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Making sense of Japan's

Sokaiya Racketeers

— BY MARK D. WEST

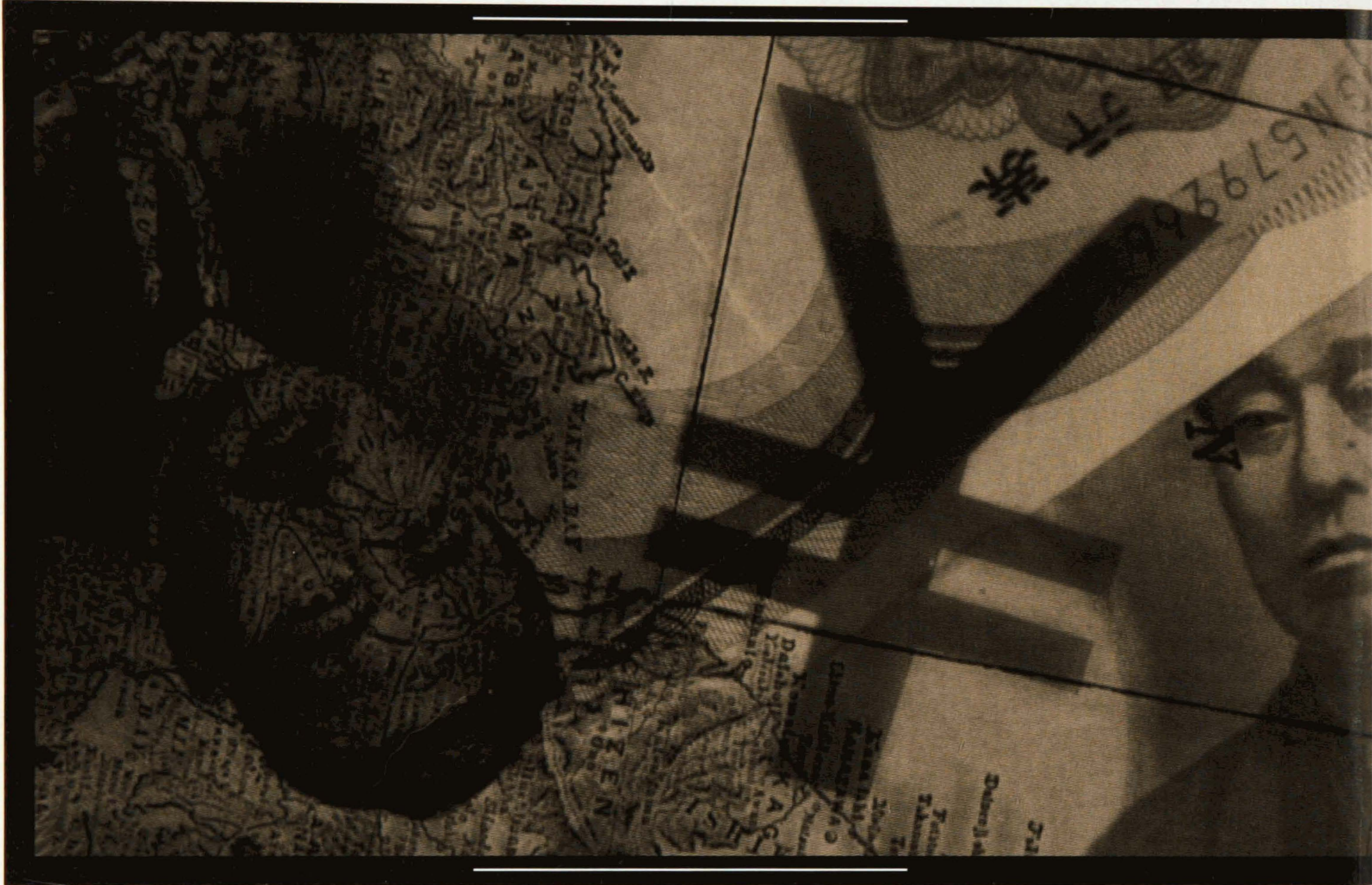
The following article is excerpted from "Information, Institutions, and Extortion in Japan and the United States: Making Sense of Sokaiya Racketeers," which will appear in its complete form in 93 Northwestern University Law Review *this summer. Publication is by permission.*

How do legal, regulatory, and organizational systems affect the emergence and development of corporate extortion? The question arises whether the extortionist is a potential plaintiff seeking settlement, a labor union threatening to strike, or the lucky finder of the mouse-in-the-soda-bottle of urban legend. In each case, including those in which extortion may be lawful and even desirable, the extortionist's threat and the corporation's response depend on the institutional context in which the extortion takes place.

In the Japanese system, corporate extortion by *sokaiya* gangster-racketeers appears to be widespread. Although *sokaiya* (literally, "general meeting operators") take several forms, a *sokaiya* typically is defined as a nominal shareholder who *either* attempts to extort money from a company by threatening to disrupt its annual shareholders' meeting *or* works for a company to suppress opposition at the meeting. Surprisingly, Japanese executives pay *sokaiya* despite the fact that payment can result in civil and criminal liability not only for *sokaiya*, but for the executive as well.

Recent scandals involving some of Japan's largest and most prestigious financial institutions have thrust *sokaiya* into international headlines and vividly illustrate some of the problems of the Japanese and/or Asian economic systems. In spring 1997, prosecutors revealed that Dai-Ichi Kangyo Bank (DKB), the fifth-largest corporation in the world, had paid *sokaiya* Ryuichi Koike a total of $96 million for his services. Koike then admitted that he used these funds to acquire a stake — significantly, for exactly the number of shares needed to give him the right to make proposals at shareholders' meetings — in each of Japan's "Big Four" securities brokerages. The brokerages subsequently paid Koike a combined total of nearly $6 million to keep their meetings quiet. The "Koike scandal" led to mass board resignations, to the arrest of 35 executives, to the suicide of a former DKB chairman, and ultimately to the dissolution of Yamaichi Securities and the collapse of the Japanese stock market. Six months later, eight executives of Hitachi, Toshiba, and three Mitsubishi group companies were arrested (and as of this writing, all but one have been convicted) for paying *sokaiya* amounts ranging from $16,800 to $72,000 — ostensibly for the use of a beach house — to keep their meetings quiet. Fewer than six months after that, prosecutors revealed that the exorbitant brochure-advertising fees that certain Mitsubishi group companies had paid a former flight attendant were actually disguised payments to her husband, a 30-year *sokaiya* veteran, to keep meetings quiet. In August 1998, two extortionists were arrested for leasing office plants (at prices to make a florist blush) to Japan Airlines in exchange for meeting protection, and Toyota and Nissan soon admitted that they had done the same.

