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Abstract:

According to a list of the 200 most highly-paid chief executives at the largest U.S. public companies in 2013, Oracle's Lawrence J. Ellison remained the best paid CEO and earned \$96.2 million as total annual compensation last year. He has received \$1.8 billion over the past 20 years. The lowest paid on the same list is General Motors' D. F. Akerson who earned \$11.1 million. The average national pay for a non-supervisory US worker was \$51,200 last year and a CEO made 354 times more than an average worker in 2012. Hunter Harrison, Canadian Pacific Railway Ltd., was the best paid CEO in Canada for 2012 and received \$49.2-million as total annual compensation, significantly higher than the 2011 best paid CEO, Magna's F. Stronach who received \$40.9 million. In 2011, the average annual salary was \$45,488 and Canada's top 50 CEOs earned 235 times more than the average Canadian. These executive pay practices contrast with the growing inequality in Canada, recently illustrated with the finding that 40% of Indigenous children live in poverty. In contrast, Japan's highest paid CEO is Nissan Motor Co.'s Carlos Ghosn who earned 988 million yen (US\$10.1 million) in the year ended March 2013, little changed from the previous year and modestly improved from his US\$ 9.5 million compensation for 2009. That does not even put him among the top 200 most highly-paid U.S. company chiefs and the top 20 best paid CEOs in Canada for 2012. Why are Japanese CEOs paid considerably less than their American or Canadian counterparts? This essay argues that the activism of long-term oriented institutional investors such as banks and the tying of executive pay to worker welfare in the context of a culture of intolerance to excessive executive compensation explain to a great extent the development of a pattern of low executive pay in Japan despite the recent weakening of bank monitoring as a result of the adoption of U.S. governance style in some Japanese companies. The Japanese experience also demonstrates that lower executive compensation does not result in compromising firm performance and is a necessary condition to build a stakeholder-friendly corporation. For example, the CEO of Toyota (world's biggest automaker), Akio Toyoda, earned 184 million yen (\$1.9 million) in 2012, a 35 percent increase from the previous year. He is the lowest-paid chief of the world's five biggest automakers and led Toyota to generate the highest return last year among the top five global automakers. Toyota's outlook for increasing profit prompted the automaker to approve the biggest bonus for workers in the last years. Alan Mulally, Ford Motor's chief and the best paid among the top five, took home \$21 million in 2012.

Keywords:

Executive Compensation in Japan, United States, Canada, CEO pay, institutional investors, Japanese banks, workers' interest, tying CEO pay to employee wages, corporate governance

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WHY DOES EXECUTIVE GREED PREVAIL IN THE UNITED STATES AND CANADA BUT NOT IN JAPAN?

The Pattern of Low CEO Pay and High Worker Welfare in Japanese Corporations

Alberto R. Salazar¹ & John Raggiunti²

July, 2014

ABSTRACT

According to a list of the 200 most highly-paid chief executives at the largest U.S. public companies in 2013, Oracle's Lawrence J. Ellison remained the best paid CEO and earned \$96.2 million as total annual compensation last year. He has received \$1.8 billion over the past 20 years. The lowest paid on the same list is General Motors' D. F. Akerson who earned \$11.1 million. The average national pay for a non-supervisory US worker was \$51,200 last year and a CEO made 354 times more than an average worker in 2012. Hunter Harrison, Canadian Pacific Railway Ltd., was the best paid CEO in Canada for 2012 and received \$49.2-million as total annual compensation, significantly higher than the 2011 best paid CEO, Magna's F. Stronach who received \$40.9 million. In 2011, the average annual salary was \$45,488 and Canada's top 50 CEOs earned 235 times more than the average Canadian. These executive pay practices contrast with the growing inequality in Canada, recently illustrated with the finding that 40% of Indigenous children live in poverty. In contrast, Japan's highest paid CEO is Nissan Motor Co.'s Carlos Ghosn who earned 988 million yen (US\$10.1 million) in the year ended March 2013, little changed from the previous year and modestly improved from his US\$ 9.5 million compensation for 2009. That does not even put him among the top 200 most highly-paid U.S. company chiefs and the top 20 best paid CEOs in Canada for 2012. Why are Japanese CEOs paid considerably less than their American or Canadian counterparts? This essay argues that the activism of long-term oriented institutional investors such as banks and the tying of executive pay to worker welfare in the context of a culture of intolerance to excessive executive compensation explain to a great extent the development of a pattern of low executive pay in Japan despite the recent weakening of bank monitoring as a result of the adoption of U.S. governance style in some Japanese companies. The Japanese experience also demonstrates that lower executive compensation does not result in compromising firm performance and is a necessary condition to build a stakeholder-friendly corporation. For example, the CEO of Toyota (world's biggest automaker), Akio Toyoda, earned 184 million yen (\$1.9 million) in 2012, a 35 percent increase from the previous year. He is the lowest-paid chief of the world's five biggest automakers and led Toyota to generate the highest return last year among the top five global automakers. Toyota's outlook for increasing profit prompted the automaker to approve the biggest bonus for workers in the last years. Alan Mulally, Ford Motor's chief and the best paid among the top five, took home \$21 million in 2012.

INTRODUCTION

Executive compensation has become a very pressing issue in the mid of the economic crisis, failing corporate governance systems and growing income inequalities in rich, industrialized countries. "One of the great, as-yet-unsolved problems today is executive

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compensation and how it is/has come to be determined”.³ Executive compensation is widely perceived as abusive and grossly excessive and an important factor in expanding the unfair distribution of wealth. Among the 200 most highly-paid chief executives at the largest U.S. public companies, Oracle’s Lawrence J. Ellison is the best paid CEO and earned \$96.2 million as total annual compensation in 2012.⁴ He has received \$1.8 billion over the past 20 years.⁵ The lowest paid on the same list is General Motors’ D. F. Akerson who earned \$11.1 million. A CEO made 354 times more than an average worker in 2012.⁶

The best paid CEO in Canada for 2012 was Canadian Pacific Railway Ltd.’s CEO, Hunter Harrison, who received \$49.2-million as total annual compensation, significantly higher than the 2011 best paid CEO, Magna’s F. Stronach who received \$40.9 million. In 2011, the average annual salary was \$45,488 and Canada’s top 50 CEOs earned 235 times more than the average Canadian worker.⁷ These executive pay practices contrast with the growing inequality. Canada ranks 25th among the 30 countries in the Organization for Economic Co-operation and

³ BEBCHUK AND FRIED, THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004), 189.

⁴ Karl Russell, *Executive Pay by the Numbers. Here are the 200 most highly-paid chief executives at U.S. public companies in 2013*, EQUILAR, NEW YORK TIMES, June 29, 2013, http://www.nytimes.com/interactive/2013/06/30/business/executive-compensation-tables.html?_r=0.

⁵ SARAH ANDERSON, SCOTT KLINGER & SAM PIZZIGATI, EXECUTIVE EXCESS 2013: BAILED OUT, BOOTED, AND BUSTED. A 20-YEAR REVIEW OF AMERICA’S TOP-PAID CEOS (2013).

⁶ Ibid.

⁷ CANADIAN CENTRE FOR POLICY ALTERNATIVES, OVER-COMPENSATING: EXECUTIVE PAY IN CANADA (2013), available at:

http://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2013/01/Overcompensating_CEOFactsheet.pdf

Development with regard to child poverty. The average child poverty rate for all children in Canada is 17% while 40% of Indigenous children live in poverty.⁸

A remarkable move forward is needed in order to narrow the gap that executive compensation creates within companies and society at large. The failures of existing corporate governance systems can be blamed for the excessiveness of executive pay. “Ultimately, the problems of executive compensation arise from a basic corporate governance problem”.⁹ The inability of modern corporate governance mechanisms to control excessive executive compensation and monitor self-interested and self-indulgent executives has become evident around the world. The problems of executive compensation can be fully addressed by adopting reforms that would confront corporate governance ideals with a different set of incentives, structures and objectives.¹⁰ Some lessons can be learned from comparative studies of corporate governance systems.

