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# **Comparing Japanese Versus U.S. Decision Making in Corporate Governance**

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C O L U M B I A   U N I V E R S I T Y   I N   T H E   C I T Y   O F   N E W   Y O R K

## **COMPARING JAPANESE VERSUS U.S. DECISION MAKING IN CORPORATE GOVERNANCE**

### **ABSTRACT**

This study examines how widespread the similarities between U.S. and Japanese corporate governance practices have become. Results suggest that, in spite of convergence in many areas of business practices, Japanese board structures and governance practices still differ greatly from those in the United States – particularly in SEC-mandated reforms such as independent audit and compensation committees. Our results suggest that findings concerning corporate governance differences between Japanese and U.S. firms may be driven, in part, by differences in directors' recognition of investors' performance expectations. In particular, our results indicate that the exit barriers related to employment impact decision-making for Japanese directors more strongly than they affect U.S. directors' decisions.

**KEYWORDS:** board structure, Japanese directors, board committee structure, director independence, performance measures, and exit barriers

## COMPARING JAPANESE VERSUS U.S. DECISION MAKING IN CORPORATE GOVERNANCE

Waning investor confidence in the performance of Japanese corporations has motivated some Japanese firms to embrace corporate governance structures and practices that resemble U.S. board reforms. Western-style CEOs, like Howard Stringer at Sony or Carlos Ghosn at Nissan Motors, were recruited to restructure Japanese firms and introduce western governance practices to improve company performance. But how much progress has actually been made towards the convergence of corporate governance policies in Japan and the United States? Where are publicly-traded firms in each respective country most similar to each other in their governance practices and outlooks and is convergence necessarily desirable?

Ahmadjian & Robbins (2005) argue that the increasing pressure of Japanese shareholder capitalism has made some Japanese managers and corporate boards accept downsizing, divestiture, and other corporate strategy practices that are more characteristic of western-style corporate governance. Does this mean that Japanese board members use performance measures and decision criteria that are similar to U.S. board members, as well? Milhaupt (2001) argues that Japanese social norms opposing downsizing practices do not have a long history and that opposition to them is waning in light of the rise of shareholder-centered ideology in Japan. Pease, *et al* (2006) suggest that greater turnover among Japanese shareholders may result in more corporate governance practices reflecting this change. Since there are conflicting perceptions of how far Japanese corporate governance reform has progressed, this study examines how widespread the similarities between U.S. and Japanese corporate governance practices have become – particularly with respect to downsizings and the treatment of distressed lines of business.

Results suggest that in spite of convergence in many areas of business practices, Japanese board structures and governance practices still differ greatly from those in the United States where corporate boards have undergone substantial reforms to regain the confidence of American investors in a post-scandal era. Wu (2004) notes that public opinion has compelled the directors of U.S. firms to improve their corporate governance systems. Most notably, the financial reporting requirements of Sarbanes-Oxley legislation and process of 404 internal controls certification have strengthened corporate governance structures and practices in the United States -- making independent audit committees stronger than they were in the era of Enron- and Tyco-related control scandals and making independent compensation committees more cautious about excessive pay schemes in the U.S. In spite of investor concerns about similar Japanese accounting scandals, our results indicate that reforms such as independent audit and compensation committees are not yet as widespread among Japanese boards as they are among U.S. boards.

The rigorous corporate governance policies imposed in the United States by the oversight of the Securities and Exchange Commission (SEC) are a mixed blessing because – although shareholders can credibly rely on these reforms to expect that troubled businesses will be dealt with efficiently – the corporate managers who implement divestitures are heavily evaluated by expectations of shareholder value maximization in the United States. Their corporate boards are more willing to sell troubled U.S. businesses to owners that can obtain better performances from them. Managers typically expect their troubled lines of business to be divested to new owners (or liquidated) if their respective turnarounds are not achieved promptly. Our results suggest that findings concerning corporate governance differences between Japanese and U.S. firms may be

driven, in part, by differences in directors' recognition of investors' performance expectations (Rosenstein & Wyatt, 1990; Gugler et al, 2004). Against a backdrop of strongly rising shareholder capitalism, financial considerations shape an increasing number of corporate directors' perceptions concerning what constitutes attractive investment opportunities and which businesses to retain in the corporate family. Pressures to divest unprofitable lines of business now tend to overcome most barriers that could discourage exit decisions.

Earlier studies of divestiture found that timely disposals of assets were impeded where exit barriers were perceived to be high by corporate directors and managers (Harrigan, 1981; 1982). Because exit barriers adversely shaped directors' perceptions concerning the ease of divesting underperforming assets (Porter, 1976), high exit barriers kept firms operating within troubled industries even where they earned subnormal returns on their investments. Our results indicate that such exit barriers have largely lost their power over U.S. managers and directors in many situations. Results also suggest that exit barriers related to maintaining employment levels influence Japanese directors more strongly than they affect U.S. directors when contemplating shutdowns and other actions intended to remedy poor business unit performance.

### **Methodology**

We created a 5-point Likert scale questionnaire in order to gather information about Japanese and U.S. firms' governance structures and perceptions of how to deal with their underperforming assets. The questionnaire was translated into Japanese by a native-born colleague. A parallel sample of publicly-traded firms in Japan and the United States was created to represent several industries from each nation's economy. As Table 1 indicates, industry classifications from each source of firm listings were not directly comparable.

