supra* note 11, at 30-31.

91. ODA & GRICE, *supra* note 11, at 72; BALLON & TOMITA, *supra* note 1, at 99.

92. BALLON & TOMITA, *supra* note 1, at 99.

sharply between the mid-1970s and the mid-1980s.<sup>93</sup> Meanwhile, domestic issues of convertible bonds increased dramatically because the regulations regarding the issuance thereof have been relaxed substantially.<sup>94</sup>

Largely due to the increased issuance of unsecured bonds, especially convertible bonds, overall issues of corporate bonds increased during the 1980s.<sup>95</sup> This increase in corporate bond issuance was related to the financial liberalization in the 1980s in which regulations were eased to improve the efficiency of the bond market.<sup>96</sup> As a result, the pace of bond trading in Japan was brisk during the 1980s.<sup>97</sup>

#### IV. EQUITY FINANCE AND THE TOKYO STOCK EXCHANGE

This section explores the equity financing of Japanese companies, focusing on the First Section of the Tokyo Stock Exchange.<sup>98</sup> The Tokyo Stock Exchange is the largest stock exchange in Japan and the second largest stock exchange in the world in terms of total capitalization.<sup>99</sup> This section discusses securities regulation in Japan, domestic stock issuance by Japanese companies, the ownership of Tokyo Stock Exchange shares by Japanese companies, individual investors, and foreign companies and individuals, Japanese financial speculation and the rise and fall of Tokyo Stock Exchange share prices during the 1980s.

##### A. Securities Regulation in Japan

Japan's Securities and Exchange Law (SEL), which is based on both the U.S. Securities Exchange Act of 1933 and Securities Exchange Act of 1934,

---

93. ODA & GRICE, *supra* note 11, at 70-72. Domestic issuance of straight bonds fell by more than 40 percent between 1975 and 1985. BALLON & TOMITA, *supra* note 1, at 99.

94. Domestic issues of convertible bonds increased 771 percent between 1974 and 1985. By 1985, more than 45 percent of all convertible bonds were unsecured. Reasons for this steep increase include companies being permitted to issue convertible bonds with the approval of the board of directors only and not shareholders (prior to 1974, convertible bond issuance required shareholder approval), companies being allowed to issue unsecured convertible bonds, and low interest rates. COMMERCIAL CODE, 2 EHSJA art. 341.7; ODA & GRICE, *supra* note 11, at 73; BALLON & TOMITA, *supra* note 1, at 99, 101.

95. Institutional investors in corporate bonds include the commercial banks, accounting for 20 percent, and other Japanese companies, accounting for roughly 7 percent, of total investment. BALLON & TOMITA, *supra* note 1, at 102.

96. *Id.*

97. Another reason for such brisk trading was that bonds were profitable when investors realized capital gains from selling them prior to maturity to maximize gains. Before the 1980s, investors in Japan tended to hold their bonds until maturity. *Id.* at 101-02.

98. In 1980, approximately 86 percent of all domestic transactions in stock occurred on the Tokyo Stock Exchange. BRONTE, *supra* note 21, at 173.

99. By 1989, the Tokyo Stock Exchange had emerged as the world's largest stock exchange. Since the decline in TSE share prices in 1990, the New York Stock Exchange (NYSE) reclaimed its position from the Tokyo Stock Exchange as being the largest stock exchange in the world in terms of total capitalization. See *Downbeat*, *supra* note 44; Karl Schoenberger, *Tokyo Stocks Were Due for Fall before Crisis, Analysts Say*, L.A. TIMES, Aug. 27, 1990, at D1.



was enacted in 1948 during the Allied Occupation.<sup>100</sup> The SEL governs the issuance and trading of securities on the stock exchanges in Japan, covering among other things the registration requirements for public offerings, the prohibition of certain types of equity securities transactions, and the operation of the TSE.<sup>101</sup>

The Securities Bureau of the Ministry of Finance is responsible for administering the Securities and Exchange Law.<sup>102</sup> The MOF through administrative guidance—in the forms of directives, requests, suggestions, and encouragements—regulates securities transactions, manages the day-to-day operations of the stock exchanges in Japan, and devises long-term plans for these stock exchanges.<sup>103</sup> Securities regulation issues—both civil and criminal—rarely have been interpreted judicially: the Ministry of Finance has used administrative guidance to resolve such issues so that they do not become part of the public record.<sup>104</sup>

