COEXISTENCE OF CONTRASTING PRINCIPLES IN CORPORATE GOVERNANCE: TWO TALES OF JAPANESE FIRMS

Taeyoung Yoo*

Abstract

The underlying logic that shapes the coexistence of contrasting mechanisms in a firm's governance system remains unclear. We examine the logic that promotes a hybrid form of corporate governance in functional terms. The empirical analysis of Japanese firms shows that a firm's reliance on capital markets for resource acquisition facilitates its adoption of shareholder-oriented mechanisms, such as committee systems. In contrast, corporate performance is still influenced by some of Japanese society's characteristic governance mechanisms, such as bank ownership. This finding illustrates that contrasting governance mechanisms coexist in a given system owing to their respective or interacting contributions to corporate performance.

Keywords: Committee System, Corporate Governance, Japan, Relationship-Based Model, Shareholder Orientation

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**College of Business Administration, Hankuk University of Foreign Studies, Seoul (130-791) Republic of Korea*

1 Introduction

A number of studies have suggested that organizational change in corporate governance reveals complicated outcomes. Firms not only adopt shareholder-oriented mechanisms but also maintain a society's characteristic ones, such as co-determination in Germany (Aguilera, Filatotchev & Gospel, 2008; Aoki & Jackson, 2008; Yoshikawa, Tsui-Auch & McGuire, 2007). The coexistence of contrasting mechanisms in a firm is explained as an outcome of compromises between market pressures and sociopolitical struggles and is called a hybrid form of corporate governance (Deakin & Whittaker, 2009; Jacoby, 2004). Sustained characteristic mechanisms reflect a society's traditions in firms, shedding light on the 'relationship' between diverse stakeholders (Ahmadjian & Robbins, 2005; Aguilera & Jackson, 2003). The relationship-based model explains that differences in institutional arrangements across societies shape a wide range of corporate governance systems despite critical changes toward the shareholder-oriented model (Olcott, 2009; Jackson & Moerke, 2005; Lubatkin, Lane & Collin, 2005).

However, the underlying logic that shapes the coexistence of contrasting governance mechanisms in a firm remains unclear. While agency theory advocates the performance contribution of shareholder-oriented mechanisms, institution-based perspective emphasizes path-dependence as the cause of diversity in corporate governance (Jackson & Deeg, 2008). The debates in the literature leave how a hybrid form of corporate governance contributes to corporate performance unexamined. The functional dimension of a society's characteristic governance mechanisms has been relatively disregarded, even though the relationship between shareholder orientation and performance is not unambiguous (Pham, Suchard & Zein, 2011). Although the institution-based perspective draws on institutional complementarities, which arrange the functional fit among a society's characteristic governance mechanisms, it does not explain how newly adopted governance mechanisms can coexist with a society's characteristic ones and affect the existing configurations of complementarities. In institutional environments where shareholder-oriented mechanisms such as outside directors are unavoidable because of the increasing pressure from capital markets, there is a need for an alternative framework to understand the newly defined roles of a society's characteristic governance mechanisms and the logic underlying the coexistence of contrasting governance mechanisms in a firm.

We therefore examine why a hybrid form of corporate governance emerges using a functional approach. Under change of institutional environments, some of a society's characteristic governance mechanisms lose their significance, while newly-adopted mechanisms fill the void. Even in this change, if both newly adopted mechanisms and a society's sustained characteristic ones contribute to a firm's value creation independently or through their interactions, their performance contributions will facilitate the coexistence of contrasting governance mechanisms in a firm. As a consequence, we also analyze what contributions the contrasting governance mechanisms make to corporate performance. Their contributions might occur in different areas of corporate activities, reflecting that the coexistence could be a result of their non-replaceable functions.

The present paper analyzes corporate governance mechanisms in two dimensions: resource acquisition and performance. Drawing on the contrasting trajectories of corporate governance change and differences in strategic conditions such as foreign ownership and profitability between firms, this study suggests that some of a society's characteristic governance mechanisms remain valid because of their contributions to corporate performance. This might be arranged by the society's idiosyncratic coordination traditions. We thus suggest that firms should operationalize traditional and newly adopted governance mechanisms simultaneously according to their strategic conditions and institutional environments of a given society. The contribution of newly adopted shareholder-oriented mechanisms is critical especially for resource acquisition from capital markets but not solely critical for performance which is the outcome of utilization of acquired resources.

For empirical analysis, we draw on the trajectory of corporate governance change in Japanese firms. Since the late-1990s, Japanese firms have experienced the pressure of governance change under globalization of capital markets and government's deregulation (Jackson & Miyajima, 2007). Despite variance of change, they embraced shareholder orientation and conducted board reforms (Buchanan & Deakin, 2008). Noteworthy is that some have substantially adopted shareholder-oriented mechanisms, such as outside directors, and consolidated the monitoring role of the board. In contrast, others have maintained their characteristic mechanisms, such as intimate relationships between a focal firm, banks, and suppliers, and did not appointed outside directors despite board reforms. The different trajectories among Japanese firms provide a rare opportunity for analyzing corporate governance change in functional terms. This study takes a comparative approach to analyze the two contrasting types of Japanese firms.

Our analysis has a couple of contributions. Empirically we analyze the differences between those firms advocating shareholder-oriented mechanisms and those still publicly upholding Japanese characteristic mechanisms in terms of antecedents and consequences of corporate governance change. There have been no legal obligations because the choice of governance mechanisms is left entirely to the discretion of individual firms. Thus, one can evaluate the triggers and outcomes of the contrasting governance mechanisms within specific contexts of a society. Theoretically, we can expand the horizon of agency theory which emphasizes shareholder value maximization in terms of resource acquisition from capital markets. While the theory assumes that the principle for resource acquisition is not different from that of value creation (Jensen, 1986), our analysis suggests that the principle for resource acquisition might be different from that for value creation, even though the difference can be relative, as a result of idiosyncratic coordination tradition in a society. This study also sheds light on institution-based perspective by highlighting traditional governance mechanisms' contribution to corporate performance, in addition to historical and sociopolitical dimensions.