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Table 1 about here  
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The Japanese questionnaire was mailed to the Presidents of 412 Japanese corporations with annual revenues in excess of ¥1 billion. Many of the sample firms appear in the *Nihon Keizai Shimbun*. General machinery firms comprised 10.6% of the Japanese firms queried, electric machinery firms comprised 9.6% of the Japanese sample, and chemical firms represented the third-largest industry concentration (8.8% of Japanese sample). Usable responses were received from 45 Japanese firms representing 16 different industry classifications (an 11% response rate). As Table 2 illustrates, general machinery firms comprised 8.9% of the Japanese responses, as did electric machinery firms.

The U.S. questionnaire was mailed to the Chief Executive Officers of 869 United States corporations with market capitalizations in excess of US\$1 billion. 87 primary industry classifications were represented in the U.S. mailing. Retailing firms comprised 9.5% of the U.S. firms queried. Insurance and oil and gas were the industries next most highly represented (each comprising 8.0% of the total sample). Sample firms' headquarters were located in 41 different states, although 59.8% of the U.S. sample was headquartered in 9 states and California alone comprised 15.8% of the U.S. mailing to firms. No questionnaires were sent to firms in either country that operated primarily in the following industries: investment services, miscellaneous financial services, money center banks, regional banks, savings & loans, savings banks, and utilities.

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As Table 2 indicates, usable responses were received from 72 U.S. firms representing 40 different primary industry classifications (a 10.4% response rate). Insurance firms comprised 7.0% of the U.S. respondents. The next three most highly-represented industries were biotechnology, printing and publishing, and scientific and technical instrumentation (each comprising 5.6% of the responding firms). Responses were received from firms in 27 states. 11.4% of the U.S. responses came from Texas; the second largest number of responses (7.1% each) came from Pennsylvania, Ohio, and Illinois.

A Chi-square analysis was performed on the two samples – Japanese and U.S. -- to test the hypothesis that the populations are the same. Where results differed significantly, the dominant response – agree or disagree – is reported. Although many totals are reported as sums of the dominant responses – agree/ strongly agree (or disagree/ strongly disagree, respectively) -- strongly-expressed responses are discussed separately where they are noteworthy. Scores are not reported for responses located at the middle of the Likert scale – for the category of “neither agree nor disagree.”

## Results

Results are reported concerning differences between the samples in director independence, board committees, directors’ performance expectations, and their perceptions of exit barriers. Director independence is an area of great divergence between the samples.

### Differences in board structure and independence

Board independence has been cited as being important to the creation of shareholder value (Cotter et al, 1997). Wagner, et al (1998) found a curvilinear relationship in which having mostly insiders (or mostly outsiders) contributed positively to firm performance. We phrased our questions about the proportion of insiders versus outsiders on a company board in terms of their respective independence.

In our study, results concerning director “independence” are significantly different for our two samples -- perhaps because we used a stringent definition of it (that is consistent with the SEC’s definition of independence). As Table 3 indicates, independence was defined in our survey such that directors are not (nor have they been) employees of the firm, represent neither supplier nor customer firms, and have no relatives holding key managerial positions within the firm nor other financial ties with it (other than shareholdings). 90.3% of the U.S. respondents agreed with the statement; all of the Japanese respondents disagreed with the statement ( $\chi^2=100.44^{****}$ ). This result may seem surprising because results from Kaplan & Minton (1994) suggested that independent outsiders are being appointed with increasing frequency to Japanese boards to monitor firms’ performance. But outsider directors on many Japanese boards that are acting as representatives of the firm’s corporate and banking institutional investors are scarcely independent (Yoshikawa & Phan, 2005). Since the *Nihon Keizai Shimbun* sample was expected to be representative of the full range of Japanese firms, additional questions probed the issue of director independence.

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Table 3 about here  
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Japanese responses differed from U.S. responses about the composition of their boards with respect to the appointment of insiders. As Table 4 indicates, in a question suggesting that few insiders served on the board of directors of their company, no Japanese respondents agreed with the statement and 84.7% of the U.S. sample agreed with it ( $\chi^2=79.94^{****}$ ). Given our earlier definition of independence, the U.S. sample showed some overestimation bias in their responses when Table 3 is compared with Table 4. Responses from the Japanese sample reflect the reality that most Japanese directors have worked for the same company as employees and worked their way up before being appointed as directors (Cooke & Sawa, 1998).

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Table 4 about here  
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We next asked a normative question that stated that the only corporate officer serving on a firm's board of directors *should* be its Chief Executive Officer (CEO) – an opinion that is consistent with guidelines offered by the North American Association of Corporate Directors (NACD), a self-governing group of professional directors (NACD, 2002). As Table 5 reveals, only 48.6% of the U.S. respondents agreed with this normative statement, as compared with 22.0% of the Japanese respondents ( $\chi^2=37.80^{****}$ ). 36.1% of the U.S. respondents disagreed with the normative statement about limiting insiders' board membership as compared with 58.3% of the Japanese respondents. Since Japanese board members are viewed as *de facto* managers who are subordinate to their CEO, the high proportion of disagreement among the Japanese responses is easy to interpret (Yoshikawa & Phan, 2005). NACD-proposed reforms have not yet reached many Japanese boardrooms.