Japan has developed a pattern of low executive pay.¹¹ For example, the highest paid CEO is Nissan Motor Co.’s Carlos Ghosn who earned 988 million yen (US\$10.1 million) in the year

⁸ DAVID MACDONALD & DANIEL WILSON, POVERTY OR PROSPERITY. INDIGENOUS CHILDREN IN CANADA (2013), available at: http://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2013/06/Poverty_or_Prosperty_Indigenous_Children.pdf

⁹ BEBCHUK et al, supra note 3.

¹⁰ Ibid.

¹¹ See e.g. Robert J. Jackson, Jr. & Curtis J. Milhaupt, *Corporate Governance and Executive Compensation: Evidence from Japan*, COLUM. BUS. L. REV. 111 (2014); Steven N. Kaplan, *Top Executive Rewards and Firm*

ended March 2013,¹² little changed from the previous year and modestly improved from his US\$ 9.5 million compensation for 2009. That does not even put him among the top 200 most highly-paid U.S. company chiefs and the top 20 best paid CEOs in Canada for 2012. Japanese executive compensation practices have thus diverged from the West and it is important to explore the reasons for such low CEO pay pattern. This paper discusses executive compensation in Japan from a comparative perspective and highlights some of facts and reasons that may account for the development of the Japanese pattern of low executive pay while maintaining high levels of efficiency and competitiveness. It argues that the activism of long-term oriented institutional investors such as banks and the informal tying of executive pay to worker welfare in the context of a culture of intolerance to excessive executive compensation to a great extent explain the development of a pattern of low executive pay in Japan. The Japanese experience also demonstrates that lower executive compensation does not result in compromising firm performance and is a necessity to build a stakeholder-friendly corporation. The paper begins with a quick overview of the corporate governance context of executive pay in Japan and the West. It then briefly reviews executive compensation practices in Japan, Canada and the United States and suggests that managers can be highly competitive with lower compensations as demonstrated

Performance: A Comparison of Japan and the United States, 102 J. Pol. Econ. 510 (1994) (finding that Japanese executives own less stock and receive lower cash compensation than U.S. executives).

¹² Anna Mukai & Horie Masatsugu, *Toyota President Delivers Highest Returns For Lowest Pay*, BLOOMBERG, June 25, 2013, <http://www.bloomberg.com/news/2013-06-24/toyota-president-delivers-highest-returns-for-lowest-pay.html>.

in Japan. The last section is central and examines the corporate governance reasons that may account for the Japanese pattern of low executive compensation.

CORPORATE GOVERNANCE AND EXECUTIVE COMPENSATION IN JAPAN AND THE WEST IN A NUTSHELL

Organizing and governing a corporation in capitalist societies have always been a challenging task for business leaders, policy-makers and academics. Some practices appear to be common around the world and encompass “no limits on how long the company can be in business, investments occurring outside the company became the norm, and most importantly directors/management gained increased power over operations, as well as strong support from the courts”.¹³ In addition, a corporation’s legal personality, transferability of shares, delegated management under a board structure, shared ownership by investors of capital, and limited liability of owners and management are considered the common characteristics that structure the modern corporation.¹⁴ This description of the corporation seems to be the consensus across countries.

Yet, the divergence in corporate governance becomes quite evident once the attention is drawn to countries with cultural differences that utilize distinctly different business practices

¹³ DAVID KORTEN & TEDNACE, GANGS OF AMERICA (2003), chapter 1 at 2.

¹⁴ Henry Hansmann & Reiner Kraakman, *The End of History for Corporate Law*, 89 GEORGETOWN LAW JOURNAL 129 (2001).

such as Japan. As known, Western nations such as Canada and the United States constitute liberal market economies whereas Japan recognizes a more coordinated market approach. Within a liberal market economy, all coordination problems between firms, financiers, employees and other participants are largely handled through market incentives or free market mechanisms.¹⁵ On the other hand, coordinated market economies rather depend heavily on non-market relationships within formal institutions and long term objectives.¹⁶ Specifically, Japanese firms tend to embody more of a total package organization and are committed to their long-term sustainability.

Companies in the West often embody a short term, top down mindset which can go a long way in flawing future company endeavors. Indeed, “the current system creates a culture of how much money they can make right now and not one that looks at how decisions affect the company ten years down the road. Few investors with power and CEO’s in general never embrace a long-term outlook”.¹⁷ Positions, bonuses and general operations are based on this short term performance and top down framework. “In the United States and Canada, corporate governance is concerned with ensuring the firm run in the interests of shareholders and that its

¹⁵ PETER HALL & DAVID SOSKICE, AN INTRODUCTION TO VARIETIES OF CAPITALISM; FROM VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPETITIVE ADVANTAGE (2001) at 8.

¹⁶ Ibid at 8

¹⁷ JOHN GILLESPIE & DAVID ZWEIG, MONEY FOR NOTHING (2010) at 131.

objective is to create wealth for them”.¹⁸ This fundamental idea is also entrenched within the legal framework of both countries, notably through strong fiduciary duties designed largely to maximize shareholder value.¹⁹

Generally, three elements characterize the Japanese corporate governance model: main bank capital markets, keiretsu cross-holdings, and insider boards of directors.²⁰ “The role of bank lending is crucial and the Japanese financial system is classified as bank-centered due to the predominance of corporate borrowings from a centrally designated bank, called the main bank. This main bank acts as the leader in monitoring Japanese firms and is also the top lender”.²¹ One of the advantages gained from the main bank is that it may operate as a mediator towards any outside market influences or tendencies. The keiretsu is an industrial group whose member firms are bound by long term cross-shareholdings and maintain strong business and financial ties.²² The keiretsu system effectively eliminates the misrepresentation of management found in Western corporations by having strong monitoring mechanisms. By pooling voting rights, the keiretsu has control over member managers and ensures that none behave opportunistically or

¹⁸ Alan Franklin & Zhao Mengxin, *The Corporate Governance Model of Japan: Shareholders are not Rulers*, University of Pennsylvania, 1-19, 2 (2007), available at:

<http://finance.wharton.upenn.edu/~allenf/download/Vita/Japan-Corporate-Governance.pdf>.

¹⁹ *Ibid* at 2.

²⁰ HUONG HIGGINS, CORPORATE GOVERNANCE IN JAPAN: ROLE OF BANKS, KEIRETSU AND JAPANESE TRADITIONS; FROM THE GOVERNANCE OF EAST ASIAN CORPORATIONS: POST ASIAN FINANCIAL CRISIS (2004) at 96; Basu, Hwang, Mitsudome & Weintrop, *Corporate Governance, Top Executive Compensation, and Firm Performance in Japan*, 15 (1) PACIFIC-BASIN FINANCE JOURNAL 56, 58-60 (2007).

²¹ HIGGINS, *supra* note 20, at 98.

²² HIGGINS, *supra* note 20, at 99; Basu, Hwang, Mitsudome & Weintrop, *supra* note 20, at 59.

collude operations.²³ Firms that belong to the keiretsu are essentially bound together by a series of connected contracts which maintain the crucial business relationships that are required. Japanese boards are divided into a hierarchical structure based on promotion from within the company with very little influence from “outsiders” except for representatives of the main bank.²⁴

It is important to note that, after the deregulation of the financial systems and corporate governance reforms in Japan, banks were limited in their use of “mochiai” or cross-shareholding²⁵ and the Commercial Code in 2003 allowed Japanese firms to adopt a new board system with three committees (auditing, nomination and compensation) similar to the Western systems²⁶ and the majority of the committee members should be outside directors²⁷. However, recent studies indicate that internationally exposed, more experienced and highly cross-held

²³ Basu, Hwang, Mitsudome & Weintrop, *supra* note 20, at 59.

²⁴ HIGGINS, *supra* note 20.