2 Coexistence of contrasting principles in a corporate governance system

With globalization of capital markets, shareholder orientation plays as a principle that governs the beliefs and behaviors of actors in reorganizing corporate governance system. It focuses on value maximization of a firm and emphasizes resource acquisition from capital markets and consolidation of monitoring mechanisms for capital providers (Fama & Jensen, 1985). As firms have increasingly relied on equity financing, shareholder-oriented mechanisms which mean specific devices such as outside directors have become indispensable for appealing to capital markets. Subsequently, corporate activities and performance should be conducted on behalf of shareholders, who are residual risk bearers as well as capital providers (Fama & Jensen, 1983). However, the shareholder-oriented approach pays little attention to the fact that economic wealth is generated not only by capitalists but also by other stakeholders, such as employees and suppliers (Hansmann & Kraakman, 2004), who provide firm-specific investments. In addition, little attention is paid to the fact that organizational forms and practices for value creation, which is implemented through diverse investment activities according to a firm's strategy might be heterogeneous owing to the context of a given society.

An alternative approach emphasizes the management of relationships between all constituents for value creation (Freeman, Wicks & Parmar, 2004). Diverse stakeholders should have rights to residual claims because they provide firms with human capital as well as physical assets, which necessitate them to share firm-specific risks (Kochan & Rubinstein, 2000). According to this principle, firms are socially constructed, and their organizational forms such as corporate governance are shaped by their society's coordination tradition. However, how to reorganize such contributions remains unclear under the increasing influence of capital markets. That is,

the multilateral relationship agenda does not explain how we can adjust the framework of cooperating relationship between diverse stakeholders in accordance with the emergent agenda of shareholder orientation. Economies which uphold the cooperating relationships tend to show weak monitoring mechanisms, as illustrated by the prevalence of expropriation behavior in European and Asian countries (La Porta, Lopez-de-Silanes & Shleifer, 2000).
Despite the contrast between shareholder-oriented and relationship-based approaches, the actual practices in corporate governance change show mixed outcomes. For example, publicly traded firms in South Korea have consolidated boards of directors with majority of outside directors, but their characteristic governance mechanisms, such as family control and business group, are still sustained (Yoo & Lee, 2009). Previous studies on corporate governance have explained the mixed outcomes using the concept of enlightened value maximization or societal context. Jensen's (2010) enlightened value maximization approach synthesizes the two governance principles by embracing the long-term perspective featured in the cooperating relationship between diverse stakeholders. However, the approach suggests that value maximization proposition should be the objective function that all firms should follow to achieve a compromise addressing various stakeholders' conflicting interests, while acknowledging that the interests of various stakeholders are real concerns that must be addressed.

Another perspective of societal context emphasizes the relevance of a specific set of governance mechanisms to institutional environments (Aoki & Jackson, 2008; Jacoby, Nason & Saguchi, 2005; Aguilera & Jackson, 2003). Defined as mutually reinforcing effects of institutional arrangements, institutional complementarity highlights that the choice of corporate governance system relies on not only the financial structure but also the historical path of a society (Hall & Soskice, 2001; Whitley, 1999; Aoki 1994). This institution-based perspective emphasizes that efficiency resides in the congruency of complementary institutional arrangements, implying that the dynamic political economy of institutions can facilitate a wide range of economic mechanisms in corporate governance. This perspective, faced with contrasting understandings of shareholder-oriented and relationship-based governance mechanisms, suggests a hybrid form as a compromise (Deakin & Whittaker, 2009; Olcott, 2009). In the face of common environmental changes in a similar way, firms will fashion adaptations to fit preexisting organizational forms (Jacoby, 2004).

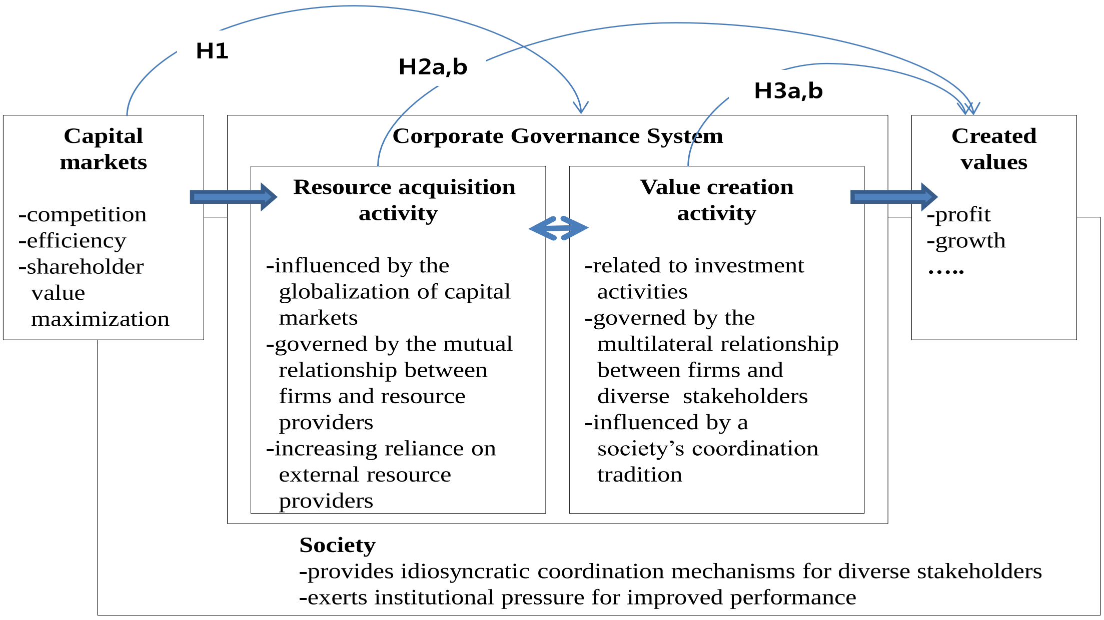
While both enlightened shareholder approach and institution-based perspective shed light on the coexistence of contrasting governance mechanisms, they do not fully grasp the point for either the contribution of a society's sustained governance mechanisms to a firm's value creation or the characteristics of adjustments that newly adopted shareholder-oriented mechanisms can make to existing structures in a firm. The enlightened shareholder approach pays little attention to the functional dimension of a society's distinct governance mechanisms. It overlooks an important aspect of corporate governance, that is, a firm's value maximization efforts require more than competition and markets because its value creation ability is dependent on the attunement to societal contexts between diverse stakeholders. This implies that the principles for value creation are heterogeneous according to a society's idiosyncratic coordination tradition, as illustrated by the distinct research and development (R&D) activities between Japanese and US firms (Lee & O'Neill, 2003). We thus understand that a firm's value creation activities should be examined not only by the requirements of capital markets but also by the distinct organizational context of a society in which the firm operates.