These recent incidents appear to be part of a much larger phenomenon. Since criminal penalties were clearly imposed on payments to *sokaiya* in 1982, executives of 31 corporations — almost all of which are household names in Japan, and only one of which is not listed on the Tokyo Stock Exchange — have been convicted of making payments to *sokaiya*. In a 1997 survey of large Japanese firms including giants such as NTT, Toyota, and Matsushita, nearly 90 percent indicated that they had been approached by *sokaiya* with extortionist demands of one kind or another. Another recent survey of 2,000 firms (1,200 responding) found that 77 percent had paid *sokaiya*. This generous corporate support is said to keep in



Estimates of how much money companies actually pay *sokaiya* vary. One study finds that typical *sokaiya* earn $20 to $200 per firm, twice a year. One firm's general affairs department chief states that his company's regular policy at one time was to pay small-time *sokaiya* ¥100,000 (about $800) per year, and to pay its "expert" *sokaiya* ¥300,000 to ¥500,000 ($2,400 to $4,000) per month, with bonuses of ¥2 million to ¥3 million ($16,000 to $24,000) around the time of the meeting. The firm's annual *sokaiya* budget was ¥500 million (about $4 million) for 2,000 *sokaiya*, which results in an average payment of $2,000 per *sokaiya*.

business 1,000 *sokaiya* who hold stock in nearly 12,000 companies.

Some commentators have argued that *sokaiya* are a cultural phenomenon, a reflection of the importance of harmony, politeness, and respect in Japan. After extensive research, including numerous interviews of Japanese managers, attorneys, prosecutors and *sokaiya*, I reach a different conclusion. In this article, I argue that a better explanation for the behavior of extortionists and managers in Japan lies in the choices that are determined by institutions. Specifically, I argue, first, that Japanese institutions lead to low levels of corporate disclosure. Because extortion correlates positively to secrecy, inadequate disclosure creates blackmail opportunities that can be used by *sokaiya* at any time. Second, I show empirically that long shareholders' meetings in Japan send negative market signals that lead to stock price drops. Japanese executives pay *sokaiya* to avoid these negative returns. Concisely stated, Japanese firms choose to pay *sokaiya* because the Japanese system makes paying *sokaiya* less costly than the alternative.

I. A CORPORATE EXTORTION PRIMER

The question of why *sokaiya* successfully extort Japanese companies in spite of the law while *sokaiya* apparently do not arise in the United States, even in the absence of legal prohibitions, principally involves three factors: *sokaiya*, corporations, and corporate law.

A. *Sokaiya*

Although *sokaiya* play a variety of roles, they usually come in one of three varieties. First, there are fighters. Japanese managers have long known that one of the easiest ways to ensure an orderly shareholders' meeting is to hire thugs to intimidate shareholders who want to speak. This rent-a-thug image is fueled by well-publicized melees of the early 1970s at Chisso Corporation, where *sokaiya* physically suppressed environmental activists, and at Mitsubishi Heavy Industries, where *sokaiya* fought to a bloody finish with shareholders who protested the company's production of military weapons for the Vietnam War. Relatively few incidents of physical shareholder repression have surfaced since that time, perhaps because *sokaiya* moved into other more profitable lines of business, perhaps because shareholders began to get the message through more subtle hints of violence.

Second, a few elite *sokaiya* are paid to keep other more dangerous *sokaiya* away from meetings. These *sokaiya* use various means to accomplish the task: intimidation, influence peddling, or outright payment. These *sokaiya* sometimes become corporate insiders, advising companies on how to deal with other troublemakers, how to organize meetings, and how to circumvent the law. As one such *sokaiya* (who prefers the title "consultant") told me, "*Sokaiya* problem? What *sokaiya* problem? I show up. I give advice. I help. I do the same thing that a lawyer would do. And I'm cheaper, too. What's the problem with that?"

Finally, and most commonly, many *sokaiya* make a living through blackmail. Sometimes *sokaiya* blackmail by threatening to reveal sensitive information at the public forum of shareholders meetings. Sometimes the blackmail is not related to meetings at all. A favorite *sokaiya* tactic is to request that a corporation subscribe to magazines published by the *sokaiya*; the underlying threat being that if the company does not subscribe, scandalous stories about the company will appear in the magazine. Other popular tactics include organizing expensive golf tournaments, leasing potted plants, and holding karaoke singing contests. Japanese police arrest approximately 200 *sokaiya* (and related actors) each year on various extortion charges, but blackmail persists.

Blackmail *might* flourish in Japan — not just among *sokaiya* but in society as a whole — because of broad legal and social differences. But this does not seem to be the case. In a recent study, Judge Richard Posner found only 124 reported published opinions (among 3 million in the Westlaw database) in blackmail cases in the United States in the last century. I have serious doubts — as does Posner — about the reliability of using the number of judicial opinions as a measure of blackmail activity. But because good alternatives are scarce, and a comparison would be nice, I adopt a similar approach for Japan. I searched for all blackmail opinions in *Hanrei Taikei*, a ten-disc CD-ROM database that is the Japanese functional equivalent of Westlaw. After reading through all the extortion cases returned by the search, I was only able to classify 15 of them as informational blackmail — a small number indeed, and easily comparable with the U.S. number given the disparity in database size.