²⁵ T. Hoshi, & A. Kashyap, *Will the U.S. bank recapitalization succeed? Eight lessons from Japan*. 97 JOURNAL OF FINANCIAL ECONOMICS 398 (2010); Hideaki Sakawa, Keisuke Moriyama & Naoki Watanabel, *Relation between Top Executive Compensation Structure and Corporate Governance: Evidence from Japanese Public Disclosed Data*, 20(6) CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 593, 594 (2012).

²⁶ Sakawa, Moriyama & Watanabel, *supra* note 25, at 594-595; Toru Yoshikawa & Jean McGuire, *Change and Continuity in Japanese Corporate Governance*, 25 ASIA PACIFIC JOURNAL OF MANAGEMENT 5, 14 (2008)(also noting that if a company chooses a committee structure, it is required to have three committees, i.e., a nominating committee, an audit committee and a compensation committee); S.H. Goo & Fidy Xiangxing Hong, *The Curious Model of Internal Monitoring Mechanisms of Listed Corporations in China: The Sinonisation Process*, 12 (3) EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 469, 507 (2011).

²⁷ Ronald J. Gilson & Curtis J. Milhaupt, *Choice As Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J. COMP. L. 343, 353 (2005); Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 122.

firms, with higher foreign ownership, are more likely to adopt the committee system.²⁸ On the other hand, firms with larger proportions of bank ownership are to some extent negatively associated with the adoption of the committee system.²⁹ As a result, the traditional monitoring of firms by banks appears to be declining.³⁰ This process of corporate governance reforms suggests that, in terms of executive compensation decisions, Japanese corporations may be making a slow transition from the old way of approving self-proposed executive compensation at the annual meeting of shareholders³¹ to compensation committee determination.

JAPANESE EXECUTIVE COMPENSATION IN COMPARATIVE PERSPECTIVE

Compensation levels in Canada and the United States have been on the rise since 2001, where increases in real terms of 285% and 370% from the years ranging 1993-2001 have been documented.³² A higher proportion of bonuses and stock options are particularly evident in United States. Gathering information from base salaries, annual bonuses, long term incentive

²⁸ Amon Chizema & Yoshikatsu Shinozawa, *The 'Company with Committees': Change or Continuity in Japanese Corporate Governance?*, 49 (1) JOURNAL OF MANAGEMENT STUDIES 77 (2012).

²⁹ *Ibid.*

³⁰ *Ibid.*

³¹ Hideaki Sakawa & Naoki Watanabel, *Executive Compensation and Firm Performance in Japan: The Role of Keiretsu Memberships and Bank-Appointed Monitors*, 9 (8) JOURNAL OF MODERN ACCOUNTING AND AUDITING 1119, 1120 (2013).

³² BEBCHUK et al, *supra* note 3.

plans and stock options from both a Canadian and United States perspective reveals just how deep the gap is:

Table 1: Top Ten Highest Paid CEO's in the U.S.A. (2008-2009)³³

<i>Company Name</i>	<i>CEO Name</i>	<i>Total Realized Compensation</i>
<i>Blackstone Group L.P.</i>	Stephen Schwarzman	\$702,440,573 million
<i>Oracle Corporation</i>	Lawrence Ellison	\$556,976,600 million
<i>Occidental Petroleum</i>	Ray Irani	\$222,639,705 million
<i>Hess Corp.</i>	John Hess	\$159,566,940 million
<i>Ultra Petroleum</i>	Michael Watford	\$116,929,392 million
<i>Chesapeake Energy</i>	Aubrey McClendon	\$114,286,867 million
<i>XTO Energy</i>	Bob Simpson	\$103,485,972 million
<i>EOG Resources Inc.</i>	Mark Papa	\$90,471,784 million
<i>Nabors Industries Ltd.</i>	Eugene Isenberg	\$79,333,079 million
<i>Abercrombie & Fitch</i>	Michael Jeffries	\$71,795,744 million

According to a list of the 200 most highly-paid chief executives at the largest U.S. public companies in 2013, Oracle's Lawrence J. Ellison remained the best paid CEO and earned \$96.2 million as total annual compensation last year.³⁴ He has received \$1.8 billion over the past 20

³³ Andy Burt, *U.S. Top Ten Highest Paid CEOs of 2008*, BLOOMBERG, 2008, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aeN1uFdDx3KA>

³⁴ Russell, *supra* note 4.

years.³⁵ The lowest paid on the same list is General Motors' D. F. Akerson who earned \$11.1 million. The top ten highest-paid CEOs on that list are as follows:

Table 2: Top Ten Highest Paid CEO's in the U.S.A. for 2012³⁶

<i>Company Name</i>	<i>CEO Name</i>	<i>Total Realized Compensation</i>
Oracle	Lawrence J. Ellison	\$96.2 million
Activision Blizzard	Robert A. Kotick	\$64.9 million
CBS	Leslie Moonves	\$60.3 million
Discovery Communications	David M. Zaslav	\$49.9 million
Level 3 Communications	James Q. Crowe	\$40.7 million
HCA	Richard M. Bracken	\$38.6 million
Walt Disney	Robert A. Iger	\$37.1 million
Nuance Communications	Paul A. Ricci	\$37.1 million
Yahoo	Marissa A. Mayer	\$36.6 million
Nike	Mark G. Parker	\$35.2 million

In Canada, Hunter Harrison, Canadian Pacific Railway Ltd., was the best paid CEO for 2012 and received \$49.2-million as total annual compensation, significantly higher than the 2011 best paid CEO, Magna's F. Stronach who received \$40.9 million. CEO pay remained very high even in 2009, the worse year of the economic recession in Canada:

³⁵ Anderson, Klinger & Pizzigati, *supra* note 5.

³⁶ Russell, *supra* note 4.

Table 3: Canada's Top Ten Highest Paid CEO's of 2009 (the worst year of the recession)³⁷

<i>Company Name</i>	<i>CEO Name</i>	<i>Total Compensation</i>
<i>Barrick Gold Corp.</i>	<i>Aaron Regent</i>	<i>\$24,217,040</i>
<i>Canadian National Railway Co.</i>	<i>Hunter Harrison</i>	<i>\$17,343,160</i>
<i>Onex Corp.</i>	<i>Gerald Schwartz</i>	<i>\$16,689,758</i>
<i>Toronto Dominion Bank</i>	<i>Edmund Clark</i>	<i>\$15,188,391</i>
<i>Rogers Communications Inc.</i>	<i>Nadir Mohamed</i>	<i>\$13,687,699</i>
<i>Gammon Gold Inc.</i>	<i>Fred George</i>	<i>\$13,061,177</i>
<i>Niko Resources Ltd.</i>	<i>Edward Sampson</i>	<i>\$12,949,343</i>
<i>Royal Bank of Canada</i>	<i>Gordon Nixon</i>	<i>\$12,095,885</i>
<i>Shaw Communications Inc.</i>	<i>Jim Shaw</i>	<i>\$11,557,119</i>
<i>Yamana Gold Inc.</i>	<i>Peter Marrone</i>	<i>\$11,534,588</i>

Table 4: Canada's Top Ten Highest Paid CEO's of 2011³⁸

<i>Company Name</i>	<i>CEO Name</i>	<i>Total Compensation</i>
Magna	Frank Stronach (Ex-Chair/Ex-CEO)	40,984,820
Valeant Pharmaceuticals Int.	Michael Pearson	36,308,716
Pretium Resources Inc.	Robert A. Quartermain	16,908,729
Shaw Communications Inc.	Bradley Shaw	15,851,336
Dundee Corp.	Ned Goodman	15,037,835

³⁷ HUGH MACKENZIE, RECESSION-PROOF: CANADA'S 100 BEST PAID CEOS (2011), available at: <http://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2011/01/Recession%20Proof.pdf>

³⁸ Canadian Centre for Policy Alternatives, *supra* note 7.