On the other hand, the institution-based perspective does not provide sufficient explanation about why contrasting governance mechanisms coexist in a firm, while emphasizing diverse institutional arrangements across countries. This perspective explains that a hybrid form is not a substantial transformation of a society's characteristic institutional arrangements owing to their path-dependent characteristics (Aoki & Jackson, 2008; Buchanan, 2007). However it suggests that the hybrid form increases the efficiency of corporate governance, measured by Tobin's Q and ROA (return on asset) for instance, since it adopts shareholder-oriented mechanisms, such as information disclosure, increase of foreign shareholders, and reorganization of employment system. Then, what is the role of a society's sustained governance mechanisms? Do they exist only by historical legacies or sociopolitical struggles without performance contributions? We do not have enough knowledge about the roles of a society's sustained governance mechanisms in the hybrid form. The performance enhancement by the hybrid form might be generated by independent functions of the contrasting mechanisms or by their interactions. More attention should be paid to the dynamics underlying the hybrid. We will examine the antecedents of coexistence of contrasting governance mechanisms in a firm and analyze specific mechanisms whereby the coexistence contributes to corporate activities and performance.

3 Functional approach to corporate governance change

This study investigates the dynamics of coexistence in functional terms, although we acknowledge that corporate governance change is affected by a variety of political, economic, and societal factors. Historical legacies can deter organizational change regardless of performance conditions (Streeck & Thelen, 2005; Vitols, 2001). Power struggles often prioritize one side's exclusive interests and manipulate organizational change at the sacrifice of the general welfare in an organization (Bourdieu, 1998; Fligstein & Brantley, 1992). Nevertheless our functional approach will help to understand sustained traditional mechanisms from their performance contribution even under the pressure of institutional change. We therefore view organizational phenomenon using utilitarian standpoint. Regarding the antecedents of corporate governance change, introduction of new mechanisms can be triggered by ineffective services of preexisting mechanisms for certain organizational goals. The fate of the newly introduced mechanisms will rely on the extent to which they contribute to a firm's value creation activities, especially when business affairs are concerned. In this sense, the coexistence of contrasting governance mechanisms in a firm can be understood as following: old mechanisms do not effectively carry out their expected roles and consequently yield their place to new ones. At the same time, some of the old ones might still successfully fulfill their functions and thus could coexist with newly adopted mechanisms. In another angle, we could interpret that newly adopted mechanisms do not completely replace the roles assumed by old mechanisms.

Figure 1. Two dimensions in a corporate governance system



As illustrated in Figure 1, a corporate governance system can be divided into two dimensions: resource acquisition and value creation activities. The resource acquisition dimension explains how a firm acquires financial and other resources. With free flow of capital, the resource acquisition dimension sheds light on changes in corporate financing. On the other hand, value creation activities indicate how the resources acquired are utilized (Lee & Yoo, 2008). A firm's investment activities, such as R&D, are related to value creation dimension in corporate governance. The left-hand area of Figure 1 explains that under globalization of capital markets, resource acquisition is increasingly subordinated to the principles of capital markets, such as shareholder value maximization, owing to increasing reliance on market financing. In contrast, the right-hand dimension of Figure 1 illustrates that value creation activities might be still influenced by a society's distinct coordination tradition, because the process for value creation requires a relatively complicated relationship between diverse stakeholders in the society (Freeman *et al.*, 2004). However, previous studies are short of balanced stances by focusing mainly on the requirements of capital markets or on the path-dependence of traditional mechanisms in corporate governance. We thus suggest that the principle for resource acquisition is not always consistent with that for value creation activities. Using Figure 1, this study juxtaposes resource acquisition activities with value creation activities and examines the mixed outcomes of corporate governance change as a result of the simultaneous operationalization of the contrasting principles to achieve expected goals in each dimension of corporate governance. As denoted by the bi-directional arrow between resource acquisition and value creation activities in Figure 1, we also consider the mutual influences between shareholder-oriented and a society's characteristic governance mechanisms, which will affect the practical outcomes of value creation, in addition to their independent functions.

Since the 1990s, firms in many European and Asian countries have increasingly relied on market capitalization and adopted shareholder-oriented mechanisms (Aoki & Jackson, 2008; Jackson & Deeg, 2008). Together with the pressure for better performance, the adoption of shareholder-oriented mechanisms for reducing agency costs has been a dominant criterion (Yoshikawa *et al.*, 2007). The evaluation of corporate governance change has been based on the extent to which external resource providers' demands are satisfied. Given that current corporate governance change is closely related to shareholder orientation upheld by capital markets, we understand that the preexisting mechanisms for corporate financing do not fulfill the expected roles. As illustrated in Figure 1, owing to the free flow of capital, firms have increasingly sought after new financing channels in capital markets. This change has brought about shareholder-oriented mechanisms, resulting in corporate governance change.