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Table 5 about here  
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Since insiders serving on a corporate board could include vice chairpersons, presidents of operating subsidiaries, and the current Chief Financial Officer (CFO), among others, we asked a clarifying question to distinguish between active corporate officers versus retired ones that may serve on a firm's board. In the normative statement that no retired officers of the company *should* serve on its board of directors after their retirements, only 18.1% of the Japanese respondents agreed (as compared with 46.5% of the U.S. respondents). 52.3% of the Japanese managers (and 33.8% of the U.S. managers) disagreed with this normative statement ( $\chi^2=21.94^{***}$ ). The Japanese responses to the question concerning the presence of retired corporate officers on company boards are consistent with Miwa & Ramseyer's (2005) findings that independent outside directors are most likely to serve on boards of Japanese firms in a very limited set of industries that may not be represented by this sample. They are not consistent with Peng's (2004) observations about outsiders serving on corporate boards nor with Yafeh's (2000) predictions of convergence. Yoshikawa & Phan (2005) would assert that the executives and former employees of Japanese corporate boards do not consider themselves as active monitors of top management.

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Table 6 about here  
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In a survey item stating that director independence ensured that the company's board of directors would be constructively critical of managerial performance, 83.1% of the U.S. respondents agreed with the statement (compared with 22.7% of the Japanese respondents). As Table 7 indicates, 15.9% of the Japanese respondents disagreed with the statement and 52.3% of them *strongly* disagreed ( $\chi^2=64.85^{****}$ ), suggesting that director independence is not yet valued on Japanese boards. Since Klein (1998) found significant positive correlations between firm performance and the number of corporate officers on finance and investment committees, we inter-

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preted our result as suggesting that respondents in the Japanese sample believed that having insider directors on their boards provides valuable information to other board members about their firm's long-term investment decisions. Moreover, as Yoshikawa & Phan (2005) point out, typical Japanese directors do not question executive management and do not delegate their managerial duties to corporate officers.

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Table 7 about here  
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### **Differences in committee structure and independence: Audit committees**

Questions about committee structures followed the NACD's Blue Ribbon Committee's guidelines concerning board structures. Our results indicated independence differences between Japanese and U.S. boards in the composition of their committees. As Table 8 shows, in this study, 90.3% of the U.S. sample *strongly* agreed with the statement that their firm's audit committee was independent. (All of the Japanese respondents disagreed with this statement,  $\chi^2=111.96^{***}$ ). Audit committee independence is one of the non-negotiable board attributes mandated by SEC reforms and publicly-traded U.S. firms are castigated for failing to satisfy this structural requirement (NACD, 2002). In Japan, it has been proposed that at least half of the audit committee members must be outside directors who cannot serve as executive officers of the company (Takehara & Nihei, 2005), but it is not known how many firms have embraced this recommendation for reform.

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Table 8 about here  
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Agrawal & Chadha (2005) found that independent directors with financial expertise are valuable in providing oversight of a firm's accounting practices. In a question suggesting that all of the members of a firm's audit committee were financially literate -- i.e., each member fulfilled the minimum regulatory requirements concerning the comprehension and use of financial statements (Report of the NACD, 2004) -- 75% of the U.S. respondents *strongly* agreed with the statement, but 86.4% of the Japanese respondents disagreed with this statement ( $\chi^2=91.4\%$  \*\*\*\*). The results -- shown in Table 9 -- are unexpected, given the abundance of tutorial courses concerning interpretation of financial statements that are offered in the United States to professional directors. It suggests that in the selection of Japanese directors, financial literacy is valued less highly than in the case of U.S. boards. Cooke & Sawa (1998) report that some Japanese companies have corporate auditors -- which are separate from accounting auditors -- who are often appointed from the firm's employee ranks with no particular financial qualifications.

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Table 9 about here  
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Responses to the question about the power of corporate audit committees provided another indication that corporate governance reforms like Sarbanes-Oxley legislation have not yet transformed all Japanese board structures. Table 10 indicates that there was some disagreement between the samples with respect to the statement that the firm's audit committee hires and fires the independent audit firm and receives the audit firm's reports concerning the accuracy of performance data to be released by the company to investors. 88.9% of the U.S. respondents *strongly* agreed with the statement that their audit committee hired audit firms and received their reports. Two-thirds (69.8%) of the Japanese respondents agreed with the statement. Only 25.6% of the Japanese respondents disagreed with this description of the audit committee's powers ( $\chi^2=43.02$  \*\*\*\*). We concluded that although Japanese audit committees possess similar powers

vis-à-vis interactions with independent audit firms, expectations concerning their oversight activities differ from those of U.S. audit committees. In particular, Japanese audit committee members are not yet placed in jeopardy by their failure to recognize and act upon internal control gaps that may elude detection by outside accounting audit firms. The combination of less jeopardy disciplining a statutory audit committee that is not really independent is a recipe for lax controls.