Suncor Energy Inc.	Rick George	14,857,818
Magna International Inc.	Donald Walker	14,836,948
Onex Corp.	Gerald Schwartz	14,133,703
Ivanhoe Mines Ltd.	Robert Friedland	12,574,305
Yamana Gold Inc	Peter Marrone	12,416,999

Table 5: Canada's Top Ten Highest Paid CEO's of 2012³⁹

<i>Company Name</i>	<i>CEO Name</i>	<i>Total Compensation</i>
Canadian Pacific Railway Ltd.	Hunter Harrison	\$49.2-million
Thomson Reuters Corp.	James Smith	\$18.8-million
Talisman Energy Inc.	John Manzoni	\$18.7-million
Eldorado Gold Corp.	Paul Wright	\$18.7-million
Magna International Inc.	Donald Walker	\$16.9-million
Open Text Corp.	Mark Barrenechea	\$14.8-million
Royal Bank of Canada	Gordon Nixon	\$13.7-million
Onex Corp.	Gerald Schwartz	\$13.3-million
Catamaran Corp.	Mark Thierer	\$12.9-million
Yamana Gold Inc.	Peter Marrone	\$12.1-million

This quick data shows that excessiveness have been dominating executive compensation practices in the United States and Canada even during one of the worst economic recessions. It also raises serious concerns about the effectiveness of disclosure and monitoring mechanisms designed to control excessive compensation in the West. Even with the Securities Exchange Commission (SEC) having precise requirements on the mandatory disclosure of the highest paid

³⁹ *How Much Canada's Top 100 Ceos Got Paid Last Year*, THE GLOBE AND MAIL, May. 27 2013, updated Jul. 23 2013), <http://www.theglobeandmail.com/report-on-business/careers/management/executive-compensation/executive-compensation/article12136604/?from=12145005>

corporate officers and their corporate holdings, efforts have still fallen short in facilitating any change to how complex compensation packages are rendered.⁴⁰ Additionally, a number of public web based disclosure sites have been initiated in Canada (sedar.com) and the United States (edgar.com) which contain all mandatory annual reports which present company, director and management based financial information. Without question the bulk of the disparity regarding CEO compensation rests within the United States. Canadian executive pay is also quite unwarranted and creates a rather ominous situation. The economy overall is not constructed to work at its ideal level when enormous compensation packages are handed out to a fraction of individuals within the population. Change is certainly needed, and it “would be wise to consider the competitive international environment in which we compete for corporate patronage”.⁴¹ “Perhaps one could accept the high pay levels of the United States and Canadian executives if one could observe the same high pay levels in other major industrialized countries”.⁴²

However, Japan has developed a pattern of low executive pay and has then made the excessiveness of executive pay and the wage disparities of the West more evident. The following data shows that Japan has maintained lower compensation levels over the last 20 years:

Table 6: International Comparison of CEO Pay⁴³

⁴⁰ Benjamin Alarie, *Executive Compensation and Tax Policy: Lessons for Canada from the Experience of the United States in the 1990's*, 61 (1) UNIVERSITY OF TORONTO FACULTY OF LAW REVIEW 39 (2003).

⁴¹ *Ibid.* at 71.

⁴² GRAEF S. CRYSTAL, *IN SEARCH OF EXCESS*(1991), at 204.

⁴³ Dr. Mark Kroll, *CEO Pay Rates: US versus Foreign Nations*, 510 MANAGEMENT 1 (2005).

<i>Country</i>	<i>Average CEO Pay (1988)</i>	<i>Average CEO Pay (2003)</i>	<i>Foreign CEO Pay Relative to U.S.</i>
Japan (65% Taxed Income)	\$437,655	\$456,937 (-4% Change)	20%
Canada	\$398,946	\$889,898 (123% Change)	45%
United States	\$759,043	\$2,249,080 (196% Change)	100%

Table 7: Japan's Top 50 Highest Paid Executives in 2009 (top 10 only displayed)⁴⁴

<i>Executive</i>	<i>Company</i>	<i>Total (millions-Yen)</i>	<i>Total (\$US)</i>
Carlos Ghosn	<i>Nissan Motor Co.</i>	891	\$9.5 (million)
Howard Stringer	<i>Sony Corp.</i>	815	\$8.7 (million)
Yoshitoshi Kitajima	<i>Dai Nippon Printing Co.</i>	787	\$8.4 (million)
Banjiro Uemura	<i>Tohokushinsha Film Corp.</i>	675	\$7.2 (million)
Alan MacKenzie	<i>Takeda Pharmaceutical Co.</i>	553	\$5.9 (million)
Chihiro Kanagawa	<i>Shin-Etsu Chemical Co.</i>	535	\$5.7(million)
Reiji Hosoya	<i>Futaba Corp.</i>	517	\$5.5 (million)
Hiroshi Mitsuhashi	<i>Nihon Chouzai Co.</i>	477	\$5.1(million)
Hajime Satomi	<i>Sega Sammy Holdings Inc.</i>	435	\$4.6 (million)
Shigetaka Komori	<i>Fujifilm Holdings Corp.</i>	361	\$3.8 (million)

("Total" figure includes salary, bonus, options, retirement, and other benefits)

⁴⁴ Taku Kato & Minh Bui, *Ghosn, Stringer, Katajima are Japan's Most Paid Executives: Top 50 Table*, BLOOMBERG, July 1, 2010, <http://www.bloomberg.com/news/2010-07-02/ghosn-stringer-katajima-are-japan-s-most-paid-executives-top-50-table.html>.

Note.- We have converted Japanese yens to US dollars based on the rate of 93.5 yens per 1 US dollar for 2009 following W. Antweiler.⁴⁵

Recent data further confirms such a pattern of low executive pay in Japan. Nissan Motor Co.'s Carlos Ghosn remains Japan's highest paid CEO and reportedly earned 988 million yen (US\$10.1 million) in the year ended March 2013.⁴⁶ His compensation little changed from the previous year and modestly improved from his US\$9.8 million compensation in 2010⁴⁷ and US\$ 9.5 million compensation for 2009, years in which he was Japan's top earner. It is important to note that the median executive among Japan's 269 most highly paid managers earned approximately \$1.48 million in total compensation for 2010 whereas the median manager's total compensation was approximately \$16.7 million among the 269 most highly paid executives in the United States in 2010.⁴⁸ Ghosn's \$10.1 million compensation for 2013 does not even put him among the top 200 most highly-paid U.S. company chiefs for 2013⁴⁹ and the top 20 best paid CEOs in Canada for 2012. In the automobile industry, Toyota's CEO, Akio Toyoda, reportedly earned 184 million yen (\$1.9 million) in 2012 and is the lowest-paid chief of the world's five biggest automakers.⁵⁰ Ford Motor's CEO, Alan Mulally, is reportedly the best paid among the

⁴⁵ Werner Antweiler, *Foreign Currency Units per 1 U.S. Dollar, 1948-2011*. PACIFIC Exchange Rate Service, UNIVERSITY OF BRITISH COLUMBIA (2012), available at: <http://fx.sauder.ubc.ca/etc/USDpages.pdf>.

⁴⁶ Mukai & Masatsugu, *supra* note 11.

⁴⁷ Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 134.

⁴⁸ *Ibid.*

⁴⁹ Russell, *supra* note 4.

⁵⁰ Mukai & Masatsugu, *supra* note 11.

top five, taking home \$21 million in 2012⁵¹ whereas General Motors' D. F. Akerson earned \$11.1 million in 2012.⁵² Toyota's CEO led his company to generate the highest return among the top five automakers,⁵³ yet he earned less than one-tenth as much as Ford's CEO and less than two-tenths of General Motors' CEO pay.

Part of the explanation for lower compensation levels in Japan vis-a-vis United States and Canada lies in the use of, or the lack thereof, stock options. These stock option components within compensation packages have without question become the single most important element of any Western executive pay plan. Stock options represent over 140% of the base salary in the United States and Canada while Japan sits at a stingy 13%.⁵⁴ More recent studies indicate that the base salary often represents about 70 percent of Japanese executive compensation packages and the incentive plans, excluding cash bonuses, account for only 17 percent.⁵⁵ This is consistent with the fact that share ownership by top executives has not been a prominent feature of executive compensation or traditional corporate governance mechanisms in Japan.⁵⁶ Stock options are a relatively new component introduced into the Japanese corporate world and until

⁵¹ *Ibid.*

⁵² Russell, *supra* note 4.