For instance, the market capitalization of publicly traded firms in Japan increased from 250 trillion Japanese yen (JPY) in 1998 to 500 trillion in 2007. Simultaneously, foreign ownership increased from 14% to 28% over the same period (www.tse.or.japan). Capital providers acquire ownership and alter the composition of decision-making boards. We therefore understand that corporate governance change towards shareholder orientation is related to change in corporate financing. The more a firm relies on external resources, the more it will incorporate demands of the resource providers. In this regard, we propose the following:

Hypothesis 1. *The more a firm relies on capital markets for resource acquisition, the more likely it will adopt shareholder-oriented mechanisms.*

Changes in resource acquisition will influence activities for value creation because a firm's investment activity is influenced by its ownership structure (Jensen & Meckling, 1976). Thus, the current debate about corporate governance change focuses on the principles for maximizing shareholder value, suggesting that shareholder orientation can facilitate optimal investment decisions, reduce agency costs, and consequently improve corporate performance (Jensen, 2010). Foreign ownership represents changes in both corporate financing and governance mechanisms (Deakin & Whittaker, 2009). Since the 1990s, foreign investors have become critical as resource providers and facilitated the augmentation of foreign ownership in many countries (Ahmadjian & Robbins, 2005). At the same time, foreign shareholders could be a sacrifice of expropriation by controlling shareholders (Young, Peng & Ahlstrom, 2008) and thus plays a monitoring mechanism for the productive utilization of resources. In this regard, foreign ownership functions as a financing channel for resource acquisition as well as a shareholder-oriented mechanism for effective monitoring in corporate governance. In addition, foreign ownership promotes the utilization of external resources such as "legitimacy, advice and counsel, and links to other organizations" (Hillman & Dalziel, 2003: 383). Foreign ownership therefore disciplines or complements a society's characteristic governance mechanisms and contributes to corporate performance independently or through interaction with preexisting mechanisms.

Hypothesis 2a. *Foreign ownership will be positively related to a firm's performance either independently or in interaction with a society's characteristic governance mechanisms (ownership concentration and bank ownership in our analysis of Japanese firms).*

Despite some positive roles, foreign investors may show short-termism: "corporate goals center on high returns on investment and maximizing current stock prices" (Porter, 1992: 71). Thus, managers, eager to retain foreign ownership as a critical channel for resource acquisition, are likely to focus on current profitability at the expense of appropriate growth (Stein, 1989). A study of foreign investors' strategic propensity in Japanese firms shows that foreign ownership is negatively related to capital expenditure (Gedajlovic, Yoshikawa & Hashimoto, 2005). Another study, which analyzed the relationship between governance mechanisms and corporate performance using European firms, also suggests that it is family control, not foreign ownership, which contributes to a firm's growth rate (Thomsen & Pedersen, 2000). This means that foreign ownership can be more positive in improving a firm's profitability than in encouraging a firm's sales growth. We thus suggest the following:

Hypothesis 2b. *Foreign ownership will be more positively related to a firm's profitability than to its sales growth.*

The influence of capital markets' principles on a firm's value creation activities might be limited, since they are also affected by a society's coordination tradition. As illustrated by the differences in R&D activities between Japanese and U.S. firms (Lee & O'Neill, 2003), the principles behind the operationalization of corporate governance mechanisms are not always consistent with shareholder orientation. Noteworthy is that value creation activities are related to multilateral relationships which are well beyond the mutual relationship for resource acquisition between a firm and resource providers. The idiosyncrasy of R&D activities across countries implies that the process for value creation involves diverse stakeholders, and that coordination of such stakeholders is critical and varies according to societal contexts (Dyer, 1996). In Japanese society, for instance, value creation activities of a firm is not only influenced by the requirements of capital markets but also arranged by intimate relationships between a focal firm, banks, and suppliers (Whitley, 1999; Orrù, 1997). This shows their historical tradition of cooperation among diverse stakeholders for value creation (Aoki & Jackson, 2008). In contrast, American firms tend to rely on contractual processes for coordination (Nooteboom, 2000), which reflects their institutional environments based on flexible labor markets and property rights (Aoki & Jackson, 2008), anchoring competition instead of cooperation.

While value creation activities can be affected by financial economics for optimal utilization of acquired resources to satisfy the demands of resource providers, it should also be understood as organizational processes (Oguzhan, 2005). The interaction between an organization and relevant participants has considerable influence on its value creation and survival, which indicates that the coordination of diverse participants in value creation activities is as important as shareholder orientation in resource acquisition. Thus, firms' responses to contrasting principles between resource acquisition and value creation activities may not lead to a unanimous outcome, i.e. the unilateral adoption of or resistance to organizational change driven by capital markets. Instead, their responses may vary because of their efforts to achieve optimal outcomes in each dimension of corporate governance according to their different strategic conditions, resulting in the coexistence of contrasting mechanisms in a firm. If a society's financing tradition has relied on capital markets and consequently its institutional arrangements are organized to be consistent with the financing tradition, firms will not find much difference between the principles of resource acquisition and value creation activities in the society. However, if a society's financing tradition has relied on other than capital markets and its subsequent institutional arrangements are distinct from the principles of capital markets, firms in the society are more likely to show separate responses to the contrasting principles between resource acquisition and value creation activities in the face of corporate governance change affected by capital markets.

Faced with the variance of capital market's influences across countries, firms should consider the scale and scope of corporate governance change in alliance with their institutional environments for value creation. Firms in the societies of cooperating relationships could maintain their traditional mechanisms at least for effective value creation activities, despite increasing influence of capital markets for resource acquisition. It is because those who operationalize value creation activities according to society-wide principles find it easy to coordinate their business partners for value creation. In this sense, in Japanese society for instance, which is characterized by ambiguously symmetric relationships between a focal firm and its relevant business partners (Aoki & Jackson, 2008; Orrù, 1997), firms which keep close ties with suppliers through cooperating governance practices may achieve better corporate performance than those who unilaterally rely on the principles of capital markets. This suggests that shareholder-oriented governance mechanisms based on capital markets might not fit perfectly with a firm's value creation activities under distinct coordination traditions of a society.