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 Table 10 about here  
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### **Differences in committee structure and independence: Compensation committees**

Questions about the composition and role of the board's compensation committee followed the NACD's guidelines concerning the setting of executive compensation (Report of the NACD, 2007). In Table 11, 97.2% of the U.S. respondents agreed that their board had an "independent" compensation committee as is required by the SEC (using the same stringent, SEC-inspired language as was used in the questions concerning the firm's audit committee members). 72.7% of the Japanese respondents disagreed with the statement that their board's compensation committee was independent ( $\chi^2=82.81^{***}$ ), which is consistent with the Japanese principle of internalism whereby companies are controlled by internally-appointed board members (Buchanan, 2007). Internalism means that Japanese shareholders accept management's recommendations on most governance matters and proxy fights where shareholders reject managerial decisions are rare – even after the proposed takeover of Tokyo Kohtetsu was defeated in 2007 (Morse & Moffett, 2007). Takehara & Nihei (2005) define an outside director as a non-managing director who does not, and never did, manage the corporate affairs of the company or one of its subsidiaries as a director, executive officer, manager or other employee and who is not an employee of the company or one of its subsidiaries. The 2005 report of the Corporate Governance

Forum of Japan recommends that at least half of the firm's compensation committee must be outside directors – assuming that the Japanese firm has committees (instead of corporate auditors as overseers). There are no restrictions about outside directors in Japan representing supplier or customer firms, having relatives holding key managerial positions within the firm, or having other financial ties with it (other than shareholdings) in these recommendations.

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Table 11 about here  
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U.S. boards are often criticized when executive salaries rise to unwarranted levels, but most of their compensation committees retain consultants only to establish CEO salaries. When asked whether their board's compensation committee acted in this manner -- setting only their CEO's salary, while ratifying salary recommendations for other officers -- 98.6% of the U.S. respondents agreed with the statement, as Table 12 indicates. Although more than half of the Japanese sample agreed with the U.S. respondents concerning this aspect of compensation committee activity, the populations are still statistically different in the distribution of their responses. In Table 12, 54.5% of the Japanese presidents agreed with the statement while 27.8% did not ( $\chi^2=78.44^{****}$ ). When combined with earlier responses from the Japanese sample, the responses shown in Table 12 suggest that, in Japanese firms, the board's compensation committee is -- in effect -- making recommendations on their own compensation packages by rubber-stamping the CEO's salary recommendations.

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Table 12 about here  
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In summary, results indicate that some Japanese and U.S. boards have compensation committees as well as audit committees. The committees of U.S. boards are more independent than their Japanese counterparts. Independent outsiders are more likely to serve on U.S. boards

than on Japanese ones, and director independence is valued more highly by U.S. boards than Japanese ones (where we infer that internalism is more highly valued). Retired corporate executives and current corporate officers other than the CEO are more likely to serve on Japanese boards than on U.S. ones. U.S. audit committees are more likely to contain finance experts and financially-literate directors than are Japanese ones.

Given that results indicated that their board compositions are different with respect to independence, we wondered whether board decisions concerning performance would also differ between the U.S. and Japanese samples. Do differences in board and committee composition explain differences in how corporate decisions such as exit and divestiture are regarded? To explore this relationship, our questionnaire posed several questions about the board's role in decision making and how the board evaluates their firm's performance.

### **Board involvement in and evaluation of corporate decisions: Performance expectations**

Responses from the two samples disagreed slightly regarding their reaction to the statement that their company's board of directors should not be actively involved in its day-to-day operations. 16.0% of the Japanese respondents and 5.6% of the U.S. respondents disagreed with this statement ( $\chi^2=16.32^{**}$ ). In particular, As Table 13 indicates, 57.8% of the U.S. respondents *strongly* agreed with the idea of a hands-off board of directors that represents shareholder interests, but whose intervention into daily operations is limited to hiring and firing the firm's CEO. By contrast, if Japanese corporate managers and directors are indeed the same individuals, the lines of control and intervention could become more easily blurred -- particularly if no delegation of duties to executive officers occurs (Hirota & Kawamura, 2007).

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Table 13 about here  
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The responses of the Japanese sample showed lower expectations that the board emphasized shareholder primacy in their decisions -- a contrast, perhaps, of the stakeholder- versus stockholder-oriented models (Abe & Shimizutani, 2007). Table 14 shows the pattern of responses to a statement that the firm's board of directors primarily represents its shareholders' interests and concerns by ensuring that the firm's activities all create value. For this statement, responses the U.S. sample largely agreed (87.2%). The dominant answer in the Japanese sample was disagreement with the statement (51.2%). Results suggested that the samples differed significantly concerning whether they perceived that their firm's board of directors primarily represents its shareholders' interests and concerns by ensuring that the firm's activities all create value ( $\chi^2=55.72^{***}$ ), with the Japanese sample apparently tolerating more deviations in the returns realized from their firm's investment activities.

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Table 14 about here  
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Japanese responses differed from U.S. responses concerning how the boards perceived attainment of their goals. In a statement suggesting that their firm's performance was evaluated primarily through increases in its stock price and dividend payments to investors, 81% of the Japanese respondents agreed with the statement. This result is surprising, given Kato & Kubo's (2006) finding that stock market performance plays a lesser role in compensating Japanese managers. As Table 15 indicates, responses from U.S. respondents were equally split between agreement and disagreement, suggesting a significant difference in dividend policies, information exchange within stock markets, and how performance is evaluated by top management and corporate boards in each respective country ( $\chi^2=27.97^{****}$ ). In the United States, board members



and managers recognize the destabilizing impact of public information, rumors and day traders on fluctuations in a firm's stock price (Bushman, et al, 2006). U.S. value creation for institutional shareholders occurs as much by the issuance of large special dividends to return capital from operations of mature industries as it does by stock price increases enjoyed by firms operating within riskier, growth industries.