B. *The Companies*

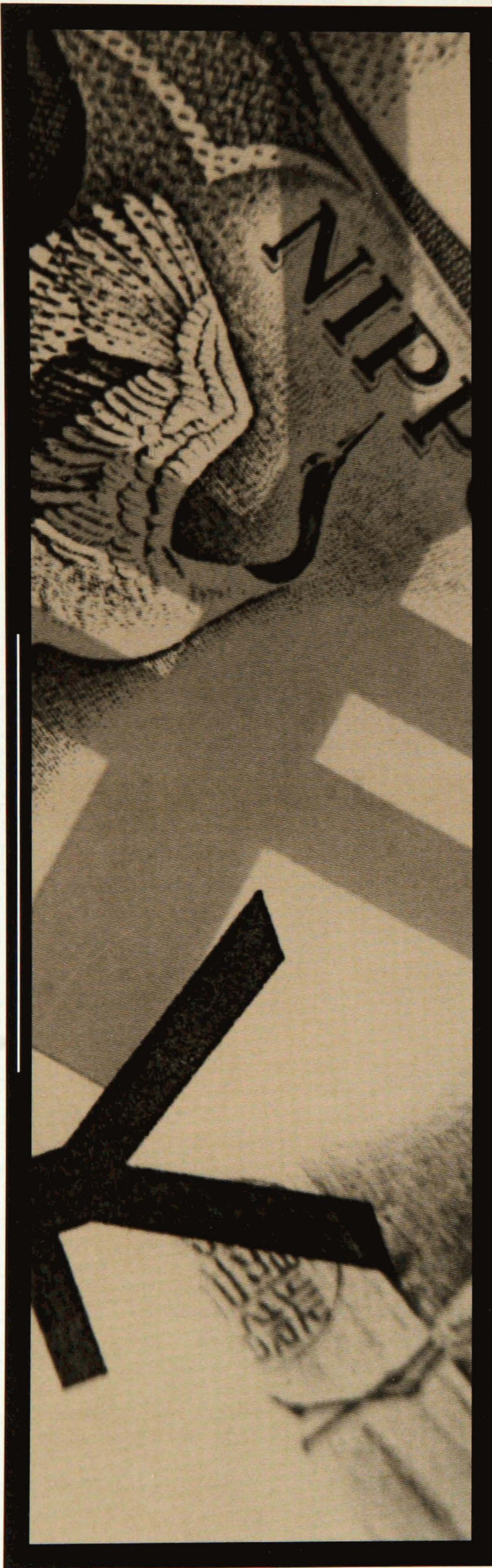
When confronted by a *sokaiya*, companies have two options: pay or resist.

1. Pay. A company's general affairs department usually handles payments to *sokaiya*. Before 1982, many companies had their affiliated *sokaiya* form a queue at the door of that department on the day of, or the day before, their shareholders' meeting. All in line received envelopes full of cash. Recent compensation schemes are more sophisticated. The 1997 Koike scandal involved off-the-books loans to a company owned by Koike's brother (by DKB), purchases and repurchases of expensive golf club memberships (Daiwa Securities), and compensation for losses incurred through Koike's discretionary "V.I.P." account (Nomura Securities), futures accounts (Nikko Securities), and Singapore International Monetary Exchange Nikkei Index accounts (Yamaichi Securities).

Estimates of how much money companies actually pay *sokaiya* vary. One study finds that typical *sokaiya* earn $20 to $200 per firm, twice a year. One firm's general affairs department chief states that his company's regular policy at one time was to pay small-time *sokaiya* ¥100,000 (about $800) per year, and to pay its "expert" *sokaiya* ¥300,000 to ¥500,000 ($2,400 to $4,000) per month, with bonuses of ¥2 million to ¥3 million ($16,000 to $24,000) around the time of the meeting. The firm's annual *sokaiya* budget was ¥500 million (about $4 million) for 2,000 *sokaiya*, which results in an average payment of $2,000 per *sokaiya*.

Other evidence comes from the amounts companies spend on subscriptions to magazines published by *sokaiya*. The Koike scandal brought to light that Nomura Securities had been paying ¥70 million ($560,000) annually for subscriptions to 700 magazines. Subsequent investigation revealed that each of Japan's large city banks subscribed to an average of 1,000 such magazines at a cost of ¥100 million ($800,000) annually.

One way to estimate the amounts companies pay is to calculate the average amount cited in court cases. From 1983 to 1998, Japanese courts sentenced executives from 36 firms who made payments to a total of 133 *sokaiya*. The total amount of the payments to *sokaiya* by these 36 firms is ¥474.4 million (about $3.8 million), representing a disbursement of about ¥3.57 million (about $28,000) per *sokaiya* or ¥13.18 million (about $105,000) per firm. The highest amount received by a single *sokaiya* was ¥94 million ($750,000); the lowest, ¥50,000 ($400). On one hand,



Enter the *sokaiya.* A skilled *sokaiya* can expertly deconstruct a balance sheet, querying discrepancies, errors, and omissions. Though the same may be true of analysts in the United States, *sokaiya* have more secrets to expose in Japan because less information is initially disclosed.

these figures may understate firms' total payments because many firms have relationships with more than one *sokaiya.* But on the other hand, these figures may overstate the payments, as prosecutors may let smaller payments slide, choosing to litigate only the large cases.

In short, it is difficult to determine how much firms pay *sokaiya.* Many of the managers I interviewed suggested that one reason this may be so is that firms pay *sokaiya* varying amounts depending on their relationship with the company, the quality of their information, the credibility of their threat, and their skills in performing other services for the company.

2. Resist. Of course, not all firms pay *sokaiya.* Those who do not pay either (1) are not bothered by *sokaiya*, (2) turn threatening *sokaiya* over to prosecutors, who pursue them on extortion charges, or (3) simply ignore *sokaiya* threats. Although the third strategy may seem to be the easiest course, a few executives who ignored *sokaiya* threats have become subject to acts of violence. One survey, conducted by a National Police Agency administrator, found 10 acts of violence against corporate officials during a one-year period alone. At least three of these incidents — assaults on executives of Tokai Bank, Fuji Film, and Sumitomo Bank — are linked to the refusal of those companies' executives to pay *sokaiya.*

C. *The Law*

Payments to *sokaiya* to suppress shareholders' rights have been illegal since the Commercial Code was promulgated in 1950. Under section 494 of the Code, it is illegal to make an "improper solicitation" with respect to the "exercise of shareholder rights." "Improper solicitation," courts have held, includes paying *sokaiya* to prevent others from "fairly speaking or fairly exercising their vote."

But this formulation of the law raised multiple problems of clarity for prosecutors and civil plaintiffs. These problems, and growing concerns about corporate gangsters in an internationalizing Japan, caused the Japanese legislature in 1981 to enact a full-scale revision of the Commercial Code aimed specifically at the elimination of *sokaiya.* Effective October 1982, prosecutors need no longer prove an "improper solicitation." Instead, they need only prove that a "benefit" was offered with respect to the exercise of shareholder rights, and in civil cases, if the benefit is "gratuitously offered" to a "specific shareholder," it is presumed that it is offered with respect to those rights.

The revisions imposed clear civil and criminal penalties on both *sokaiya* and management. The new code also introduced clear criminal penalties — up to six months' imprisonment or fines of up to ¥300,000 ($2,400) for both the originator of the benefit (management) and the recipient (*sokaiya*).

The "*sokaiya* provisions" of the Commercial Code create incentives against payments to *sokaiya*, and may have contributed to the decline in the estimated *sokaiya* population from about 6,000 pre-1982 to about 1,000 in 1997. But the provisions have at least three readily apparent problems. First, the six-month sentence specified by the code carries a statute of limitations of only three years. Second, the presumption that a benefit, if gratuitously offered, is made in connection with shareholders' rights, only arises if the payment is made to a shareholder. Third, the *sokaiya* provisions do not address the *sokaiya* magazine subscription phenomenon, which can be a significant sphere of *sokaiya* activity.