⁵³ Mukai & Masatsugu, *supra* note 11.

⁵⁴ Gregory Jackson, THE ORIGINS OF NON-LIBERAL CAPITALISM: GERMANY AND JAPAN IN COMPARISON (2001) at pp. 121-170 ("The Origins of Non-Liberal Corporate Governance in Germany and Japan").

⁵⁵ WATSON WYATT WORLD, EXECUTIVE PAY PRACTICE AROUND THE WORLD (2009); Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 114 (finding that the structure of executive pay in Japan relies heavily on payments unrelated to performance such as salary).

⁵⁶ N. Abe, N. Gaston & K. Kubo, *Executive pay in Japan: The role of bank-appointed monitors and the main bank relationship*, 17 (3) JAPAN AND THE WORLD ECONOMY 371, 386 (2005); Steven N. Kaplan, *supra* note 11. (finding that Japanese executives own less stock and receive lower cash compensation than U.S. executives)

recently they did not make much use of them.⁵⁷ Only after the 1997 amendment to the Japanese Commercial Code, it became legally possible to grant stock options.⁵⁸ Moreover, disclosure levels had not been seen as necessary due to the lower compensation levels of top Japanese management. Only recently, on March 31, 2010 the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc. was amended to require companies to disclose the total amount of directors' remuneration, total amount by category and total amount of remuneration of officers whose remuneration exceeds 100 million yen⁵⁹ (approximately \$1 million).⁶⁰ . However, only 152 Japanese public companies disclosed that their 269 executives earned more than 100 million yen in 2009.⁶¹

The disparities between executive pay and worker wages further show the extent to which Japan has diverged from the Western patterns of excessive executive compensation. “CEO pay was 7.8 times higher in Japan than the average worker, and 25.8 times in the United States in 1991, and this figure rose 11 times higher in Japan and an astounding 35 times larger in the

⁵⁷ Basu, Hwang, Mitsudome & Weintrop, *supra* note 20, at 60; Masayuki Morikawa, *infra* note 68.

⁵⁸ Abe, Gaston & Kubo, *supra* note 52, at 381; Masao Nakamura & Syen T. Rebien, *Corporate social responsibility and corporate governance: Japanese firms and selective adaptation*, 45 UBC Law Review 723, 758-59 (2012).

⁵⁹ Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 69 (February, 2013) <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje6000003ukm8.pdf>.

⁶⁰ *In Japan, Underpaid-and Loving It*, BLOOMBERG BUSINESSWEEK, 2011 (indicating \$1.1 million) http://www.businessweek.com/magazine/content/10_28/b4186014341924.htm; Daisuke Wakabayashi, *Japan's Executives to Reveal Compensation Under New Rules*, Wall St. J., June 9, 2010, <http://online.wsj.com/news/articles/SB10001424052748703890904575296390830444072>; Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 127.

⁶¹ Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 131-132; *In Japan, Underpaid-and Loving It*, BLOOMBERG BUSINESSWEEK, 2011 (noting that fewer than 300 executives at Japan's 3,813 public companies earned enough in 2009 to require disclosure), http://www.businessweek.com/magazine/content/10_28/b4186014341924.htm

United States”.⁶² The CEO-worker pay disparity continued to worsen in the United States in the following years, reaching alarming proportions particularly when compared to the Japanese ratio:

Table 8: Ratio of CEO Pay to the Average Worker⁶³

<i>Country</i>	<i>Total Ratio</i>
Japan	11:1
Canada	20:1
United States	475:1

Recent studies have confirmed that CEO-worker pay ratio in the United States and Canada remains extremely high. The pay gap between large company chief executives and average American workers has grown from 195-to-1 in 1993 to 354-to-1 in 2012.⁶⁴ The average national pay for a non-supervisory US worker was reportedly \$51,200 in 2012.⁶⁵ Needless to say, these large pay disparities harm employee morale and productivity. The 2010 Dodd-Frank legislation requiring CEO-worker pay ratio disclosure was enacted to correct such huge disparity and executive excessiveness, but it has not yet been implemented after three years⁶⁶ and has

⁶² Jackson, *supra* note 52, at 292.

⁶³ Kroll, *supra* note 41.

⁶⁴ Anderson, Klinger & Pizzigati, *supra* note 5, at 4.

⁶⁵ Mark Gongloff, *CEOs Paid 273 Times More Than Workers in 2012: Study*, THE HUFFINGTON POST, June 26, 2013, http://www.huffingtonpost.com/2013/06/26/ceos-paid-times-more-than-workers_n_3504821.html

⁶⁶ Anderson, Klinger & Pizzigati, *supra* note 5, at 21.

faced strong opposition from American corporations.⁶⁷ In Canada, the average annual salary was \$45,488 in 2011 and Canada's top 50 CEOs earned 235 times more than the average worker.⁶⁸

Interestingly, Japanese corporations have become some of the most competitive and efficient companies in the world while developing a pattern of low executive pay, low CEO-worker pay ratio and heavy income taxes. This presents important challenges to Western beliefs of the need to correlate high executive pay, shareholder value and firm competitiveness. "The Japanese regularly lecture the West on their short-sighted behavior. They ask how they will ever become competitive unless you are willing to make long-term investments –investments that may produce only losses for years before they begin to pay off".⁶⁹ In particular, Canada and the United States may want to learn that even with lower salaries, higher tax levels, and greater monitoring/disclosure mandates, corporate lifestyle and business operations do not have to suffer. A critical factor in maintaining firm competitiveness with a pattern of low executive pay has been the uniqueness of the Japanese corporate governance system that provides effective monitoring and disclosure and aids in reducing high risk investments/business ventures. The following section further discusses the importance of this Japanese corporate governance system for controlling executive compensation.

⁶⁷ Sarah Anderson, Interview, as reported in "40% of top-paid CEOs busted, bailed out or booted, study says. CEOs of U.S. large companies got about 354 times as much pay as the average American worker in 2012, CBC News, Aug 30, 2013, <http://www.cbc.ca/news/business/story/2013/08/30/business-executive-excess.html>

⁶⁸ Canadian Centre for Policy Alternatives, *supra* note 7.

⁶⁹ Crystal, *supra* note 40, at 205-206.

EXPLAINING THE PATTERN OF LOW EXECUTIVE PAY IN JAPAN

The above review of the patterns of executive pay in Japan, Canada and the US once again confirms that excessive executive compensation is not a universal norm and has little to do with efficiency. Furthermore, the Japanese experience sheds light on the factors that may account for the development of low executive pay patterns. While the Japanese corporate governance system can be credited for the development of lower executive compensation practices, the Japanese business culture steers the governance of corporations towards a practice that is unfriendly to excessive executive pay. A business culture that does not tolerate excessiveness neither encourage greed is likely to both favor lower executive compensation practices and harness the corporate governance system to control executive excessiveness.

The Japanese practice of paying lower compensations to executives appears to be consistent with a long-standing tradition of discouraging greed and shareholder value maximization as the dominant principles of running a company. Contemporary Japanese firms continue to share long-standing attitudes against greed and shareholder primacy in order to maintain social harmony and are often concerned about the long-term sustainability of the firm.⁷⁰

⁷⁰ Nakamura & Rebien, *supra* note 58, at 729. See also Michael E. Porter, *Capital Disadvantage: America's Failing Capital Investment System*, HARV. BUS. REV., Sept.-Oct. 1992, at 70 (claiming that Japanese owners look to the long-term); PAUL MILGROM & JOHN ROBERTS, *ECONOMICS, ORGANIZATION AND MANAGEMENT* 443 (1992) (noting that Japanese firms “are not run in the interest of their shareholders”).