Thus, despite organizational change in corporate governance toward capital markets for resource acquisition, some of a society's distinct coordination tradition may still influence organizational practices for value creation. In this study, we consider Japanese society's characteristic coordination mechanisms in corporate governance: ownership concentration and bank ownership (Aoki, 1994).

Hypothesis 3a. *Ownership concentration in Japan will be positively related to a firm's performance.*
Hypothesis 3b. *Bank ownership in Japan will be positively related to a firm's performance.*

4 Data and methodology

Japanese firms provide a rare opportunity for analyzing the complicated trajectory of corporate governance change. They help to determine the effectiveness of newly adopted governance mechanisms in a society characterized by intimate relationships between diverse stakeholders. Since the 1990s, some Japanese firms have voluntarily adopted shareholder-oriented committee system, "based, loosely, on American practice, with provision for an enhanced role for independent directors" (Deakin & Whittaker, 2009: 1), by separating monitoring and control functions of boards of directors, whereas others have maintained the integrated system of their boards. This paper uses a statistical comparison of the two types of Japanese firms for a better understanding of the underpinnings of the coexistence of contrasting mechanisms in a firm's governance system.

Table 1. Two-sample t-test: Firms with committee system vs. those without committee system

Variables		(1) Firms without committee system	(2) Firms with committee system	Difference: (1)-(2) (t-test)
Total assets (log)	Mean	18.127 (1.598)	18.282 (1.870)	-0.155
	Median	17.737	17.778	-0.041
	No. of observations	1,569	313	
Sales (log)	Mean	17.991 (.041)	18.155 (.108)	-0.164
	Median	17.655	17.851	-0.196
	No. of observations	1,569	313	
Age (log)	Mean	3.860 (.547)	3.882 (.509)	-0.021
	Median	3.951	4.007	-0.056

	No. of observations	1,569	313

Standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05, † p<0.1.

For the statistical analysis, we collected longitudinal data for the 1995-2004 period from the Development Bank of Japan (DBJ). Regarding the choice of time window in this study, we paid attention to the debates on the factors that promoted adoption of shareholder-oriented mechanisms. On the one hand, aggravated performance might be the main factor. However, on the other hand, resource dependence perspective could be an alternative. Our data which are relatively long backward in terms of the reference year, in which the Commercial Code of 2003 for governance reform was in effect, help to effectively analyze the determinants of governance change, since the change is not sudden and radical and requires preparations for some years (Fuwa, 2009). Our analysis will shed light on antecedents of governance change as well as diverse trajectories for achieving a compromise between contrasting governance mechanisms.

Over the period, about 110 firms adopted shareholder-oriented committee system by separating the monitoring and control functions of boards of directors. However, we excluded non-listed firms, financial institutions, and other firms which do not have relevant information. We also excluded 14 affiliates of Hitachi owing to their involuntary decision as the outcome of their mother firm's business policy. We further selected 7 or 8 matching firms, on the condition of availability, for each of the remaining 24 firms in terms of their size and industry. As shown in Table 1, these firms did not show any significant difference in size and business experience. Finally, we constructed a panel data set composed of 208 firms for the analysis.

4.1 Dependent variables

In the studies of corporate governance, shareholder-oriented mechanisms can be measured by a variety of proxies, such as stock repurchase programs (Westphal & Zajac, 2001) and appointment of outside directors (Miwa & Ramseyer, 2005). Regarding the Japanese case in our study, we pay attention to the Commercial Code of 2003 which promoted corporate governance reform toward shareholder orientation. While left at the discretion of individual firms and not fully implemented even when adopted (Buchanan & Deakin, 2008), the Code envisaged shareholder orientation by promoting firms to adopt "company with committees" system (Deakin & Whittaker, 2009). Those firms with committee system appointed outside directors, established independent subcommittees for audit, nomination, and remuneration, and also adopted US-style practices in monitoring activities (Fuwa, 2009). The legal change explains the Japanese context in which foreign ownership increases and ownership concentration and bank monitoring decrease. Firms with committee system usually accompany announcement of shareholder value orientation, stock option, stock repurchase program, and appointment of outside directors (see Sony's 2003 annual report: 25, 48, 74, 114). Therefore the adoption of shareholder-oriented committee system by separating the monitoring and control functions of boards of directors can be a persuasive as well as practical proxy for a shareholder-oriented mechanism. This change in corporate governance will indicate whether a firm emphasizes shareholder orientation through its board reform or still relies on Japan's characteristic coordination tradition based on "integrated internal governance and execution" (Buchanan, 2007: 28).

Regarding corporate performance as an outcome of value creation, which is related to the hypotheses 2 and 3, we use two proxies: profitability and growth (Thomsen & Pedersen, 2000). For profitability, we measure ROA (return on asset). To measure growth, we use sales growth rate (100*((current year's sales - previous year's sales)/ previous year's sales)).

4.2 Independent variables

First, regarding reliance on capital markets, we considered foreign ownership. While other proxies, such as corporate bonds, equity issues, bank loans, or internal resources for funding, can appropriately measure the extent of reliance on capital markets, foreign ownership shows practical advantages over others. Foreign ownership has played as a new force for governance change as well as represented a new mechanism. It brings about a new voice with power, since foreign ownership accompanies the change of ownership structure in a firm (Olcott, 2009; Ahmadjian & Robbins, 2005) despite its variance and consequently causes decline in cross-shareholdings among large firms and erosion of bank-led monitoring (Deakin & Whittaker, 2009). Foreign ownership therefore increases capital markets' pressure. We consider this a critical function over other shareholder-oriented mechanisms, since a mechanism without power finds it difficult to implement an expected role. Even though whether foreign ownership has sufficient power can be debated, it is more likely to change ownership structure and thus have a better position to implement market-based practices. In contrast, outside directors and auditing practices, for instance, might be easily manipulated, since their independence is structurally susceptible owing to their lack of voting powers (Buchanan & Deakin, 2008; Claessens, Djankov & Fan, 2002). External auditors are hired by a firm, while outside directors can be excluded from strategic decision making (Deakin & Whittaker, 2009), as illustrated by frequent auditing scandals like that of Enron (Deakin & Konzelmann, 2004). On the contrary, although foreign ownership might be the presence of foreign shareholders rather than any detailed reliance on corporate bonds or equity issues for funding, it could trigger a shift in value creation activities by departing from traditional Japanese investment practices (Deakin & Whittaker, 2009). Foreign ownership requires the consolidation of monitoring mechanisms to protect their investment (Yoshikawa & Gedajlovic, 2002). It is also relatively liquid affecting share prices and related to downsizing (Ahmadjian, 2007). We therefore use foreign ownership as a proxy for a firm's association to the pressure of capital markets by the combined ownership stake of the firm's top five foreign shareholders to control the commodity-like purchase of shares in foreign ownership.