The Japanese judiciary has added an additional reason why the *sokaiya* provisions may not have the full impact that they otherwise could. In the scores of cases adjudicated since the *sokaiya* provisions took effect, only three *sokaiya* (in the Noritake, Ajinomoto, and Mitsubishi group cases) actually were sentenced to prison. All others received suspended sentences. In no case did any of the executives convicted in those incidents receive jail time — they *all* received suspended sentences. This is not an aberration from the Japanese criminal justice system as a whole, which sends fewer than 5 percent of its suspects to prison, compared to over 30 percent in the United States, but it does show that the *sokaiya* provisions are not being enforced to their fullest extent.

II. INFORMATION

Some *sokaiya* blackmail has nothing to do with shareholders' meetings. This is clearly evidenced by year-round *sokaiya* magazine subscriptions and implied in relevant case law. To put it another way, what would be the expected result if holding Japanese shareholders' meetings suddenly were made illegal? After executives sobered up from the tremendous parties that they surely would throw in celebration, *sokaiya* activity would continue as usual. Information with blackmail potential would still be available, and executives would still be vulnerable. The *sokaiyas*' broadcast of information would simply switch to some other forum.

A. *Types of Information*

The U.S. corporate governance system and U.S. corporate law regime, defined broadly to include regulatory institutions, makes available more useful information to independent investors, reducing the marginal costs to investors of information acquisition. In contrast, the Japanese system often keeps such information — most importantly, *negative* information — secret. *Sokaiya* normally blackmail corporations with three types of information: financial and accounting data, potentially scandalous information relating to corporate malfeasance, and private information about management.

1. Financial and Accounting Data. It is widely recognized that Japanese corporations do not disclose as much information as their U.S. counterparts. First, a Japanese corporation's annual report contains no mention of management compensation, as required in the United States. Second, Japanese reports do not break down sales by industry or business line, so it is difficult to determine a firm's profitability. Third, assets a Japanese firm holds in the form of securities are booked at the price at which the firm bought the shares, not the current market price. Finally, a Japanese financial statement usually is not specific about the method the company uses to depreciate its assets. The aggregate result is that the annual report, which is mandatory in both systems, contains significantly less useful information in Japan than in the United States.

A recent survey by the Organization for Economic Cooperation and Development (OECD) further illustrates the point. The OECD studied the consolidated financial statements of several large public corporations and rated their disclosure of operating results relative to OECD guidelines as full or partial. Of 53 U.S. firms studied, 34 had full disclosure, and 19 had partial. The 25 British firms in the survey ranked similarly with 19 full, 6 partial. Of the 23 Japanese firms surveyed, the results were nearly opposite: only 2 firms had full disclosure, while 21 firms had partial disclosure. A similar survey by the Investor Responsibility Research Center found that on average, Japanese listed corporations were required by law to disclose only 40 percent of the information that is required in the United States.

Enter the *sokaiya*. A skilled *sokaiya* can expertly deconstruct a balance sheet, querying discrepancies, errors, and omissions. Though the same may be true of analysts in the United States, *sokaiya* have more secrets to expose in Japan because less information is initially disclosed.

2. Past Bad Acts. More often, *sokaiya* use information regarding past corporate misdeeds to blackmail corporate executives. Sometimes the acts are illegal; sometimes they are merely embarrassing. A list of bad acts that *sokaiya* typically use for blackmail would include silently settled product liability claims, hiring and employment issues, bid-rigging, poor management practices, and other unreported liabilities.

It is difficult to determine whether Japanese firms on average commit more "bad acts" than U.S. firms or if more bad acts simply are kept secret. If the former is true, it is probably because Japanese overregulation creates incentives for firms to commit bad acts. An obvious case is that of now-defunct Yamaichi Securities. Yamaichi competed in what is perhaps the most heavily regulated sector of the Japanese economy: the securities industry. Unlike the United States, where brokerage fees were deregulated in1975, commissions on securities transactions in Japan remained fixed until 1998. In order to maintain the accounts of its largest customers, Yamaichi agreed to perform "tobashi" transactions, the illegal practice of repurchasing losses that have been shifted so that favored customers do not have to report losses. *Sokaiya* learned of the arrangement and used it to blackmail Yamaichi.

3. Personal Information. Sometimes the information that *sokaiya* use to blackmail companies is purely personal in nature — an executive's extramarital affair, a director's criminal son, a manager's questionable background — all make excellent blackmail fodder and payments are usually made by the corporation, not the individual.

B. *Information Concealment: The Role of Government and Governance*

What elements would a regime need to facilitate the non-disclosure of negative information? First, it would need an organizational system that would tend to prevent negative information from being unwillingly released. Second, it would require minimal enforcement of disclosure requirements so that firms would (a) not get caught keeping secrets and (b) if caught, would not be too severely punished. Third, it would need some mechanism through which economy-wide (or at least industry-wide) unraveling effects could be deterred. In Japan, firms appear to benefit from all three elements.

1. Maintaining Secrecy. Three aspects of the Japanese corporate governance system help to maintain secrecy better than in the United States. First, the cross-shareholding (*keiretsu*) system common in the Japanese economy lessens the need for market-wide disclosure. If a small number of institutional shareholders hold a large percentage of a company's stock, there is lessened incentive to share information outside of that limited group.

Second, most large Japanese firms are affiliated with a main bank. Main banks are in some ways similar to non-financial cross-shareholders because their inside position reduces the need for public disclosure.

Finally, Japanese boards of directors are composed almost exclusively of insiders. The lack of outside directors may result in a reduced flow of information to sources outside the firm.

2. Enforcement. The Japanese disclosure regime is characterized by a lack of enforcement of disclosure laws by civil or criminal means relative to the level of enforcement in the United States. The U.S. Securities and Exchange Commission investigates an average of 150 to 200 cases annually. By contrast, from 1992 to 1995, the Japanese Securities and Exchange Surveillance Commission (SESC) investigated only six.

Virtually no securities fraud litigation, civil or criminal, occurs in Japan. Japan has no class action mechanism. Another potential enforcement mechanism, the shareholder derivative suit, has only recently become active, as a result of a 1993 Commercial Code amendment that made the mechanism moderately more accessible. However, because of reliance on the business judgment rule, in cases involving listed companies, the only shareholders who have litigated successfully have been those whose directors committed illegal acts. Japan's judge-centered civil law discovery system also may yield less corporate information than the U.S. adversary system.