Executives have customarily avoided standing out as highly compensated individuals.⁷¹ A recent study has, for example, found some evidence that executive compensation at Japanese firms with traditional statutory-auditor structures seems to be subject to an upper limit that executives carefully observe with the consequence of not receiving increases that would exceed the limit.⁷² Moreover, this constraint on excessive executive compensation appears to be common to all Japanese managers regardless of whether they lead a firm with the traditional auditor system or the new committee system.⁷³ Similarly, significant portion of executive compensation packages has traditionally been in the form of perquisites as opposed to salary, which has to some extent changed with the recent introduction of stock options in Japan.⁷⁴ Even after stock options were legally allowed in 1997, the number of firms that adopted stock options increased until the mid-2000s and since then has remained the same or decreased slightly.⁷⁵ According to a Ministry of Economy, Trade and Industry survey of approximately 30,000 large and medium-sized Japanese firms, only 1,505 firms or 5.4% of the total firms surveyed adopted stock options in 2009.⁷⁶ As

⁷¹ Nakamura & Rebien, *supra* note 58, at 729

⁷² Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 146.

⁷³ *Ibid.* at 156.

⁷⁴ Kato, Hideaki Kiyoshi, Michael Lemmon, Mi Luo & James Schallheim, *An Empirical Examination of the Costs and Benefits of Executive Stock Options: Evidence from Japan*, 78 (2) JOURNAL OF FINANCIAL ECONOMICS 435, 438-439 (2005).

⁷⁵ Masayuki Morikawa, *Stock Options and Productivity: An empirical analysis of Japanese firms*. RIETI, The Research Institute of Economy, Trade and Industry, RIETI Discussion Paper Series 12-E-011 (February 2012) at 2, <http://www.rieti.go.jp/jp/publications/dp/12e011.pdf>.

⁷⁶ *Ibid.* at 2.

for TSE-listed companies, only 31.1.% (down 0.4%) of listed companies have introduced stock option plans as of February 2013 while expressing hesitation and resistance.⁷⁷

This unfriendly attitude to corporate greed and ensuing lower compensation practices have not resulted in compromising firm performance. For example, Toyota's CEO, Akio Toyoda, reportedly earned 184 million yen (\$1.9 million) in 2012, a 35 percent increase from the previous year. He is the lowest-paid chief of the world's five biggest automakers whereas Alan Mulally, Ford's chief, is the best paid among the top five and took home \$21 million in 2012. Akio Toyoda led Toyota to generate the highest return last year among the top five global automakers.⁷⁸ Toyota has retaken the title of world's biggest automaker from General Motors last year.⁷⁹ Moreover, it is not uncommon that Japanese CEO's will return a portion of their compensations when their companies perform poorly. For instance, in 2010, Toyoda rejected his bonus pay after a recall of more than 8 million cars worldwide, making his annual compensation the lowest among Japan's three largest automakers for that year.⁸⁰ Sony CEO Kazuo Hirai along with approximately 40 Sony senior executives voluntarily forwent annual bonuses for 2012 as the company's profit continued to suffer.⁸¹ More recently, many Japanese listed companies have

⁷⁷ Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 64 (February, 2013), <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje6000003ukm8.pdf>.

⁷⁸ Mukai & Masatsugu, *supra* note 12.

⁷⁹ *Ibid.*

⁸⁰ *Ibid.*

⁸¹ Caroline Fairchild, *Sony CEO among 40 Execs to Give Up Bonuses as Company Struggles*, THE HUFFINGTON POST, May 1, 2013, http://www.huffingtonpost.com/2013/05/01/sony-ceo-bonus_n_3194446.html

indicated that they would cut officer compensation in the event of deteriorating business performance.⁸² This contrasts with Western practices of paying excessive compensation even when the company performs poorly. For example, Oracle's Larry Ellison is the 2012 highest-paid CEO in the United States and received \$96.2 million, a 24 percent increase despite his company's share fell by 23 percent.⁸³ This weak link between pay and performance has been recently proven with the finding that, in the past 20 years, nearly 40 per cent of the highest-paid CEOs in the U.S. have been bailed out, fired or arrested for illegal activities.⁸⁴

Such Japanese business culture has encouraged a clear responsibility of the corporation to its stakeholders.⁸⁵ The prevalence of such strong stakeholder culture in Japan has also worked against the development of excessive executive compensation practices. The belief that, a company should not be run solely to protect the interest of shareholders or executives and the interests of multiple participants that have a stake and contribute to the sustainability of the company are also important,⁸⁶ has often influenced executive pay decisions. "Japan actively ensures that firms are run in such a way that society's resources are used efficiently by taking into account a range of stakeholders, in addition to shareholders, while not having a fiduciary

⁸² Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 66 (February, 2013), <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje6000003ukm8.pdf>

⁸³ Caroline Fairchild, *supra* note 81.

⁸⁴ Anderson, Klinger & Pizzigati, *supra* note 5.

⁸⁵ Nakamura & Rebien, *supra* note 58, at 729.

⁸⁶ Porter, *supra* note 71, at 75 (claiming that Japanese governance process incorporates the interests of employees, suppliers, customers, and the local community).

responsibility”.⁸⁷ Such stakeholder culture influences the role and expectations of CEOs. The Japanese company Toyota illustrates the pursuit of stakeholders’ interests while maintaining high levels of competitiveness. On August 1, 2001 the Financial Times reported details of the annual meeting of the International Corporate Governance Network which was held in Tokyo that year:

Hiroshi Okuda, chairman of Toyota Motor Corporation and of the Japan Federation of Employers’ Associations told the assembled money managers that it would be irresponsible to run Japanese companies primarily in the interests of shareholders. His manner of doing so left no doubt about the remaining depth of Japanese exceptionalism in corporate governance....Mr. Okuda made his point by telling guests what Japanese junior high school textbooks say about corporate social responsibility. Under Japanese company law, they explain, shareholders are the owners of the corporation. But if corporations are run exclusively in the interests of shareholders, the business will be driven to pursue short -term profit at the expense of employment and spending on research and development. To be sustainable, children are told, corporations must nurture relationships with stakeholders such as suppliers, employees and the local community. So whatever the legal position, the textbooks declare, the corporation does not belong to its owners.⁸⁸

Embedded in a culture that is often unfriendly to greed and friendly to stakeholders’ interest, institutional investors, with a long-term stake and therefore interested in the long-term sustainability of corporations, have been a driving force in maintaining lower compensation levels in Japan. Specifically, Japanese banks have played a critical role in controlling excessive compensation, particularly in keiretsu firms. The main bank is usually the top lender to, and one

⁸⁷ Franklin & Mengxin, *supra* note 18, at 3.

⁸⁸ *Ibid.*

of the largest shareholders of, the firm.⁸⁹ In such a position, banks have been able to monitor management via shareholder ownership and bank-appointed directors.⁹⁰ Banks have been effective in limiting the ability of CEO's to control corporations and their monitoring role has helped keep executive compensation at lower levels.⁹¹ In particular, "CEOs of keiretsu firms are more subject to major shareholder monitoring and less able to use their power to increase their own compensation".⁹² Some studies have found that executive compensation is lower in keiretsu firms than in non-keiretsu firms.⁹³ Such shareholder monitoring is associated with the leading role of the main bank that has great control over the keiretsu member firms⁹⁴ and helps reduce managerial opportunism.⁹⁵

⁸⁹ M. Aoki, *Towards an economic model of the Japanese firm*, 28 JOURNAL OF ECONOMIC LITERATURE 1 (1990); Basu, Hwang, Mitsudome & Weintrop, *supra* note 20, at 58.

⁹⁰ Sakawa, Moriyama & Watanabel, *supra* note 25, at 596.

⁹¹ H. Sakawa & N. Watanabel, *Relationship between managerial compensation and business performance in Japan: New evidence using micro data*, 22 ASIAN ECONOMIC JOURNAL 431, 451 (2008); Basu, Hwang, Mitsudome & Weintrop, *supra* note 20.