Regarding Japan's characteristic governance mechanisms, we use ownership concentration and bank ownership (Deakin & Whittaker, 2009; Miyajima & Kuroki, 2007; Jackson & Moerke, 2005). Japanese firms are characterized by high ownership concentration, which often leads to closely coordinated business groups called keiretsu. The keiretsu structure is found in many industries, including the electronics, steel, chemical, and automobile industries among others. This structure helps firms to be growth-oriented at the sacrifice of short-term profitability (Porter, 1992) and avoid capital markets' pressures, such as takeover attempts, through the interlocking or cross-holding of shares among several firms. The strength of group orientation for member firms depends on ownership concentration. In this study, we measure ownership concentration for a firm by the combined ownership stake of the firm's top five shareholders.

Another critical axis of Japan's corporate governance system is bank ownership. Banks used to be financing channels as well as main monitors (Deakin & Whittaker, 2009; Jackson & Moerke, 2005; Streeck, 2001). Bank-based system of finance in an economy is not the sole outcome of late industrialization to deploy capital in a more targeted way, but its causal significance relies on political decisions and inter-institutional dynamics (Vitols, 2001). By law in Japan, banks can acquire up to a 5% stake in each firm. Banks assess investment projects and provide long-term loans. This affects the principles for value creation activities and helps Japanese managers to disregard short-term investment losses. We measured the influence of banks on a firm by the combined ownership stake of the firm's top five banks.

4.3 Control variables

We considered some other variables that could influence organizational change in corporate governance. We included profitability by measuring it with return on assets (ROA). Given that those who were performing badly are more likely to be forced to reform governance system, profitability can help to explain the effects of corporate performance on governance change. We also examined the moderating effects of profitability on the relationship between foreign ownership and governance change, since foreign shareholders are often interested in acquiring stakes in higher-performing firms (Deakin & Whittaker, 2009). We controlled for firm size by total assets (log-transformed) (Lee & O'Neill, 2003). We included the age of the firm (log-transformed) because accumulated experience can influence firms' investment and resource acquisition behaviors. We also controlled for leverage by using the debt-asset ratio. Finally, we included year and industry dummies

Table 2. Summary statistics and correlations between variables

Variables	Obs.	Mean	Std. Dev.	1	2	3	4	5	6	7	8
1.Ownership concentration	1882	38.535	16.778	1.000							
2.Bank ownership	1882	8.218	6.488	-0.437*	1.0000						
3.Foreign ownership	1882	2.056	8.325	0.246*	-0.110*	1.0000					
4.ROA	1882	4.175	4.267	0.149*	-0.008	0.067*	1.000				
5.Total assets (log)	1882	18.153	1.647	-0.529*	0.418*	-0.010	-0.157*	1.0000			
6.Leverage	1882	24.296	19.984	-0.140*	0.081*	-0.059*	-0.371*	0.215*	1.000		
7.Firm age (log)	1882	53.284	21.335	-0.476*	0.362*	0.006	-0.308*	0.460*	0.209*	1.000	
8.Committee system (binary)	1882	.022	.146	0.051*	0.056*	0.143*	0.005	0.020	-0.023	0.034	1.000

* $p<0.05$

5 Results

Tables 2 and 3 show the summary statistics for the variables and the results of the pooled logit regression respectively. The results for the logit regression in Model 1 of Table 3 indicate that foreign ownership is closely related to the adoption of committee system ($p < 0.001$), while it is negatively moderated by ROA ($p < 0.05$) in Model 2. However, the moderating effect is not large enough, since the coefficient of foreign ownership becomes much larger (.084 → .180, $p < 0.001$) in Model 2. In contrast, ROA does not show any significant relationship to the adoption of committee system. The results imply that the effects of performance on governance change are not large enough. Even different time lags produce the same results in Models 3 and 4 of Table 3. There is no difference between the influence of the one-year time lag and that of the three-year time lag. These regression results explain an increase in the influence of foreign ownership on the change of Japanese firms' governance mechanisms, providing support for Hypothesis 1 (the more a firm relies on capital markets for resource acquisition, the more likely it will adopt shareholder-oriented mechanisms).

Table 3. Pooled logit regression of committee system

Dependent variable	logit regression (committee system dummy)			
Independent variables	Model 1	Model 2	Model 3	Model 4
Ownership concentration (t-1)	0.019	0.020		
	(0.016)	(0.016)		
Bank ownership (t-1)	0.045	0.051+		
	(0.029)	(0.029)		
Foreign ownership (t-1)	0.084***	0.180***		
	(0.025)	(0.056)		
ROA (t-1)	0.003	0.052		
	(0.052)	(0.055)		
Foreign ownership*ROA (t-1)		-0.012*		
		(0.005)		
Total assets (log) (t-1)	0.235	0.143		
	(0.152)	(0.156)		
Leverage (log) (t-1)	-0.005	-0.009		
	(0.011)	(0.012)		
Firm age (log) (t-1)	0.015	0.020		
	(0.012)	(0.013)		
Constant	-26.753	-26.577		
	(1,544.805)	(1,824.733)		
Ownership concentration (average t-1,-2,-3)			0.013	0.015
			(0.016)	(0.016)
Bank ownership (average t-1,-2,-3)			0.040	0.052
			(0.034)	(0.033)
Foreign ownership (average t-1,-2,-3)			0.116***	0.249***
			(0.036)	(0.065)
ROA (average t-1,-2,-3)			0.039	0.096
			(0.056)	(0.060)
Foreign ownership*ROA (average t-1,-2,-3)				-0.019**
				(0.007)
Total assets (log) (average t-1,-2,-3)			0.243	0.160
			(0.150)	(0.153)
Leverage (log) (average t-1,-2,-3)			-0.001	-0.003
			(0.011)	(0.012)
Firm age (log) (average t-1,-2,-3)			0.014	0.018
			(0.012)	(0.013)
Constant			-9.156**	-8.447**
			(3.029)	(3.026)
Industry & year	Included	Included	Included	Included
No. of observations	482	482	338	338
LR chi2	74.08***	81.64***	39.66***	48.25***
Pseudo R2	.2687	.2961	.1614	.1963

Standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05, † p<0.1.

Table 4. Pooled regression of corporate performance

Dependent variables	ROA		Sales growth rate	
Independent variables	Model 1	Model 2	Model 3	Model 4
Ownership concentration (t-1)	0.004	0.002	0.117*	0.130*
	(0.008)	(0.008)	(0.050)	(0.051)
Bank ownership (t-1)	0.069***	0.064***	0.002	0.011
	(0.017)	(0.019)	(0.117)	(0.121)
Foreign ownership (t-1)	0.041***	-0.075	-0.037	0.692
	(0.013)	(0.066)	(0.084)	(0.426)
Ownership concentration (t-1)* foreign ownership (t-1)		0.002†		-0.012*
		(0.001)		(0.006)
Bank ownership (t-1)* foreign ownership (t-1)		0.002		0.017
		(0.003)		(0.022)
Total assets (log) (t-1)	-0.056	-0.040	0.803	0.653
	(0.077)	(0.078)	(0.504)	(0.506)
Leverage (log) (t-1)	-0.059***	-0.060***	-0.077*	-0.074*
	(0.005)	(0.005)	(0.033)	(0.033)
Firm age (log) (t-1)	-2.030***	-2.037***	-3.523*	-3.416*
	(0.235)	(0.235)	(1.532)	(1.531)
Industry/ Year	included	included	included	included
Constant	14.565***	14.467***	-0.198	1.718
	(1.686)	(1.688)	(10.981)	(10.985)
No. of observations	1,674	1,674	1,674	1,674
F	17.43***	16.19***	2.73***	2.79***
Adjusted R2	.1843	.1850	.023	.026

Standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05, † p<0.1.

However, the results of pooled regression in Table 4 indicate a complicated relationship between shareholder orientation and corporate performance. ROA and sales growth rate were influenced by either independent functions of Japanese characteristic and newly adopted governance mechanisms or their interactions. Model 1 of Table 4 shows that both bank ownership and foreign ownership have positive relationship to ROA ($p < 0.001$). Regarding sales growth rate, ownership concentration shows positive relationship ($p < 0.05$) in Model 3 of Table 4. Noteworthy is that the interactions between ownership concentration and foreign ownership are significantly related to a firm's value creation. They are positively affecting ROA in Model 2 of Table 4 ($p < 0.1$), while negatively related to sales growth rate in Model 4 of Table 4 ($p < 0.05$). The interactions between bank ownership and foreign ownership do not show any significant relationships to ROA and sales growth rate. The outcomes partly support Hypotheses 2a and 2b: foreign ownership positively affects a firm's performance either independently or in interaction with a society's characteristic governance mechanisms, while more effective in increasing ROA than in promoting sales growth rate. In addition, the results in Table 4 support Hypotheses 3a and 3b, which predicted that some of a society's distinct governance mechanisms, i.e., ownership concentration and bank ownership in our study, would retain their positive relationship to a firm's performance.

Table 5. Two-sample t-test: A performance comparison between firms with committee system and firms without committee system

Variables		(1) Firms without committee system	(2) Firms with committee system	Difference: (1)-(2) (t-test)
ROA	Mean	4.172 (0.098)	4.308 (0.972)	-0.1359 (0.674)
	Median	3.274	3.064	0.210
	No. of observations	1,841	41	
Sales growth rate	Mean	3.618 (1.372)	1.351 (5.739)	2.266 (9.234)
	Median	1.061	0.966	0.095
	No. of observations	1,841	41	
Sales/total assets	Mean	1.046 (0.016)	0.960 (0.078)	0.086 (0.105)
	Median	0.877	1.038	-0.161
	No. of observations	1,841	41	

Standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05, † p<0.1.

Table 6. Two-sample t-test: Corporate performances before and after the adoption of committee system

Variables		(1) Before committee system	(2) After committee system	Difference: (1)-(2) (t-test)
ROA	Mean	5.059 (0.271)	4.308 (0.972)	0.751
	Median	4.198	3.064	1.134†
	No. of observations	272	41	
Sales growth rate	Mean	1.208 (0.797)	1.351 (5.739)	-0.143
	Median	1.288	0.966	0.322
	No. of observations	272	41	
Sales/total assets	Mean	1.108 (0.049)	0.960 (0.078)	0.148
	Median	0.984	1.038	-0.054
	No. of observations	272	41	

Standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05, † p<0.1.

We further conducted two sample t-tests to examine the difference in performance of the two types of Japanese firms: 1) t-test comparing the performance of firms with committee system with that of those without such system and 2) t-test comparing the performances of firms with committee system before and after the adoption of the system. The results of the first t-test in Table 5 do not indicate better performance of the firms with committee system. As shown in Table 6, firms with committee system did not show a significant performance change after the adoption of the system.

6 Discussion and conclusion

Using Japanese firms, we examined how a change in resource acquisition triggers corporate governance change and its effects on a firm's value creation. The results indicate no substantial difference in corporate performance between the firms that advocated shareholder-oriented mechanisms and those that maintained Japanese coordination tradition. We examined this phenomenon using two dimensions of corporate governance: resource acquisition and value creation activities. Japanese society's coordination tradition still affects a firm's value creation efforts. This suggests that firms should consider the contrasting principles in corporate governance simultaneously, that is, resource acquisition based on the increasing influence of shareholder orientation and value creation activities affected by societal contexts.