3. Deterring Disclosure. Even in the absence of mandatory disclosure provisions, competitive markets should still produce something close to the right level of information to investors. Firms with positive outlooks have every reason to disclose their rosy futures. Those firms with the next most favorable information then disclose, and the unraveling process continues until all firms disclose except for those firms with the worst information. At this point, investors can draw inferences about those firms' financial outlook from their silence. In Japan, this "unraveling effect" appears not to occur as frequently or as deeply as it does in the United States.

The broad range of Japanese corporate secrets may limit unraveling as investors cannot be sure what type of information to seek. Some deterrence to the unraveling effect probably also results from direct coordination among managers of "competitive" firms.

But most importantly, corporate Japan may have mitigated the unraveling effect by relying on an institution — the bureaucracy — to monitor firms and keep disclosure at preset levels, in effect creating an "information cartel." Although bureaucratic influence may come from a variety of different sources, I focus in particular on the most prominent ministry (particularly in recent *sokaiya* scandals), the Ministry of Finance (MOF). MOF serves as regulator, protector, and promoter of the financial services industry and securities markets. In many cases, MOF chooses protection and promotion over regulation. Examples abound; two recent events from January 1998 tend to confirm what had always been widely suspected:

- Two MOF financial inspectors were arrested on charges that they took bribes from Sumitomo Bank, Tokyo-Mitsubishi Bank, Sanwa Bank, Dai-Ichi Kangyo Bank, Asahi Bank, and Hokkaido Takushoku Bank in return for revealing *inspection plans* to the "MOF-tan" (a manager in charge of MOF relations) at those banks. During and after a subsequent investigation, a senior investigator committed suicide, the minister and vice-minister were forced to resign, and 112 officials were disciplined for "excessive" wining and dining.
- Koichi Miyakawa, a former MOF financial inspector, admitted to prosecutors that he learned of illegal loans by Dai-Ichi Kangyo Bank to *sokaiya* Ryuichi Koike in 1994 and deleted information regarding those loans from his official report.

The reasons why MOF might withhold information are plentiful, and suggest that the incidents recounted above are not mere aberrations. Sometimes the goal may be market stability. Sometimes MOF may withhold information in order to prevent firms from failing — a goal that can be observed in the United States in cases like the 1979 Chrysler Corporation rescue or the 1998 Long-Term Capital bailout — but that is supported more openly and invoked more frequently in Japan. Private interest, rather than public policy, is also likely; recent scandals suggest that bribery, at least in the form of lavish entertainment, if not cash, may be widespread. Even if outright bribery is limited to a few high-profile cases (which, unfortunately, appears not to be the case), it is no secret that bureaucrats' careers are determined by legislators, who receive large contributions from large corporations. Also a potential contributing factor is the practice of *amakudari*, through which former bureaucrats, especially in heavily regulated industries, retire to high-paying positions in the very companies that they formerly monitored, supported, and promoted.

The case is easy to overstate; I do not intend to imply that MOF or any other agency purposely limits disclosure as a matter of policy (though they might). But through small steps and individual actions, MOF and other agencies can be effectively employed as institutional solutions to collective action problems, ensuring that "excessive" disclosure does not occur, and allowing all firms to profit while maintaining minimum disclosure policies.

C. Information Acquisition: Organized Crime Syndicates

A blackmail threat is only credible if the blackmailer has sensitive information and the means to expose it. *Sokaiya* are often able to acquire both by means of relationships to the *yakuza* or *boryukuden* (Japan's organized crime syndicates) and related groups.

Yakuza are more numerous and more pervasive in everyday Japanese life than their Mafia counterparts in the United States. The general explanation for this in the socioeconomic literature is that Japan's overregulated economy, layered bureaucracy, and slow-moving court system create an environment in which it is often quicker and easier for corporations, individuals, and occasionally government itself, to turn to the *yakuza* than to legitimate organizations. In the corporate context, firms turn to *sokaiya* to handle activities that they either are not equipped to handle or are not willing to undertake directly. Companies can hire *yakuza* to enforce judgments, a skill at which gangs appear to be more adept than the legal system. Construction firms reportedly use *yakuza* to monitor bid rigging for public works projects. Such firms also turn to *yakuza* to bypass strict immigration laws so that Southeast Asian immigrants can be used on construction projects. For securities firms, one common use of *yakuza* is said to be in the manipulation of stock prices, especially in the ramping of prices for new issues. For real estate firms, *yakuza* can be used to

intimidate stubborn holdout owners into vacating land at a low price, a niche created at least in part by Japanese landlord-tenant law, which heavily favors tenants. For lenders, *sokaiya* can assist with debt collection or may even purchase bad debts so that banks do not have to write them off (*yakuza* can then make the debtors offers that cannot be refused).

The problem for the corporation is that once it turns to the *yakuza* for private law enforcement, the *yakuza*, via *sokaiya*, can then use information gathered in performing the services to blackmail the company. And the company knows that the *yakuza/sokaiya* can follow through on the threat of exposure — after all, it is the *yakuza's* expertise in such matters that leads corporations to turn to them in the first place.

The foregoing is not meant to suggest that all firms hire *yakuza* to do their dirty work. The degree of involvement varies by industry, and it is doubtful that every firm in any industry would turn to the underground. These services are more available in Japan, and because of their sheer numbers, most firms — or at least vulnerable secret-holding employees of those firms — are likely to encounter organized crime representatives.

Mob ties help *sokaiya* in other ways. First, and perhaps obviously, *yakuza* can impose occasional threats of physical violence when necessary. Second, mob ties also help *sokaiya* maintain their monopoly over information that has blackmail potential.

As noted earlier, not all *sokaiya* are involved in blackmail. Some fill important roles of silencing dissenters, whether they are shareholders or other *sokaiya*. In this sense, *yakuza/sokaiya* are classic racketeers, mixing extortion with enforcement of illegal monopolies. Many *yakuza/sokaiya*, rather than working against the company, simply reinforce existing collusion between managers and large shareholders, providing services for which many managers pay.

Nor do all *sokaiya* have organized crime connections. A small group of *sokaiya* intelligentsia makes its living blackmailing corporations with information derived from standard securities analyses of firms' financial statements and other public documents. This group, which even includes a couple of corporate law professors, makes money more on analytical acumen than mob ties. Their tactics are more subtle, as they often send their written findings to the corporations, with attached cover letters suggesting that

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perhaps the companies might wish to purchase the information in lieu of more widespread publication.