⁹² Sunny Li Sun, Xia Zhao & Haibin Yang, *Executive compensation in Asia: A critical review and outlook*, 27 ASIA PAC. J. MANAG 775, 784 (2010); similarly T. Kato, *Chief executive compensation and corporate groups in Japan: new evidence from micro data*, 15 INTERNATIONAL JOURNAL OF INDUSTRIAL ORGANIZATION 455 (1997).

⁹³ E. Berglof & E. Perotti, *The governance structure of the Japanese financial keiretsu*, 36(2) JOURNAL OF FINANCIAL ECONOMICS 259 (1994); Kato, *supra* note 87 (finding that "CEOs of keiretsu firms earn 21% less than those of independent firms, after controlling for performance and other relevant variables"); Basu, Hwang, Mitsudome & Weintrop, *supra* note 20; Hideaki Sakawa & Naoki Watanabel, *Executive Compensation and Firm Performance in Japan: The Role of Keiretsu Memberships and Bank-Appointed Monitors*, 9 (8) JOURNAL OF MODERN ACCOUNTING AND AUDITING 1119, 1121 (2013).

⁹⁴ Sunny Li Sun, Xia Zhao & Haibin Yang, *supra* note 80, at 784; Kato, *supra* note 87.

⁹⁵ Sakawa, Moriyama & Watanabel, *supra* note 25, at 596; Basu, Hwang, Mitsudome & Weintrop, *supra* note 20, at 63.

However, after the deregulation of the financial system and corporate governance reforms in Japan and in the face of the pressures from global capital markets, Japanese banks appear to be gradually withdrawing from their traditional monitoring of firms.⁹⁶ The adoption of committee systems and the increase of foreign ownership over the last decade are likely to affect the traditional bank-centered corporate governance systems with their higher bank ownership and bank-appointed directors.⁹⁷ These changes may diminish the power of banks to control potentially excessive executive compensation in the future.⁹⁸ For instance, according to the 2003 reforms of the Commercial Code, firms were allowed to adopt the committee systems, including a compensation committee which is expected to design individual executive compensation and be composed mostly of outside directors.⁹⁹ Similarly, the increasing presence of foreign shareholders puts pressure on existing executive compensation practices and may eventually result in spreading practices such as the wide use of stock options¹⁰⁰ that may bring executive compensation closer to the excessiveness of Anglo-American standards.

⁹⁶ Chizema & Shinozawa, *supra* note 26.

⁹⁷ Sakawa, Moriyama & Watanabel, *supra* note 25, at 605.

⁹⁸ See generally Amon Chizema & Yoshikatsu Shinozawa, *supra* note 28.

⁹⁹ Sakawa, Moriyama & Watanabel, *supra* note 25, at 606; Toru Yoshikawa & Jean McGuire, *supra* note 26; Ronald J. Gilson & Curtis J. Milhaupt, *supra* note 27; Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 122, 125; Robert N. Eberhart, *infra* note 93; Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 44 (February, 2013).

¹⁰⁰ Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 66 (February, 2013) (finding that “there is a trend of the higher the foreign shareholding ratio, the higher the ratio of implementing a performance-linked remuneration system”), <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje60000003ukm8.pdf>

In fact, preliminary evidence indicates that Japanese firms that have adopted U.S. board structures including committees have also adopted similar U.S. pay practices¹⁰¹ suggesting the development of higher executive compensation practices. Highest-paid executives at committee-based firms receive some forty percent of their compensation in performance-sensitive payments such as bonuses and stock options whereas executives at firms with traditional governance structures receive less than twenty percent of their compensation in bonuses and stocks.¹⁰² Non-Japanese executives earn about forty percent more than Japanese executives and receive fifty percent more of their compensation in the form of stock options in comparison to their Japanese counterparts.¹⁰³ While this represents a recent change to the traditional pattern of low executive pay in some Japanese companies, it should be noted that only 112 public Japanese companies adopted the committee system as of April 2009,¹⁰⁴ just 7% of the 152 firms that were required to disclose individual executive compensation in 2010 adopted committees¹⁰⁵ and only 2.2% of all TSE-Listed Companies are companies with committees as of February 2013.¹⁰⁶ Similarly, the total

¹⁰¹ Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 115.

¹⁰² Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 114, 139-140. Traditional Japanese governance structures are also referred to as ‘statutory auditor systems’. See *Ibid.* and Robert N. Eberhart, *infra* note 93.

¹⁰³ Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 114-115.

¹⁰⁴ Robert N. Eberhart, *Corporate Governance Systems and Firm Value: Empirical Evidence from Japan's Natural Experiment*, 6 J. ASIA BUS. STUD. 176, 178 (2012); Rock Center for Corporate Governance at Stanford University Working Paper No. 94 at 4, <http://ssrn.com/abstract=1739292> or <http://dx.doi.org/10.2139/ssrn.1739292>

¹⁰⁵ Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 136.

¹⁰⁶ Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 15 (February, 2013) (indicating that this trend has not changed since the Report system began in 2006), <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje6000003ukm8.pdf>. The same numbers were reported in 2011. See Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 15 (March, 2011), <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje60000037hvl.pdf>

number of Japanese firms that have adopted stock options remains low¹⁰⁷ and the structure of executive pay still relies very heavily on payments unrelated to performance notably salary.¹⁰⁸ It thus remains to be seen whether the Japanese pattern of low executive pay will resist and survive the new pressures.

In such a context in which banks, as lenders and major shareholders, have been active in controlling executive compensation, it should not be surprising to find competent boards that are also active in monitoring executives and are intolerant to excessive executive pay. Japanese boards are better able to think strategically and often provide a strong oversight while bringing a wide range of relevant experiences to the boardroom.¹⁰⁹ Taft and Gangaram maintain that “Japanese boards of directors pride themselves on the long-term solvency of the corporation and the solidification of consistent competition levels” and “stress the intrinsic rewards a CEO receives from steering the ship in the appropriate direction”.¹¹⁰ Yet, unlike their American counterparts, Japanese boards of directors have not succumbed to the notion that CEO’s need an

¹⁰⁷ Masayuki Morikawa, *supra* note 68; Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 64 (February, 2013), <http://www.tse.or.jp/rules/cg/white-paper/b7gie60000005ob1-att/b7gie60000003ukm8.pdf>.

¹⁰⁸ Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 114, 131 (finding that generally Japanese executives own relatively small amounts of stocks in their firms) and 139 (finding that the compensation structure for highly paid executives at committees-based Japanese firms for 2010 is as follows: 52% salary, 31% bonus, 9% stock options, 2% retirement benefits and 1% other; whereas the compensation structure for traditional firms with auditors is: 62% salary, 13% bonus, 6% stock options, 7% retirement benefits and 1% other); WATSON WYATT WORLD, *supra* note 53.

¹⁰⁹ Gillespie & Zweig, *supra* note 17, at 270.

¹¹⁰ Darrell Taft & Gangaram Singh, *Executive Compensation: Comparison of the United States and Japan*, COMPENSATION AND BENEFITS REVIEW 68, 73-75 (2003). See also AMES C. ABEGGLEN & GEORGE STALK, JR., KAISHA: THE JAPANESE CORPORATION 188 (1985) (claiming that Japanese managers focus on the future success of their companies).

excessive compensation to be effective or efficient.¹¹¹ Wealth concentration in the form of both increasing short-term shareholder returns and huge bonus for directors does not seem to be an imperative in the eyes of Japanese boards. In particular, Japanese boards that are smaller and have outside directors tend to pay lower compensations to their executives.¹¹² Bank-appointed directors are active monitors of executives and executive compensation is both smaller and less sensitive to performance in firms with a main bank relationship or bank-appointed directors.¹¹³

Consistent with a strong stakeholder culture, the interests of workers are given significant consideration and thus inform the decisions about the compensation of corporate executives. The perception of corporate management as a group effort further encourages the need to relate CEO compensation to employees' salaries.¹¹⁴ This is indicative of the central place that employee welfare has in Japanese firms.¹¹⁵ Indeed, "Japan has made a conscious decision to try to protect its workers from unemployment, even at the expense of financial gain".¹¹⁶ Japanese corporations are known for their commitment to lifetime employment,¹¹⁷ although this has not been applied

¹¹¹ *Ibid.* at 75.