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Table 15 about here  
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The Japanese and U.S. samples were dissimilar in their responses concerning the use of revenue-growth forecasts and the length of time required to pay back their investments ("pay-back") as primary criteria for evaluating attractive investment opportunities. As Table 16 indicates, 54.2% of the U.S. respondents agreed that their firm's investments in new lines of business were evaluated primarily on the basis of revenue growth and payback, compared with 29.5% of the Japanese respondents ( $\chi^2=11.62^*$ ). In the Japanese sample, 33.1% of the respondents disagreed with these metrics being the primary criteria for evaluating new lines of business, which suggests that the traditional strategic performance measures of return on investment and return on sales may be weighted more heavily in Japanese boards' evaluations of new lines of business (Banker, et al, 1996).

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Table 16 about here  
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Posing a question about the measure most typically used by investment bankers to value firms, we found similarity between the distributions of responses for the two samples. In Table 17, 56.3% of the U.S. respondents agreed that the future value of their firm was evaluated primarily in terms of the firm's revenue growth and outlook for industry-wide profit margins while 21.2% disagreed, as compared with 40.9% of the Japanese respondents who agreed while 36.4%

disagreed ( $\chi^2=3.91$ , which is *not* statistically significant). Apparently some (but not all) of the board members in both countries are aware of the calculation of enterprise value, keep their firm's current valuation in mind when making decisions concerning their firm's lines of business, and strive to make decisions that realize the firm's corporate value (Whittaker & Hayakawa, 2007). The survey statement did not seek concurrence about what constitutes an attractive line of business within the corporation.

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Table 17 about here  
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Finally we asked about the importance of maintaining stable levels of employment as a metric for evaluating the attractiveness of their firm's lines of business. In Table 18, 33.3% of the Japanese respondents agreed that attractiveness as an investment was evaluated primarily in terms of its success at maintaining stable employment (compared with only 4.4% of the U.S. respondents), while 52.4% of the Japanese respondents disagreed with the statement (compared with 84.1% of the U.S. respondents). In Japan, the frequent adjustment of employment during the negative phase of business cycles has been regarded as an irresponsible transfer of business risks to employees (Suzuki, 1999). Results suggest that greater concerns exist among the Japanese respondents in maintaining stable employment ( $\chi^2=22.18^{***}$ ) and the distributions of these responses were in the directions that are consistent with our expectations concerning the impact of employment-related exit barriers on the outcome of boards' decision making in Japan and the United States.

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Table 18 about here  
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Results indicate that boards are not expected to intervene in day-to-day operations in neither Japan nor the United States. Shareholders' interests and concerns weigh heavily in evaluations of business activities within U.S. boards of directors. Rises in stock prices and dividend payments are weighted more heavily within Japanese boards when evaluating their firms' performance. Payback and expectations of revenue growth are weighted more heavily when U.S. boards evaluate investments. Boards of directors in both Japan and the United States acknowledge that revenue growth and industry attractiveness will determine their firm's future value. Japanese boards consider stable employment substantially more important than U.S. boards do when evaluating a firm's attractiveness. Given these criteria, we wondered how Japanese and U.S. boards coped with underperforming lines of business within their respective firms. Were labor-related exit barriers likely to impede the willingness of Japanese boards to divest unprofitable businesses?

### Exit barriers and divestitures

If the decisions of corporate directors can affect their firms' performance, we would expect boards to support divestiture when restructuring efforts are not successful. In our survey, the two samples responded very differently to a statement suggesting that their firm's board of directors would divest under-performing lines of business that cannot be turned around successfully in order to meet performance targets ( $\chi^2=61.44^{****}$ ). The Japanese responses were dramatically bimodal; 56.1% of the Japanese responses strongly disagreed with this statement, but 29.3% of the Japanese responses strongly agreed with it. The U.S. responses to this question were bunched in the middle of the Likert scale, with a total of 19.7% disagreeing with the statement while 43.7% of the U.S. respondents agreed with it. These results support findings that, although downsizings in Japan have become more widespread, many Japanese firms are still resistant to them (Ahmadjian & Robinson, 2001). Indeed, Kang & Shivdasani (1997) reported that when they experience a decline in performance, Japanese firms are less likely to downsize or terminate the employment of a large fraction of their workforce.

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Table 19 about here  
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The samples also differed in their perception of exit barriers associated with showing accounting losses on disposal of a line of business ( $\chi^2=42.73^{****}$ ). As Table 20 indicates, write-off losses are not perceived as an exit barrier for the boards of most of the U.S. firms in our sample (82.8%). In the Japanese sample, 23.3% of the responses suggested that their firm would not get out of an unprofitable line of business if a troubled unit were divested until the firm had recovered its investment. (51.2% of the Japanese responses were neutral.) The U.S. sample indicated a stronger willingness to exit from unprofitable businesses before reaching their payback level of returns.