Moreover, the obstacles to shareholders in bringing derivative lawsuits are many even though the Japanese Commercial Code describes the steps that shareholders need to take in bringing derivative lawsuits on behalf of the Japanese company against the directors.<sup>105</sup> These obstacles include the lack of a class action procedure, difficulties in the discovery of evidence, and the high monetary costs of prosecuting a civil suit in Japan.<sup>106</sup>

In sum, despite the similarities between the securities laws of the United

100. In addition, Article 65 of the Securities and Exchange Law (SEL) was based on the U.S. Glass-Steagall Act: Article 65 completely separates the securities business from the banking business by prohibiting banks from participating in any aspect of the securities business. However, in reality, this separation is not as clear: for example, a bank is permitted to own up to 5 percent of the shares in a Japanese company. Securities Exchange Law, Law No. 25 of 1948 art. 65. ODA & GRICE, *supra* note 11, at 21, 80-81; BALLON & TOMITA, *supra* note 1, at 114. The United States supported the enactment of the Securities and Exchange Law in Japan. The U.S. viewed the SEL as a means of helping to dissolve the *zaibatsu* and to democratize the Japanese capital market. Lawrence Repeta, *Declining Public Ownership of Japanese Industry: A Case of Regulatory Failure?*, 17 LAW IN JAPAN 153, 158 (1984); 5 DOING BUSINESS IN JAPAN § 1.02[1][a] (Zentaro Kitagawa gen. ed. 1989) [hereinafter DOING BUSINESS 1989].

101. In addition, to a lesser extent, Book II of the Japanese Commercial Code regulates equity securities transactions. Chapter IV of Book II contains provisions for Japanese companies such as those for the issuance of equity securities and the protection of shareholders. DOING BUSINESS 1989, *supra* note 100, at § 1.02[1][a], 1.02[1][e]; COMMERCIAL CODE, 2 EHSJA.

102. Between 1948 and 1952, Japan's Securities and Exchange Commission (SEC), an independent agency modelled on that of the United States, was responsible for implementing the Securities and Exchange Law. In 1952, the SEC in Japan was abolished and replaced by the Finance Bureau of the Ministry of Finance. In 1964, The Securities Bureau of the MOF was established to take over the securities regulation duties of the Finance Bureau. The Securities Bureau is composed of six divisions—the Coordination Division, the Capital Market Division, the Corporate Finance Division, the Trading Market Division, the Business Operations Division, and the Inspection Division. DOING BUSINESS 1989, *supra* note 100, at § 1.02[4][a], 1.02[4][b].

103. *Id.* at § 1.02[4][b].

104. The situation in the U.S. is the complete opposite of that in Japan: the civil and criminal court precedents of securities regulation issues are numerous. *Id.*

105. COMMERCIAL CODE, 2 EHSJA art. 267; Repeta, *supra* note 100, at 175.

106. Repeta, *supra* note 100, at 175.

States and Japan, the systems of securities regulation in these countries are different:

The American system is centered around an independent regulatory commission that utilizes an array of judicial and other public proceedings to implement policy and is bolstered by an active class of shareholder-litigators that also seek enforcement of various provisions of the securities laws through public proceedings. In Japan, the Securities Bureau of the Ministry of Finance occupies the central position in the regulatory system. The Bureau rarely takes any actions against specific corporations or securities companies that become a matter of public record. Similarly, shareholder recourse is rare.<sup>107</sup>

### *B. Equity Finance through Domestic Stock Issuance*

Japanese companies can raise capital through equity finance, in the form of domestic issuance of stock. As discussed earlier, Japanese companies traditionally have not relied on equity finance because debt finance has been a more convenient and less expensive way to raise capital.<sup>108</sup> As a result, Japanese companies have, on average, a debt-to-equity ratio of 2 to 1 whereas public U.S. corporations have, on average, a debt-to-equity ratio of 0.5 to 1.<sup>109</sup>

Japanese companies can issue common or preferred stock.<sup>110</sup> Most companies issue par value shares of common stock, which traditionally have been issued at a price equal to the stated par value.<sup>111</sup> The par value of shares issued upon incorporation must be at least ¥50,000: most Japanese companies listed on the TSE meet the ¥50,000 requirement by assigning a ¥50 par value to outstanding shares and counting 1,000 shares as one share unit.<sup>112</sup> Such stock may be issued in public offerings, in offerings to shareholders, and through private placements.<sup>113</sup> The trend in the 1980s was towards public offerings.<sup>114</sup>

However, when Japanese companies sought to make capital increases in the 1980s, the companies overwhelmingly chose to issue new shares at market price rather than at par value in offerings to existing shareholders.