D. Information, Reputation, and Regulation

Sokaiya choose their targets knowing that Japanese corporate secrecy has a dual effect. First, the lack of publicly available information in Japan means that the secrets that *sokaiya* can unearth have more blackmail potential than more public "secrets" of the United States. Second, the non-availability of information means that the release of such information poses a greater threat to the Japanese corporation than to its U.S. counterpart, as investors in Japanese markets should be more likely to attach meaning to relatively immaterial information than they would in U.S. markets.

This analysis implies that *sokaiya* will target firms with specific characteristics. A list of firms that pay *sokaiya* should be composed largely of (1) firms with secrets and (2) firms to whom the release of information would be the most damaging. Of course there is no such list. But a substitute does exist — a list of firms implicated in *sokaiya* payment scandals. Since 1982, executives of 36 companies have been sentenced for *sokaiya* payments (a 100 percent conviction rate). Executives of one other firm (Nomara Securities) have been arrested and pleaded guilty and agreed to pay more than $3 billion in civil damages. Of these 37 total firms, seven, or nearly 20 percent, are very large food, convenience, and department stores. Another 11, or almost 30 percent, are financial institutions. Combined, these two industry categories account for 18 of the 37 — roughly half — of *sokaiya* arrest incidents. The same industry categories account for only 13 percent of Tokyo Stock Exchange firms, and for an even smaller percentage of all public Japanese firms.

This industry breakdown shows that reputation plays an important role in determining which firms tend to pay *sokaiya*. Game theory shows that "the power of reputation seems to be positively related to its fragility." Firms whose reputations are most easily shattered will value reputation more highly than other firms will. The applicability to financial institutions is clear; they operate in a highly competitive industry in which public trust is essential to success. Department stores in Japan function under similar constraints. Japanese department stores sell food, a commodity in which trust is essential. Moreover, the margins in retail in Japan, and especially in food retail, are comparatively very thin, and the market is quite competitive: In Japan, there are 120 retailers and 46 food retailers per 10,000 persons; in the United States the corresponding numbers are 59 and 7 per 10,000. This thin-margin environment in which multiple competitors are often selling identical products may lead some Japanese department stores to value their reputation more highly than corresponding U.S. firms.

The degree to which industry is regulated also seems to determine *sokaiya* targets. MOF plays a predominant role in the financial services industry. In the retail industry, the Ministry of International Trade and Industry (MITI) is in charge, heavily regulating retail stores with inefficient requirements relating to floor space, vacation days (a minimum of 24 days per year), and even requiring local merchant consent to the creation of new large stores. Heavy regulation may lead to questionable practices, the knowledge of which can be used for subsequent blackmail, or it may be a conduit for deterring the informational unraveling effect.

E. Uses for Negative Information, or Why Don't They Just . . .?

Why do *sokaiya* choose to blackmail executives with negative information as opposed to using it to profit in some legal manner? While extortion-like uses for negative information can arise in all systems, institutions determine the form of the extortion. In the United States, three potential uses for negative information — securities lawsuits, financial instruments, and publication — are readily apparent. In Japan, however, these sources of profit are much more limited, and holders of negative information thus turn to extortion, whether as *sokaiya* or by selling information to *sokaiya*.

1. Lawsuits. Negative information in the United States is often used for profit by securities plaintiffs, or more specifically, by their attorneys. In the United States, as a congressional committee noted, securities

class litigation is "lawyer-driven" and often carried out by "professional plaintiffs" who own nominal interests in many different companies and who stand willing to lend their names to class actions in exchange for an extra "bounty" payment upon settlement. In such a system, nominal professional plaintiffs perform the same economic function as *sokaiya*: They simply exercise their claim legally after disclosure, while *sokaiya* make their claim illegally before the information can be disclosed.

In Japan, the class action system does not exist. The Japanese derivative suit mechanism creates little monetary incentive either for shareholders or their attorneys. Without a legal mechanism through which to profit from negative information, an illegal one emerged.

2. Financial instruments. Investors can profit on undisclosed negative information by the use of financial instruments such as put options or short sales. But due to heavy regulation, options and short sales are more difficult, more costly, and much less popular in Japan than in the United States.

Regulation aside, in the Japanese system, *sokaiya* blackmail has at least three advantages over trading. First, income earned from either short sales or options is a one-shot affair, while income earned from blackmail can be repeated at least once a year with continued threats of exposure. Of course, blackmail and trading are not mutually exclusive. A *sokaiya* could blackmail the company, short the stock, announce the information, and reap a dual profit — but then he would be unable to reap future profits using either method.

Second, *sokaiya* blackmail may be less risky. A holder of a short position or a put option has no way of determining whether, when, or to what extent market prices will actually fall. Short-sellers face additional risks. "Uptick" rules that prohibit short sales in a falling market prevent *sokaiya* from shorting after the release of the information. If multiple *sokaiya* attempt to short-sell, purchases required to cover their repayment obligations can actually drive prices up. Blackmail, on the other hand, involves almost certain payment, and the risk of arrest is minimal.

Finally, in a market of low informational availability, many companies may actually prefer blackmail to the use of financial instruments. Shorting is a viable investment strategy only if negative information is to be released. Companies have no desire to see negative information released. Accordingly, some should be willing to pay potential short-selling *sokaiya* significant sums not to short.

3. Publication. When cooperation leads to efficiency gains that the market fails to capture, "private order" economic institutions will emerge. Perhaps the cooperation of *sokaiya* with managers constitutes such a "private order" institution. But if there is so much valuable negative information out there, why don't securities agencies, newspapers, or some other third party profit from it legally by selling it to investors?

Part of the answer may lie in the players in the game. The most likely distributors of the information would be securities houses and their affiliated research groups. These groups may not always have the proper incentives to research and convey to customer's negative information. Japanese securities firms traditionally earn the bulk of their profits through commissions rather than from trading on their own accounts. Accordingly, their goal is to influence customers to buy more securities and pay more commissions. Moreover, as recent scandals have shown, the securities houses themselves are often so deeply mired in *sokaiya* activity that pointing out the mistakes of others could simply be a suicide request.

The media may constitute another source of negative information distributorship. But the Japanese media has long been known for its press club that rewards positive publicity for the news source over exposé reporting. Moreover, many Japanese media with enough capital to publish news of hidden corporate wrongdoing are often owned and affiliated substantially with the very large corporations on whom they would be reporting.