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Strategic exit barriers associated with market share appear to be stronger for directors in Japan than in the United States ( $\chi^2=27.93^{****}$ ). In our results, Table 21 indicates that, if a troubled line of business were unprofitable, 47.7% of the Japanese responses agreed that their firm would not get out of it if its market share were large. 63.6% of the U.S. responses disagreed that large market share would deter their board from divesting an unprofitable line of business, suggesting that market position is not perceived as a strategic exit barrier to them.

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Table 21 about here  
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Employee terminations are not perceived as exit barriers in U.S. firms. Table 22 shows that, in a statement suggesting that their firm would not get out of an unprofitable line of business if many employees would lose their jobs, 82.1% of the U.S. responses disagreed with the statement. Although 37.1% of the Japanese responses also disagreed with the statement (42.9% of the Japanese responses were neutral for this question, while 19% of the responses agreed with the statement), the samples are statistically different regarding this deterrent ( $\chi^2=26.27^{****}$ ). The reluctance of Japanese respondents to comment on this source of exit barriers may be indicative of the special role that lifetime employment policies play in Japanese society (Gilson & Roe, 1999), although Jacoby (2005) would argue that the two employment systems are slowly converging in their practices.

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Table 22 about here  
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Our results suggest that a relationship exists between having independent outsiders on corporate boards and those boards' willingness to divest underperforming assets. Results are consistent with the Perry & Shivdasani (2005) study of firms facing material declines in perfor-

mance which noted that firms having a majority of outsiders on their boards were faster to initiate restructurings leading to performance improvements. Perhaps the absence of questioning outsiders on Japanese boards increases perceived exit barrier heights in the minds of directors?

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- \* Probability < .05
  - \*\* Probability < .01
  - \*\*\* Probability < .001
  - \*\*\*\* Probability < .0001

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Table 1  
Distribution of Samples by Primary Industry

<u>Industry</u>	<b>Japanese Sample</b>				<b>United States Sample</b>			
	<u>Firms</u>	<u>(%)</u>	<u>Received</u>	<u>(%)</u>	<u>Firms</u>	<u>(%)</u>	<u>Received</u>	<u>(%)</u>
Advertising	0	0.00	0	0.00	7	0.81	0	0.00
Aerospace & defense	0	0.00	0	0.00	11	1.27	1	1.39
Air courier	0	0.00	0	0.00	1	0.12	0	0.00
Airlines	0	0.00	0	0.00	4	0.46	0	0.00
Apparel & accessories	0	0.00	0	0.00	5	0.58	0	0.00
Appliances & tools	0	0.00	0	0.00	5	0.58	0	0.00
Audio/video equipment	0	0.00	0	0.00	2	0.23	0	0.00
Automobiles/trucks_	0	0.00	0	0.00	5	0.58	0	0.00
Automobile/truck parts	0	0.00	0	0.00	10	1.15	2	2.78
Beverages--alcoholic	0	0.00	0	0.00	4	0.46	1	1.39
Beverages-non-alcoholic	0	0.00	0	0.00	4	0.46	0	0.00
Biotechnology/-drugs	0	0.00	0	0.00	52	5.98	3	4.17
Broadcasting/cable TV	0	0.00	0	0.00	24	2.76	0	0.00
Business services	0	0.00	0	0.00	19	2.19	4	5.56
Capital goods	0	0.00	0	0.00	21	2.42	2	2.78
Casinos/ gaming	0	0.00	0	0.00	8	0.92	0	0.00
Chemicals	34	8.79	2	4.44	24	2.77	3	4.17
Coal	0	0.00	0	0.00	4	0.46	1	1.39
Commerce	12	3.10	1	2.22	0	0.00	0	0.00
Communications	9	2.33	0	0.00	34	3.91	0	0.00
Computers	0	0.00	0	0.00	40	4.62	3	4.17
Conglomerates	0	0.00	0	0.00	14	1.61	2	2.78
Construction/ agriculture machinery	0	0.00	0	0.00	5	0.58	2	2.78
Construction materials	0	0.00	0	0.00	5	0.58	1	1.39
Construction services	27	6.98	0	0.00	14	1.61	0	0.00
Containers/ packaging	0	0.00	0	0.00	9	1.04	2	2.78
Electric machinery	37	9.56	4	8.89	0	0.00	0	0.00
Electronic components	1	0.26	0	0.00	29	3.34	0	0.00
Electronic instruments	0	0.00	0	0.00	0	0.00	0	0.00
Finance	20	5.17	3	6.67	13	1.50	1	1.39
Fishery & farming	5	1.29	0	0.00	1	0.12	0	0.00
Food processing	20	5.17	3	6.67	25	2.88	1	1.39
Footwear	0	0.00	0	0.00	3	0.35	0	0.00
Forestry and wood	0	0.00	0	0.00	3	0.35	0	0.00
Furniture/ fixtures	0	0.00	0	0.00	9	1.04	0	0.00
General machinery	41	10.59	4	8.89	0	0.00	0	0.00
Glass & ceramics	13	3.36	2	4.44	0	0.00	0	0.00
Healthcare facilities	0	0.00	0	0.00	9	1.04	0	0.00
Hotels/ motels	0	0.00	0	0.00	7	0.81	2	2.78
Insurance	2	0.52	0	0.00	69	7.94	5	6.95
Iron & steel	10	2.58	0	0.00	4	0.46	0	0.00
Jewelry & silverware	0	0.00	0	0.00	2	0.23	0	0.00