¹¹² Basu, Hwang, Mitsudome & Weintrop, *supra* note 20, at 75.

¹¹³ Abe, Gaston & Kubo, *supra* note 52, at 389; Sakawa & Watanabel, *supra* note 79.

¹¹⁴ Jeswald W. Salacuse, *Corporate Governance in the New Century*, 25(3) COMPANY LAWYER 69, 80 (2004).

¹¹⁵ See e.g. RODNEY CLARK, THE JAPANESE COMPANY 137 (1979) (Japanese firms pursue "aims which are given rather lower priority in the West, such as the provision of welfare to employees.")

¹¹⁶ Susan J. Stabile, *My Executive Makes More than Your Executive: Rationalizing Executive Pay*, NEW YORK INTERNATIONAL LAW REVIEW, 3 (2001).

¹¹⁷ Abe, Gaston & Kubo, *supra* note 52, at 389.

equally to male and female workers and the gender wage gap remains high.¹¹⁸ Nevertheless, the strong protection of workers' interest is part of the larger commitment to promote industrial citizenship of labor in addition to the financial commitment of capital.¹¹⁹

It should not come as a surprise then that employees' wages are often taken into account when setting executive pay. Some studies have indicated that changes in Japanese executive base pay are linked to general movements in employee wages and salaries.¹²⁰ According to a survey by the Employment System Research Center, approximately 70% of the surveyed firms indicated that they adjust annual executive salaries based on an increase of employees' salary in addition to firm performance and industry standards.¹²¹ In recent years, there has been significant public pressure to further narrow the gap between the salaries of top managers and average employees. Critics have suggested that the large cash reserves of many public companies should be used to pay higher salaries to workers.¹²² Similarly, stock options, albeit recent and modestly used, have been granted not only to executives but also to employees. A Ministry of Economy, Trade and Industry survey of approximately 30,000 large and medium-sized Japanese firms indicates that 70% or more of the total firms that have adopted stock options granted stock options to both

¹¹⁸ Nakamura & Rebien, *supra* note 54, at 743.

¹¹⁹ Jackson, *supra* note 52, at 121.

¹²⁰ K. Kubo, *Executive compensation policy and company performance in Japan*, 13 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 429 (2005); Asli M. Colpan & Toru Yoshikawa, *Performance Sensitivity of Executive Pay: The Role of Foreign Investors and Affiliated Directors in Japan*, 20 (6) CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 547 (2012), Special Issue: Executive Compensation.

¹²¹ Basu, Hwang, Mitsudome & Weintrop, *supra* note 20, at 61.

¹²² Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 129.

executives and employees during the 1998-2005 period.¹²³ As of February 2013, a high number of statutory auditor and committee-based TSE-listed companies with stock option plans offer these plans mostly to employees and inside directors.¹²⁴ Bonuses are also given to executives and employees. Toyota provides a very recent example. Toyota's CEO, Akio Toyoda, earned 184 million yen (\$1.9 million) in 2012, a 35 percent increase from the previous year. He is the lowest-paid chief of the world's five biggest automakers and Toyota's outlook for increasing profit has prompted the automaker to approve the biggest bonus for workers since 2008.¹²⁵

It would also be expected that executive bonuses will be lowered when employee bonuses are reduced in order to save labour cost and avoid massive lay-offs in tough economic times.¹²⁶ The possibility of a promotion tournament that uses executive compensation also as a reward for a successful career after a series of employee competitions within Japanese corporations further reinforces the need to link executive pay to the wages of workers at lower levels.¹²⁷ These corporate practices may reflect the strong commitment to social equality in Japan, which is an important cultural constraint both to control potential excessiveness in executive compensation and reduce the gap between the compensation of executives and

¹²³ Morikawa, *supra* note 66, at 2.

¹²⁴ Tokyo Stock Exch., Inc., *TSE-Listed Companies White Paper on Corporate Governance*, 67 (February, 2013), <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje6000003ukm8.pdf>

¹²⁵ Mukai & Masatsugu, *supra* note 11.

¹²⁶ Abe, Gaston & Kubo, *supra* note 52, at 379.

¹²⁷ *Ibid.* at 388-389.

employees.¹²⁸ In sum, this Japanese practice of tying executive pay to the salary of workers helps keep executive compensation lower while considerably narrowing the pay gap between CEOs and average Japanese workers down to some of the smallest in the world and distributing corporate gains more equally.

In contrast, CEO's in the West have gained significant power in corporate decisions and earn excessive compensations often regardless of workers' wages, losses, and un-competitiveness. "The CEO has no boss. We pretend that the CEO has a boss. We pretend that it is the board of directors. But it almost never is. Basically, the board of directors of most organizations, just like all other subordinates, see themselves as employees of the CEO".¹²⁹ Most CEO's dictate and work to implement their own boards, agendas, compensation packages and information flows. "Thus, many boards even though their primary commitment is to shareholders, come to represent executive interests instead".¹³⁰ Corporate board oversight has become largely an illusion. "There is a continued dysfunction of too many boards: selecting inadequate CEOs in the first place; failing to advise and mentor executives and avoiding realistic successful planning".¹³¹ As a result, excessive executive compensation and short-term profit maximization dominate corporate decisions to the detriment of the long-term sustainability of

¹²⁸ Some authors have suggested that widely held norms of social equality may be behind the constraints on executive compensation in Japan. See e.g. Robert J. Jackson, Jr. & Curtis J. Milhaupt, *supra* note 11, at 156.

¹²⁹ Gillespie and Zweig, *supra* note 17, at 97.

¹³⁰ *Ibid* at 97.

¹³¹ *Ibid.* at 104.

companies and the well-being of employees. Countrywide Financials and the compensation paid to its CEO Angelo Mozilo is one of the most obvious examples of that problem:

Mr. Mozilo ran roughshod over his board, while receiving more than \$200 million in salary and bonuses in 2007, while Countrywide, the very same year announced a \$1.2 billion dollar loss in the third quarter and a \$422 million loss in the fourth quarter. As the company's stock dropped 80% during this time, Mr. Mozilo was paid \$2 million and received an additional \$20 million in stock options while selling off \$122 million more.¹³²

CONCLUSION

This paper has discussed the pattern of low executive compensation in Japan. It was argued that the activism of long-term oriented institutional investors such as banks and the informal tying of executive pay to worker welfare in the context of a culture of intolerance to excessive executive compensation have been critical in the development of a pattern of low executive pay in Japan. The Japanese experience also reveals that lower executive compensation does not result in compromising firm performance and is a necessary condition to build a stakeholder-friendly corporation. These findings suggest some lessons for regulating excessive executive compensation in modern corporations around the world. Japan's executive compensation practices indicate that the presence of more effective internal controls may help in controlling excessiveness in executive pay. In particular, the active role of institutional

¹³² *Ibid.* at 126-127.

shareholders with a long-term orientation and the adoption of a tougher board oversight in the context of a culture that is unfriendly to greed and friendly to stakeholders would be ideal, but this requires fundamental changes to existing corporate beliefs in the West. Furthermore, the tying of employees' interest to executive pay is effective in lowering executive compensation and some form of employee participation in the governance of corporations should also be given serious consideration as it may help monitor the implementation of such tying while fostering a stakeholder culture.

Further research is needed in several respects. This work is based on a review of the literature on the determinants of executive compensation in Japan and more empirical investigations would be ideal to expand some of the findings associated with the pattern of low executive compensation. It is also important to explore in a more in-depth manner both the influence of the Japanese business culture on the development of executive compensation practices and the extent to which the pressures from the globalization of the capital market can transform such practices in the near future.