This leaves one particular group of actors with enough capital and consumer trust to fill the gap — foreign securities firms. Although foreign firms have been in Japan since 1961, their activity was relatively limited until the bubble economy that began in the mid-1980s. As new entrants to the market, establishing a reputation among Japanese securities customers was relatively difficult, and such firms were forced to be much more active in trading for their own accounts than their Japanese counterparts, who could rely on churning alone. But as foreign firms lured foreign customers to Japanese markets, and developed reputations in Japanese domestic markets, that picture began to change, and now the top four foreign firms conduct more retail trading than do the Japanese top four.

These foreign firms already may have affected *sokaiya* activity. The decline in *sokaiya* from 6,000 pre-1982 to about 1,000 in 1997 is often cited as a result of enforcement of the 1982 *sokaiya* provisions. But very little actually changed in 1982 — *sokaiya* activity was illegal before 1982, and a handful of arrests in the following years does not amount to rigorous enforcement. A better explanation for the decline of *sokaiya* may be the relatively unbiased dissemination of information by foreign firms in Japan. With fewer ties to listed firms and an initial reliance on trading wholesale rather than retail for profit, foreign firms are often said to be less reluctant to distribute (true) negative information about listed firms. Foreign firms can make legitimate use of negative information on which *sokaiya* would otherwise profit. As the foreign retail presence increases, their distribution of negative information to investors may further drive *sokaiya* out of business.

F. A Brief Comparative Test

If institutions determine how negative information is used, we would expect to see *sokaiya*-like actors in similar institutional environments. As it turns out, *sokaiya*-like actors are not unique to Japan. In South Korea, *chongheoggun* are "hecklers" who demand money from companies in exchange for pro-management services or speeches during shareholders meetings.

Although not identical, the similarity between Japanese and Korean institutions and organizations is more than cosmetic. Korean firms are arguably even more heavily regulated than Japanese firms. Korean *chaebol* look a lot like Japanese *keiretsu* and other cross-shareholding arrangements, and *chaebol* is written with the same Chinese characters used in Japanese for *zaibatsu*, Japan's pre-war conglomerates. Similar institutions lead to similar results.

It could be that *sokaiya* simply plague Asian systems. But how, then, could Italian "*disturbatori*" be explained? *Disturbatori* are, as the *International Herald Tribune* has reported, "professional claques that get paid under the table not to disrupt a company's annual shareholders' meeting" — in other words, Italian *sokaiya*. Italy has no labels like *keiretsu* or *chaebol* for its corporate system, but its largest organizations are structured in the form of pyramidal groups of financial and operational firms. As in Japan and Korea, the state plays an inordinate role in corporate governance, and corruption scandals occur with some regularity. The Mafia parallel to *yakuza* is inescapable.

III. FILIBUSTER BLACKMAIL

Shareholders' meetings seem to play a critical role in the *sokaiya* framework. Magazine subscriptions aside, most of the payments to *sokaiya* come just before a firm's shareholders' meeting. And *sokaiyas'* use of *shitsumonjo* — a written list of expository questions to be raised at the meeting that *sokaiya* submit to management to induce payment — also underscores meeting importance.

Two reasons explain the annual concentration of *sokaiya* payments. First, if management had to pay *sokaiya* year-round, accounting would be more difficult, and the risk of detection would increase. Second, annual payments are a mechanism by which the *sokaiya* can precommit to limited extortion. The *sokaiya's* implicit message to the firm is "pay me this one time and you won't see me again until next year."

Why shareholders' meetings? Don't firms know that in most cases, a shareholders' meeting is nothing but, as A.A. Berle Jr. aptly described it in *Economic Power and the Free Society* (1957), "a kind of ancient, meaningless ritual like some of the ceremonies that go on with the mace in the House of Lords?" Why do managers pay *sokaiya* to keep their meetings short and quiet? Who cares if a "meaningless ritual" of a meeting runs long?

A. *The Role of Shareholders' Meetings*

In both Japan and the United States, shareholders' meetings are usually meaningless rituals that have all the entertainment value of watching wet paint dry. In Japan, however, meetings take on heightened significance. Almost all Japanese corporations hold their shareholders' meetings on a designated "meeting day" in June. In 1998, 2,325 firms, including 95 percent of all firms listed on the first section of the Tokyo Stock Exchange, held their meetings on "meeting day."

Meeting time in Japan is all-important. The top story of the evening news on meeting day is usually the length of large firms' meetings. After their meetings, each of Japan's large commercial banks must call the Banking Department of MOF to report its meeting time. As the manager of one of those banks' general affairs departments told me, "This really puts us in a bind. If our meeting is too short, MOF thinks it's because we're paying *sokaiya*. If it's too long, they say, 'What's wrong? You got bad loans outstanding or something?' " As a consequence, most firms try to hit the magic number of 30 minutes for their meetings — and most succeed. In 1997, average meeting length on meeting day was 29 minutes, over 95 percent of meetings ended in less than an hour, and no questions were asked at 87.5 percent of meetings.

Companies employ a variety of strategies to keep meetings short. Some, of course, pay *sokaiya*. This tactic seems to work; firms that pay *sokaiya* tend to have short, orderly shareholders' meetings, while those that do not pay have long ones. Three recent stories illustrate the point. First, Sony, often held to be a model of good corporate governance practices in Japan, publicly announced in 1983 that to comply with the new *sokaiya* provisions, it unequivocally would have no further relations with *sokaiya*. *Sokaiya* responded by questioning Sony executives for over 13 hours at its 1984 meeting. The market responded negatively, "chilling" a two-month rise in Sony's stock price. Second, in contrast, Nomura Securities' most potentially volatile meeting was its 1995 gathering, in which it (1) announced a record $500 million loss and (2) reinstated as directors its former chairman and president, who had resigned four years earlier to take responsibility for *sokaiya* and loss compensation scandals. Nomura paid *sokaiya* Ryuichi Koike for his silence at the firm's 1995 meeting. The meeting lasted half an hour. Finally, department store Matsuzakaya's 1994 and 1995 meetings lasted 4 hours and 3 hours, respectively. Matsuzakaya executives began paying *sokaiya* in 1996. Its 1996 meeting lasted 19 minutes; its 1997 meeting, 38 minutes.

Executives in any country would prefer short meetings to long ones — even General Motors has measures in place to keep its meeting short, and almost all firms have policies to control unruly parties.