Media	2	0.52	1	2.22	6	0.69	0	0.00
Metal products	8	2.07	0	0.00	6	0.69	0	0.00
Mining	5	1.29	0	0.00	3	0.35	0	0.00
Mobile homes/ RVs	0	0.00	0	0.00	2	0.23	0	0.00
Non-apparel textiles	0	0.00	0	0.00	2	0.23	1	1.39
Non-ferrous metals	16	4.13	3	6.66	0	0.00	0	0.00
Office equipment	0	0.00	0	0.00	4	0.46	0	0.00
Office supplies	0	0.00	0	0.00	3	0.35	0	0.00
Oil & gas	0	0.00	0	0.00	58	7.94	5	6.95
Other products	12	3.10	1	2.22	6	0.69	0	0.00
Paper & paper products	0	0.00	0	0.00	9	1.04	1	1.39
Personal/ household products	0	0.00	0	0.00	15	1.73	2	2.78
Personal services	0	0.00	0	0.00	6	0.69	1	1.39
Pharmaceuticals	18	4.65	1	2.22	8	0.92	1	1.39
Photography	0	0.00	0	0.00	2	0.23	0	0.00
Precision machinery	10	2.58	0	0.00	0	0.00	0	0.00
Printing & publishing	0	0.00	0	0.00	23	2.65	4	5.56
Pulp & paper	4	1.03	0	0.00	0	0.00	0	0.00
Railroads	0	0.00	0	0.00	6	0.69	1	1.39
Real estate	5	1.29	0	0.00	0	0.00	0	0.00
Recreational products & services	0	0.00	0	0.00	14	1.61	2	2.78
Rental & leasing	0	0.00	0	0.00	3	0.35	0	0.00
Restaurants	0	0.00	0	0.00	16	1.84	1	1.39
Retailing	0	0.00	0	0.00	82	9.48	6	8.34
Rubber products	5	1.29	0	0.00	0	0.00	0	0.00
Schools/ training	0	0.00	0	0.00	9	1.04	1	1.39
Scientific & technical instruments	0	0.00	0	0.00	14	1.61	4	5.56
Security systems/ service	0	0.00	0	0.00	1	0.12	0	0.00
Services	9	2.33	0	0.00	0	0.00	0	0.00
Software	4	1.03	1	2.22	30	3.45	2	2.78
Specialized machinery	7	1.81	0	0.00	0	0.00	0	0.00
Textiles & apparel	11	2.84	0	0.00	0	0.00	0	0.00
Tires	0	0.00	0	0.00	2	0.23	0	0.00
Tobacco	0	0.00	0	0.00	4	0.46	0	0.00
Transport equipment	25	6.46	2	4.44	0	0.00	0	0.00
Transportation services	8	2.07	0	0.00	11	1.27	2	2.78
Wholesale services	7	1.81	0	0.00	0	0.00	0	0.00
Unknown	25	0.60	17	37.78	1	0.12	2	2.78
Totals	412	100.00	45	100.00	869	100.00	72	100.00

Table 2  
Distribution of Responses by Primary Industry

<u>Industry</u>	<b>Japanese Sample</b>				<b>United States Sample</b>			
	<u>Firms</u>	<u>(%)</u>	<u>Received (%)</u>		<u>Firms</u>	<u>(%)</u>	<u>Received (%)</u>	
Aerospace & defense	0	0.00	0	0.00	11	1.27	1	1.39
Automobiles/trucks	0	0.00	0	0.00	5	0.58	0	0.00
Automobile/truck parts	0	0.00	0	0.00	10	1.15	2	2.78
Beverages--alcoholic	0	0.00	0	0.00	4	0.46	1	1.39
Biotechnology & bio-drugs	0	0.00	0	0.00	52	5.98	3	4.17
Business services	0	0.00	0	0.00	19	2.19	4	5.56
Capital goods	0	0.00	0	0.00	21	2.42	2	2.78
Chemicals	34	8.79	2	4.44	24	2.77	3	4.17
Coal	0	0.00	0	0.00	4	0.46	1	1.39
Commerce	12	3.10	1	2.22	0	0.00	0	0.00
Computers	0	0.00	0	0.00	40	4.62	3	4.17
Conglomerates	0	0.00	0	0.00	14	1.61	2	2.78
Construction & agriculture machinery	0	0.00	0	0.00	5	0.58	2	2.78
Construction materials	0	0.00	0	0.00	5	0.58	1	1.39
Construction services	27	6.98	0	0.00	14	1.61	0	0.00
Containers/ packaging	0	0.00	0	0.00	9	1.04	2	2.78
Electric machinery	37	9.56	4	8.89	0	0.00	0	0.00
Finance	20	5.17	3	6.67	13	1.50	1	1.39
Fishery & farming	5	1.29	0	0.00	1	0.12	0	0.00
Food processing	20	5.17	3	6.67	25	2.88	1	1.39
General machinery	41	10.59	4	8.89	0	0.00	0	0.00
Glass & ceramics	13	3.36	2	4.44	0	0.00	0	0.00
Healthcare facilities	0	0.00	0	0.00	9	1.04	0	0.00
Hotels/ motels	0	0.00	0	0.00	7	0.81	2	2.78
Insurance	2	0.52	0	0.00	69	7.94	5	6.95
Media	2	0.52	1	2.22	6	0.69	0	0.00
Non-apparel textiles	0	0.00	0	0.00	2	0.23	1	1.39
Non-ferrous metals	16	4.13	3	6.66	0	0.00	0	0.00
Office equipment	0	0.00	0	0.00	4	0.46	0	0.00
Oil & gas	0	0.00	0	0.00	58	7.94	5	6.95
Other products	12	3.10	1	2.22	6	0.69	0	0.00
Paper & paper products	0	0.00	0	0.00	9	1.04	1	1.39
Personal & household products	0	0.00	0	0.00	15	1.73	2	2.78
Personal services	0	0.00	0	0.00	6	0.69	1	1.39
Pharmaceuticals	18	4.65	1	2.22	8	0.92	1	1.39
Printing & publishing	0	0.00	0	0.00	23	2.65	4	5.56
Railroads	0	0.00	0	0.00	6	0.69	1	1.39
Recreational products & services	0	0.00	0	0.00	14	1.61	2	2.78
Restaurants	0	0.00	0	0.00	16	1.84	1	1.39
Retailing	0	0.00	0	0.00	82	9.48	6	8.34
Schools/ training	0	0.00	0	0.00	9	1.04	1	1.39
Scientific & technical instruments	0	0.00	0	0.00	14	1.61	4	5.56
Transport equipment	25	6.46	2	4.44	0	0.00	0	0.00
Transportation services	8	2.07	0	0.00	11	1.27	2	2.78
Unknown	25	0.60	17	37.78	1	0.12	2	2.78
Totals	289	100.00	45	100.00	628	100.00	72	100.00