---

107. *Id.* at 158-60.

108. Semkow, *supra* note 21, at 95; BALLON & TOMITA, *supra* note 1, at 89-90.

109. ABEGGLEN & STALK, *supra* note 66, at 150.

110. BALLON & TOMITA, *supra* note 1, at 105.

111. COMMERCIAL CODE, 2 EHSJA art. 202. By comparison, payment for shares of stock with par value in U.S. corporations tends to be greater than the par value due to the free market.

112. Shares with no par value must be issued at no less than ¥50,000. BALLON & TOMITA, *supra* note 1, at 105.

113. *Id.*

114. During the early and mid-1980s, the percentage of new stock issued in public offerings ranged between roughly 71 and 87 percent. *Id.*

ers.<sup>115</sup> Existing shareholders have preemptive rights only when the articles of incorporation provide for them.<sup>116</sup> When existing shareholders have preemptive rights, they have the option, but not the duty, to subscribe to new shares in proportion to their existing holdings in outstanding shares.<sup>117</sup> Where existing shareholders either have preemptive rights and opt out of subscribing to new shares or do not have preemptive rights, Japanese companies can issue new shares to other parties within the total number of shares authorized for issue under the articles of incorporation.<sup>118</sup>

Issuing new shares at market price rather than at par value in offerings to existing shareholders enables Japanese companies to increase equity capital.<sup>119</sup> Market price issuance also permits Japanese companies to raise the same amount of capital by issuing fewer shares than with par value issuance.<sup>120</sup> By the late 1980s, the ratio of market price shares to par value shares was 3 to 1.<sup>121</sup>

### C. Shareholding by Japanese Companies

Three main types of shareholders own the shares listed on the Tokyo Stock Exchange—Japanese companies, individual investors, and foreign companies and individuals. In 1987, Japanese companies owned about 70 percent, individual investors owned approximately 25 percent, and foreign companies and individuals owned roughly 5 percent, of the shares listed on the Tokyo Stock Exchange.<sup>122</sup>

Japanese companies own roughly 70 percent of the shares on the Tokyo Stock Exchange due to cross-shareholding.<sup>123</sup> Japanese companies generally will own equal percentages of shares in each other at an equivalent market

115. Further issuance of shares at market price began in the mid-1960s. Previously, further issues of shares had been made at par value. *Id.*

116. COMMERCIAL CODE, 2 EHSJA art. 280-2; 4 DOING BUSINESS IN JAPAN § 2.10[2] (Zentaro Kitagawa ed., 1991) [hereinafter DOING BUSINESS 1991].

117. COMMERCIAL CODE, 2 EHSJA art. 280-4, 280-5; DOING BUSINESS 1991, *supra* note 116, at § 1.06[24], 2.10[2].

118. COMMERCIAL CODE, 2 EHSJA art. 280-5; DOING BUSINESS 1991, *supra* note 116 at § 2.10[2].

119. DOING BUSINESS 1991, *supra* note 116 at § 2.10[2].

120. BALLON & TOMITA, *supra* note 1, at 107.

121. *Id.*

122. The percentage of Tokyo Stock Exchange share ownership attributed to Japanese companies includes such institutional investors as pension funds and investment trusts. *Id.* at 108, 113.

123. Paul Blustein, *Japanese Firms Confronted By Major U.S. Shareholders*, WASH. POST, July 5, 1991, at C10. Cross-shareholding between the companies within a particular *keiretsu* contributes to this high percentage of cross-shareholding of TSE shares. For example, the percentage of outstanding shares of each company in a *keiretsu* held by all the other companies in each of the six major *keiretsu* ranges between roughly 20 to 30 percent. BALLON & TOMITA, *supra* note 1, at 67.

value.<sup>124</sup> Cross-shareholding results from direct contact between officers of both companies and from securities house (*shoken gaisha*) recommendations to purchase stock in a client company.<sup>125</sup> These recommendations primarily come from four securities houses (with *keiretsu* affiliation listed in parentheses)—Nomura Securities (no affiliation), Nikko Securities (indirectly or loosely affiliated with the Mitsubishi group), Daiwa Securities (indirectly or loosely affiliated with the Sumitomo group), and Yamaichi Securities (no affiliation)—which are known collectively as the “Big Four” because they dominate the securities brokerage industry in Japan.<sup>126</sup>