This study differs from the literature of corporate governance, which emphasizes the increasing importance of shareholder orientation or pays attention to the heterogeneity of corporate governance across countries, relatively disregarding the functional dimension of a society's characteristic governance mechanisms. Instead, our study sheds light on the underlying logic which shapes the coexistence of contrasting governance mechanisms in a firm in terms of their performance contribution. The results of this study indicate that firms show separate responses to contrasting principles to fulfill expected goals in each dimension of corporate governance, which should enhance their performance. This suggests that the coexistence of contrasting mechanisms in a firm's governance system is not the sole result of sociopolitical power struggles or historical legacies. On the contrary, contrasting mechanisms appealing to different external pressures (e.g., the need to compromise shareholder value in capital markets and the cooperating relationship in Japanese society) may facilitate a division of functions in corporate governance and help firms to enhance their performance in each dimension of resource acquisition and value creation activities. The results illustrate that the adoption of shareholder-oriented practices is related to market financing for resource acquisition, and that organizational practices based on the societal tradition are also positively related to a firm's value creation activities.

The encounter of contrasting governance principles in a firm facilitates both change and continuity. Firms' separate responses to contrasting principles for the acquisition of resources from capital markets and for value creation based on their society's coordination tradition may facilitate diverse formulae for achieving a compromise between contrasting mechanisms and result in a wide range of corporate governance systems across firms and countries. The differences in organizational forms and practices between shareholder-oriented and relationship-based firms in Japan highlight how contrastingly the two types of Japanese firms respond to the two dimensions of corporate governance, even though it is disputable whether the differences are substantial (Deakin & Whittaker, 2009; Fuwa, 2009). For instance, Sony's adoption of shareholder-oriented mechanisms was associated with its increasing reliance on foreign ownership (50.6% as of 2008, Sony's 2008 annual report: 100) in capital markets, coupled with aggravated performance. Toyota, whose ownership structure mainly relied on domestic corporate and financial institutions (53.5% as of 2008, Toyota's 2008 annual report: 135), was relatively stable in terms of external pressure from capital markets. Sony transformed its structure through the "company-in-company" system for autonomous decision-making. This change in corporate structure sheds light on third-party contracts beyond the characteristic virtually internalized relationship (Sony's 2008 annual report: 33, 67, 76). In contrast, Toyota implemented the "built-in" strategy in accordance with Japanese society's cooperating relationships. Nevertheless, because of capital markets' increasing influence, demonstrated by foreign investors' 26.1% ownership stake in the firm, Toyota was influenced to some extent (although not as much as Sony was) by the principle of shareholder orientation: the number of board members decreased from approximately 50 in the 1990s to 30 in 2008; the position of managing director, a non-board member, was introduced; and a majority of corporate auditors were outsiders (Toyota's 2008 annual report: 54, 58-59).

The two tales of corporate governance change in Japan indicate that firms consider their idiosyncratic formula for achieving a compromise between contrasting principles. Each firm's respective formula can be justified by the fact that there is no difference between the performance of Japanese firms with a more shareholder-oriented board structure and that of those less responsive to the pressure of capital markets, as illustrated by Tables 5 and 6. This suggests that firms which advocate Japanese cooperating tradition can be also rationalized to achieve value creation, while they cannot perfectly avoid shareholder orientation arisen from capital markets. Our statistical outcome supports the distinct responses of Toyota from that of Sony to make an appropriate formula for operationalization of the contrasting principles in corporate governance. Created values, measured by ROA and sales growth rate in this study, are affected by either a society's characteristic governance mechanisms and shareholder-oriented ones or their interactions. Our study illustrates that unilateral compliance to the requirements of capital markets is not the only solution to improve corporate governance system and consequent corporate performance.

Our analysis of the different scope of relationships between resource acquisition and value creation activities suggests that the mechanisms for resource acquisition based on shareholder orientation may not be directly applicable to value creation for firms operating in a society characterized by cooperating relationships. Although the adoption of outside directors and committee systems can be appealing to capital markets for resource acquisition and may facilitate market financing, it has limitations to support multilateral relationships between a focal firm and its diverse stakeholders for value creation activities. The results indicate that firms should design compromises between the mechanisms underlying resource acquisition and capital providers' requirements as well as between the mechanisms underlying value creation and the society's coordination tradition.

6.1 Concluding remarks

While the literature of corporate governance, regardless of whether it advocates shareholder orientation or emphasizes societal contexts, has relatively disregarded the functional dimension of a society's characteristic governance mechanisms, our analysis of the general performance of Japanese firms illustrates the division of functions in corporate governance and their simultaneous operationalization of contrasting principles between newly adopted and a society's distinct organizational constraints. Noteworthy is that one governance model is not likely to dominate, but to complement another in a given society through their independent or interacting contributions to performance enhancement. In this regard, the focus should be put on understanding diverse formulae for achieving an appropriate compromise between the two contrasting corporate governance mechanisms and improving their effectiveness for performance. The compromise will facilitate the coexistence of contrasting mechanisms in firms and its heterogeneity will shape diverse corporate governance systems across firms and countries.

For future research, nevertheless, we have to acknowledge a couple of limitations in this study. We need to extend the time window to recent years to effectively measure the influence of governance change on performance. While the current dataset has advantage to explain the antecedents of governance change, it is not efficient enough to capture performance implications in governance change. We also need to include more strictly quantified variables. Regarding reliance on capital markets, foreign ownership as a proxy, despite its merits, seems to be the presence of foreign shareholders rather than any detailed study of companies' reliance on corporate bonds, equity issues, bank loans, or internal resources for funding. We also need to pay attention to the process of value creation, such as resource allocation. Allocation of resources can be measured by, for example, changes in R&D.

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