B. *An Empirical Test*

I hypothesize that if long meetings are more damaging than short meetings, on average, firms that have long meetings will have significantly negative stock returns. To test the hypothesis, I use the following method. A publication named *Shiryōban Shōji Hōmu* (loosely, *Corporate Data Book*) publishes an accurate list of the length of the shareholders' meetings of virtually every large Japanese firm — 1,927 firms in 1997, and a total of 12,301 observations for the period 1990-97. From these lists, I constructed a dataset of all long meetings held on meeting day (when 95 percent of firms hold their annual meetings) by first-section Tokyo stock exchange firms during the eight-year period from 1990 to 1997. I define "long" as one hour or longer. My review of the *Shiryōban Shōko Hōmu* data yielded 285 such long meetings. Of the firms that held these 285 meetings, all but five had complete stock price data in the Datastream electronic database, yielding a total of 280 observations. I then used financial economics methodology to conduct an event study designed to test the price effects on the firms' stock in the year of their long meeting for the two-day period beginning the day of the meeting.

The results were as follows. The average market adjusted returns for the entire sample of 280 firms with meetings of over one hour were relatively unexciting; they showed a statistically insignificant decline of .06 percent. Perhaps investors only care if a firm has an *extraordinarily* long meeting. To test this hypothesis, I split the 280 firms that had long meetings into two groups; those whose meetings lasted from one to two hours, and those whose meetings exceeded two hours. Again results were not very exciting and most were not statistically significant.

Finally, I split the sample into two groups: repeaters and non-repeaters. I define "repeater" as those firms in the dataset of long meetings whose meetings in the year previous *preceding* their long meeting also exceeded one hour. All other firms are non-repeaters. The reasoning behind this division is that if a firm regularly has long meetings, investors eventually learn that there is no information being signaled by the length of the firm's meeting. Electrical utilities, for instance, almost always have very long meetings; they were the only repeater firms in 1991, 1992, and 1994 to have meetings longer than two hours. But these meetings run long because of anti-nuclear protests, not *sokaiya*. And some meetings of Japanese firms with good investor relations programs run long for the same planned reasons that they might in the United States: speeches, entertainment, and *hors d'oeuvres*. Realizing this, the market should not react to the length of repeaters' meetings.

In fact, in my study, repeaters on average showed a slight, though insigificant *increase* in market adjusted returns during the meeting day window. The surprising story in my experiment was the set of firms that have long meetings out of the blue; that is, the non repeaters. In the year of their long

meetings, these firms, on average, had statistically significant market-adjusted returns of –0.59 percent. Stated concretely, the data show that during the period 1990-97, if a company that did not regularly have long meetings suddenly had a long meeting, that company lost, on average, 0.59 percent of its value (adjusted for market risk and variation in the Tokyo Stock Price Index) during the two-day period beginning the day it held its meeting.

Faced with these stock price effects, how might each actor — managers, *sokaiya*, and shareholders — behave? Managers have incentives to pay *sokaiya* to keep meetings short, whether the payments are made to keep *sokaiya* quiet at meetings or as compensation for *sokaiya* suppression of "legitimate" shareholder voice. *Sokaiya* clearly have incentives to disrupt meetings, and given negative returns for long meetings, it may not be necessary that all of their information is always true or even always secret, so long as they can make the meeting run long and collect enough true information over time to maintain the signal's validity. Finally and somewhat perversely, investors should in some cases welcome payments to *sokaiya*, as *sokaiya*, for a relatively trivial fee, can prevent an average loss in shareholder wealth of 0.59 percent.

Investors thus tend to buy the stock only of those companies that have short meetings. Of course, this pleases companies that usually have short meetings. But some companies — presumably those with such low information disclosure that shareholders can only acquire relevant information by asking lengthy questions at shareholders' meetings — will tend to have long meetings. These companies have clear incentives to pool with (mimic) companies that have short meetings. Paying *sokaiya* helps them do so.

CONCLUSION

Why would rational executives of highly successful Japanese firms pay *sokaiya* racketeers to keep their shareholders' meetings short? This article has shown that sometimes they pay *sokaiya* for blackmail, which is hardly a uniquely Japanese phenomenon. But sometimes the blackmail actually does center around shareholders' meetings. The econometric data I have gathered suggest that because meeting length is correlated to share prices, payments to *sokaiya* to keep meetings short can increase shareholder wealth.

This wealth maximization potential is a direct product of Japanese corporate law, regulation, and corporate governance, which facilitate barren information markets. *Sokaiya* — often armed with mob connections that make their threats perfectly clear — simply take advantage of the fact that little information is disseminated. U.S. corporate blackmail apparently does not reach the scale of that of Japan because the U.S. federal system, relatively unfettered by inefficient corporate law, heavy regulation, and other anti-competitive institutions, makes publicly available more information with blackmail potential.

The *sokaiya* payment institution persists because, given other existing institutions, almost all actors have reason to choose it over alternative choices. Obviously *sokaiya* can profit with little chance of detection. Managers and shareholders benefit, too. The Japanese press sometimes describes *sokaiya*-paying managers as gutless and cowardly. Managers counterattack with cries that they bravely pay *sokaiya* "for the good of the company." On this issue, managerial and shareholder interests are aligned. Given that the system is one of non-disclosure, shareholders (and perhaps society as a whole) may derive further benefit from *sokaiya* activity, as *sokaiya* may serve as monitors of management behavior, forcing managers to calculate the cost of *sokaiya* bribes into the cost of their actions. And if MOF wants to prevent firms from failing, it, too, may have incentives to support *sokaiya* activity.

The institutional incentive structure implies that recent Japanese legislative efforts to curtail *sokaiya* activity may be of limited efficacy. In November 1997, the Japanese legislature enacted revisions to the Commercial Code designed (once again) to eliminate *sokaiya*. The new provisions increase criminal penalties for payment from imprisonment of 6 months *or* a $2,400 fine to 3 years *and* $24,000; impose criminal liability for *sokaiya* who demand payment (as opposed to liability only for receiving payment); and increase penalties for related wrongdoing such as money laundering and making false statements to regulators. This legislation may have some marginal effect. But even after the law — which ignores the institutional dynamics discussed in this article — was enacted (and several months after the most publicized scandals), 60 percent of surveyed directors, 79 percent of auditors, and 75 percent of managers still said that they would be unable to cut *sokaiya* ties in 10 years.

Despite these recent legislative attempts at reform, *sokaiya* influence remains pervasive. On a recent and utterly unscientific walk around Tokyo's Kabutocho securities brokerage district, I saw three types of freshly-inked posters in brokerage windows. Eight firms' posters warned *sokaiya* and other unsavory types to stay away. Four firms' posters apologized for their recent *sokaiya* scandals. Three firms had posters announcing the dissolution of the firm. Breadwinning calligraphers and poster-printers can take comfort. Unless and until the incentive structures created by corporate law, corporate governance, and regulatory policy change to encourage more "stay away" signs, demand for *sokaiya* apology signs, and perhaps dissolution signs as well, is likely to persist.

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