There are three important consequences of cross-shareholding. First, cross-shareholding promotes stable shareholding, a situation in which the shareholders of a particular company loyally accommodate the management of this company.<sup>127</sup> Thus, stock ownership tends to be separated from management in Japanese companies.<sup>128</sup> Second, stable shareholders hold their stock indefinitely.<sup>129</sup> Through stable shareholding, roughly 60 percent of TSE shares effectively are withheld from the market; only about 40 percent of TSE shares are traded.<sup>130</sup> Because the stock market is based on fewer available shares, there are steeper stock price swings.<sup>131</sup> Third, cross-shareholding expands the shareholding structure of both companies since each company has a stake in the other company.<sup>132</sup>

One check upon cross-shareholding is the Antimonopoly Law, which restricts a financial company (e.g., bank) from holding more than 5 percent

---

124. Cross-shareholding began in order to provide support for the market when the prices of shares were deflated. BALLON & TOMITA, *supra* note 1, at 114.

125. *Id.* Since a securities brokerage firm often is referred to as a securities house (*shoken gaisha*) in Japan, the latter term will be used in this article. BRONTE, *supra* note 21, at 77.

126. BRONTE, *supra* note 21, at 77-83; KESTER, *supra* note 22, at 291; *Fat Players Face Lean Years*, FAR EASTERN ECONOMIC REVIEW, Dec. 13, 1990, at 54 [hereinafter *Fat Players*]. In 1990, the Big Four accounted for 74 percent of the underwriting business and 41 percent (65 percent when smaller brokers that the Big Four effectively control are included) of the securities brokerage business in Japan. Richard Waters, *Life in the Shadow of Deregulation*, 4 FIN. TIMES, Mar. 19, 1991, at IV.

127. Two aspects of shareholders loyally accommodating management deserve mention. The first aspect is that the shareholders are not very concerned about receiving dividends on their investment in the particular company. For example, although the average annual yield on Japanese company shares in 1986 was slightly less than 1 percent, Japanese companies continued to hold their shares. This is “the exact opposite of [the situation] found in American corporations, where the main direction of management responsibility is toward shareholders and where managers keep or lose their positions depending on how well they perform in terms of producing a high [rate of return on investment].” The second aspect is that the shareholders tend to vote with management at the annual general shareholder meetings and do not dispatch representatives to observe or take part in these meetings as is done in the United States. As a result, general shareholder meetings in Japan, most of which last for less than one hour, are largely symbolic. KOJI MATSUMOTO, THE RISE OF THE JAPANESE CORPORATE SYSTEM 5-7 (1991); Commercial Code, 2 EHSJA art. 234.

128. MATSUMOTO, *supra* note 128, at 5-6.

129. Ted Holden, *The Tokyo Stock Exchange*, BUSINESS WEEK, Feb. 12, 1990, at 74, 76.

130. Repeta, *supra* note 100, at 183.

131. *Id.*

132. BALLON & TOMITA, *supra* note 1, at 114.

of the outstanding shares of another Japanese company.<sup>133</sup> A financial company needs to obtain approval from the Fair Trade Commission in order to hold more than 5 percent of such outstanding shares.<sup>134</sup> Because of this 5 percent requirement, the six largest banks in Japan own less than 5 percent of the shares of the companies in their respective *keiretsu* groups.<sup>135</sup> Furthermore, the percentage of shareholdings that these banks own in the other companies decreased throughout the 1980s.<sup>136</sup> As of March 1990, city banks collectively held 9 percent of the shares of other companies on the Tokyo Stock Exchange.<sup>137</sup>

There is one notable exception to the 5 percent requirement: an insurance company is allowed to own 10 percent of the outstanding shares of another Japanese company.<sup>138</sup> However, no insurance company possesses more than 10 percent of such shares.<sup>139</sup> As of March 1990, Japanese life insurance companies collectively held 13 percent of the shares of other companies on the Tokyo Stock Exchange.<sup>140</sup>

#### D. Shareholding by Individual Investors

The percentage of shares owned by individual investors has decreased since the postwar period. In 1949, when the stock exchanges in Tokyo, Osaka, and Nagoya reopened after World War II, individual investors held 68 percent of all outstanding shares traded on these exchanges.<sup>141</sup> However, by 1985, individual investors owned only about 25 percent, whereas Japanese companies owned roughly 75 percent, of the shares listed on the Tokyo Stock Exchange.<sup>142</sup>

Individual investors have lost their shareholding dominance in most

---

133. A 1977 amendment to the Antimonopoly Law mandated that this ceiling on the percentage of share ownership be lowered from 10 percent to 5 percent by the end of 1987. Antimonopoly Law art. 9; BALLON & TOMITA, *supra* note 1, at 114. In 1987, about 42 percent of the shares on the Tokyo Stock Exchange were held by financial institutions. MATSUMOTO, *supra* note 127, at 3.

134. BALLON & TOMITA, *supra* note 1, at 114.

135. KESTER, *supra* note 22, at 207.

136. *Id.*

137. *See Downbeat*, *supra* note 44, at 15.

138. KESTER, *supra* note 22, at 211.

139. *Id.*

140. *See Downbeat*, *supra* note 44, at 15.

141. Immediately after the postwar dissolution of the *zaibatsu*, wide dispersed ownership of Japanese company stock by individual investors was favored. The following three procedures ensured wide dispersion—public tender, underwriting sales, and sales to company employees. BISSON, *supra* note 3, at 26, 73-74; BALLON & TOMITA, *supra* note 1, at 109.

142. BALLON & TOMITA, *supra* note 1, at 109. Since 1975, the percentage of share ownership by Japanese companies has increased whereas that by individual investors has decreased. This situation differs from that in the U.S., where individual investors owned more than 50 percent of all outstanding shares in the early 1980s. Repeta, *supra* note 100, at 153, 158.

Japanese companies for many reasons.<sup>143</sup> First, individual investors have bought and sold their stock more frequently than Japanese companies since profits from selling securities are not taxed where fewer than 200,000 shares are involved in such a transaction and fewer than 50 such transactions are conducted per year.<sup>144</sup> Second, since this tax exemption does not require a certain time period of stock ownership, the short-term speculation that is characteristic of the TSE is in effect promoted.<sup>145</sup> Third, individual investors traditionally have favored more conservative investments such as savings deposits with banks and the post office, which offer a small but fixed rate of return on investment in the form of interest.<sup>146</sup> Finally, Japanese companies have consolidated their control over outstanding shares by distributing new shares selectively (e.g., to Japanese companies that are existing shareholders) and by cross-shareholding with other Japanese companies.<sup>147</sup>

### *E. Shareholding by Foreign Companies and Individuals*

As mentioned previously, foreign companies and individuals own approximately 5 percent of the shares on the Tokyo Stock Exchange.<sup>148</sup> The revised Foreign Exchange Law, which went into effect in 1980, relaxed guidelines on foreign equity investment in Japanese companies.<sup>149</sup> The restrictions which previously prohibited foreign companies from owning more than 25 percent of all outstanding shares of most Japanese companies and more than 15 percent of all outstanding shares of Japanese companies in designated "strategic" industries (e.g., banking) were abolished.<sup>150</sup> As a result of this relaxation, the percentage of foreign ownership of shares on the

---

143. Though the number of individual investors increased in the 1980s, the percentage of individual investor ownership of shares on the Tokyo Stock Exchange decreased during that decade. BALLON & TOMITA, *supra* note 1, at 109-13.

144. *Id.* at 109. Another reason for such frequent purchases and sales is the great pressure that securities house salesmen exert on individual investors in order to earn commissions therefrom. Repeta, *supra* note 100, at 167-69.

145. *Id.* at 180, 183.

146. In the short term, stock investments offer meager but constant dividends. See MATSUMOTO, *supra* note 127; BALLON & TOMITA, *supra* note 1, at 139. However, over the long term (e.g., 10 years), stock investments earn capital gains which appreciate and generally are tax free. ABEGLLEN & STALK, *supra* note 66, at 169-73; Repeta, *supra* note 100, at 180; Holden, *supra* note 129.

147. BALLON & TOMITA, *supra* note 1, at 107, 109.

148. Foreigners initially were allowed to invest in Japanese securities in 1960. BRONTE, *supra* note 21, at 181.

149. See *supra* notes 36, 134. The most common way that foreigners invest in shares of Japanese companies is through the overseas offices of the Big Four securities houses. In addition, foreign investors that deal with brokers in their home countries can purchase foreign depository receipts which are listed on foreign stock exchanges. Depository receipts entitle foreign investors to claims on share certificates which trustee banks in Japan hold. American depository receipts are denominated in U.S. dollars. Bronte, *supra* note 21, at 182.

150. *Id.* at 183-84.

TSE doubled between the mid-1970s and the mid-1980s.<sup>151</sup>

The main limitation on foreign companies under the Foreign Exchange Law is that purchases exceeding 25 percent of all outstanding shares of Japanese companies which “would have a major impact on the nation’s economy or security” are subject to review by the Ministry of Finance.<sup>152</sup> The primary restriction on foreign individuals under this law is that they can own up to 10 percent of all outstanding shares of Japanese companies.<sup>153</sup>

#### *F. The Rise and Fall of Tokyo Stock Exchange Share Prices*

Japanese financial speculation (*zai-teku*) contributed to both the increases in Tokyo Stock Exchange share prices in the 1980s and the decreases in these share prices and the credit contraction in 1990. During the 1980s, Tokyo Stock Exchange share prices increased nearly five-fold because of rampant Japanese financial speculation.<sup>154</sup> Investment conditions were ripe for financial speculation: interest rates were low, and the yen was strong.<sup>155</sup>

The Japanese practice of financial speculation, begun by the overseas financial subsidiaries of *sogo shosha* during the early 1980s, helped to increase stock prices.<sup>156</sup> Japanese financial speculation specifically refers to the practice of Japanese companies obtaining bank loans in order to finance potentially higher-yielding investments in the stock market, especially the Tokyo Stock Exchange.<sup>157</sup>

As Tokyo Stock Exchange share prices increased in the 1980s, assets that Japanese companies held such as land or stock in other companies appreciated.<sup>158</sup> Japanese companies borrowed more and more against these

---

151. In 1975, foreign companies and individuals collectively owned 2.6 percent of shares on the TSE. In 1987, foreign companies owned about 5 percent of such shares. BALLON & TOMITA, *supra* note 1, at 108, 113.

152. BRONTE, *supra* note 21, at 184.

153. *Id.*

154. Rowley, *supra* note 50, at 43. Tokyo Stock Exchange share prices did not fall sharply after the October 1987 New York Stock Exchange crash. This is because the Ministry of Finance took the following steps to prop up share prices. First, the MOF urged brokers not to sell. Second, the MOF informed large investors of significant changes in accounting rules in order to discourage stock sales. Finally, the MOF encouraged consumer investment in stock by revoking the tax exemption for small savings accounts. Holden, *supra* note 129, at 77.

155. See *Downbeat*, *supra* note 44.

156. The Japanese term “*zai-teku*” literally translates as financial technology: “It is thus the ‘high-tech’ of making money through financial operations.” BALLON & TOMITA, *supra* note 1, at 141-42. It is interesting to note that foreign investors also engaged in stock market speculation in Japan. To quote one executive with the Japanese office of a U.S. securities firm: “Traders of foreign firms began to pay more attention to [Japanese] speculators’ buying moves and rumors of fund raising . . . since they began to chase speculative issues—just like Japanese traders.” *Foreigners Keep up TSE Selloff but Speculators Are on the Rise; Japanese Buying Patterns Affecting Investor Views Abroad*, Nihon Keizai Shimbun, Aug. 20, 1988, at 1.

157. BALLON & TOMITA, *supra* note 1, at 141-42; BURSTEIN, *supra* note 52, at 44.

158. Rowley, *supra* note 50, at 43.

rising collateral values in order to purchase stock in other companies, including the lending banks.<sup>159</sup> Moreover, Japanese banks bought and sold stock in Japanese companies. The stock that Japanese banks held appreciated. The banks used the increased value of this stock as collateral to lend against. In this manner, Japanese banks were able to continue to make loans to Japanese companies during the rising stock market.<sup>160</sup>

Japanese financial speculation, which involved heavy bank lending, helped to bring about the steep decline in Tokyo Stock Exchange share prices. This decline resulted from the "lending spree which created enormous liquidity in terms of money supply—exceeding by far the amount needed to finance real economic activity."<sup>161</sup> After rising to an all-time high at the end of 1989, the Nikkei index of the Tokyo Stock Exchange dropped by 45 percent between February and October 1990.<sup>162</sup> In addition, during the remainder of 1990, the share issuance activity by Japanese companies was slow.<sup>163</sup>

When Tokyo Stock Exchange share prices fell, the value of the collateral for existing loans was impaired. Furthermore, the banks were unable to make further loans due to the decreased value of collateral.<sup>164</sup> This bank lending situation also was exacerbated by the increased cost of raising capital from higher domestic interest rates.<sup>165</sup> Hence, Japanese banks were adversely affected by the decline in Tokyo Stock Exchange share prices.<sup>166</sup>

As a result, a worldwide contraction in Japanese bank credit occurred.<sup>167</sup> In response to the credit contraction, Japanese banks began to sell their stock in Japanese companies in order to meet Bank for International Settlements capital adequacy standards.<sup>168</sup> Japanese companies also started to sell stock which they held in Japanese banks.<sup>169</sup>

## V. CONCLUSION

Two levels of corporate interdependence in the debt and equity financing of Japanese companies, which offer these companies certain benefits, can be identified. The first level is the interdependence among Japanese companies

---

159. *Id.*; Auerback, *supra* note 51, at A18.

160. BALLON & TOMITA, *supra* note 1, at 141-42; BURSTEIN, *supra* note 52, at 44; Rowley, *supra* note 50, at 43.

161. Rowley, *supra* note 50.

162. *See Downbeat*, *supra* note 44; Rowley, *supra* note 50.

163. *Fat Players*, *supra* note 126, at 55.

164. Auerback, *supra* note 51, at A18.

165. *See supra* note 56.

166. *See supra* note 57.

167. Baum, *supra* note 39; *See supra* note 129.

168. *See supra* note 59. At the end of 1990, banks still owned approximately 26 percent of the stock of all companies listed on stock exchanges in Japan. Rowley, *supra* note 50, at 41.

169. Auerback, *supra* note 51.



and between these companies and the principal bank within a *keiretsu*. One example of interdependence among Japanese companies that are *keiretsu* members is cross-shareholding. Cross-shareholding involves reciprocal financing: companies provide financing for and obtain financing from each other by purchasing each other's shares. Cross-shareholding also promotes stable shareholding, in which companies hold their shares indefinitely. In addition, companies tend to issue new shares of stock to existing shareholders. Through cross-shareholding, the companies continue to finance each other and are able to consolidate their control over the outstanding shares of other companies. -

An example of the interdependence between Japanese companies and the principal bank within a *keiretsu* are the principal bank loans to these companies which they depend on to meet capital needs. The principal bank realizes benefits from lending within a *keiretsu*. First, the principal bank often has influence over the management of the companies to which the bank makes loans. Second, by providing loans to the different companies in the *keiretsu* (i.e., diversified lending), the principal bank has information about the capital needs of these companies and can spread the risks of loan defaults among them.

The second level of interdependence in the financing of Japanese companies is that between the companies and the principal bank in a *keiretsu* and the Japanese government. The Bank of Japan covers the principal bank loans by lending more to these banks than a private bank would and allows the principal bank to focus on meeting the demands of Japanese companies for funds without worrying about being rendered insolvent. Also, the Ministry of Finance provides funds to banks which are in financial trouble. Hence, the Bank of Japan and the Ministry of Finance loans to banks contribute to the financing process by insuring against business risk.

These levels illustrate the advantages of corporate interdependence in the debt and equity financing of Japanese companies. The first level of interdependence demonstrates how membership in a *keiretsu* facilitates the financing process. *Keiretsu* members work together in order to meet the capital needs of member companies. Without the *keiretsu*, companies would function independently, and the financing process would become less efficient and less certain. Independently functioning companies would need to locate sources of finance and to work out financing arrangements with these sources before securing financing rather than simply obtaining financing from familiar sources.

The second level of interdependence shows how the Japanese government facilitates the financing of Japanese companies within the *keiretsu* by ensuring that the principal bank is able to meet the capital needs of member companies. Thus, the *keiretsu* does not operate in isolation; the *keiretsu* relies on government support. Without any BOJ and MOF loans, funds would become scarce, the principal bank would face any financial troubles alone, and Japanese companies would not always be assured of obtaining principal bank

loans when needed. Consequently, the financing process would be impaired.

In sum, the interdependence between Japanese companies, Japanese banks, and the Japanese government is important in the financing of Japanese companies. Such interdependence affords the companies advantages that they would be unable to realize if they functioned without this. As Japanese companies continue to realize these advantages, this corporate interdependence continues.