Table 3

Most of the members of this firm's Board of Directors are "independent" – that is, they are not (nor have they been) employees of the firm, represent neither supplier nor customer firms, and have no relatives holding key managerial positions within the firm nor other financial ties with it (other than shareholdings).

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	77.78	12.50	4.17	1.39
Japanese Sample	-0-	-0-	79.55	20.45

$$\chi^2 = 100.44$$

$$n = 116$$

$$\text{probability} < .0001$$

Table 4

Few insiders serve on the Board of Directors of this company.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	62.50	22.22	2.78	5.56
Japanese Sample	-0-	-0-	31.82	18.18

$$\chi^2 = 79.94$$

$$n = 116$$

$$\text{probability} < .0001$$

Table 5

The only corporate officer who serves on the Board of Directors of this firm should be its Chief Executive Officer.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	30.56	18.06	20.83	15.28
Japanese Sample	13.89	8.34	30.55	27.77

$$\chi^2 = 37.80$$

$$n = 108$$

$$\text{probability} < .0001$$

Table 6

No retired officers of this company should serve on its Board of Directors after their retirements.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	26.76	19.72	22.54	11.27
Japanese Sample	-0-	18.18	50.00	2.27

$\chi^2 = 21.94$   
 n = 115  
 probability < .001

Table 7

Director “independence” ensures that this company’s Board of Directors will be constructively critical of managerial performance.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	36.62	46.48	2.82	4.23
Japanese Sample	29.55	-0-	15.91	52.28

$\chi^2 = 64.85$   
 n = 115  
 probability < .0001

Table 8

The Audit Committee of this company’s Board of Directors is “independent” – that is, none of the Audit Committee members are (nor have been) employees of the company, represent neither supplier nor customer firms, and have no relatives holding key managerial positions within the firm, nor other financial ties with it (other than shareholdings).

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	90.28	8.33	1.39	-0-
Japanese Sample	-0-	-0-	43.18	56.82

$\chi^2 = 111.96$   
 n = 116  
 probability < .0001

Table 9

All of the members of this firm's Audit Committee are "financially literate" – that is, they fulfill the minimum regulatory requirements concerning the comprehension and use of financial statements.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	75.00	18.06	1.39	-0-
Japanese Sample	2.27	9.09	43.18	43.18

$\chi^2 = 91.40$   
 $n = 116$   
 probability < .0001

Table 10

The Audit Committee of this company hires and fires the independent auditing firm and receives its reports concerning the accuracy of performance data released by the company to investors.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	88.89	8.33	-0-	-0-
Japanese Sample	32.56	37.21	23.26	2.33

$\chi^2 = 43.01$   
 $n = 115$   
 probability < .0001

Table 11

The Compensation Committee of this firm's Board of Directors is "independent" from the firm - that is, none of the Compensation Committee members are (nor have been) employees of the firm, represent neither supplier nor customer firms, and have no relatives holding key managerial positions within the firm, nor other financial ties with it (other than shareholdings).

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	84.72	12.50	-0-	1.39
Japanese Sample	6.82	11.36	36.36	36.36

$\chi^2 = 82.81$   
 $n = 116$   
 probability < .0001

Table 12

The Compensation Committee of this firm determines the compensation package of the Chief Executive Officer and ratifies recommendations for the compensation packages of other top corporate officers.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	84.72	13.89	-0-	-0-
Japanese Sample	2.27	52.27	18.18	9.09

$\chi^2 = 78.44$   
 n = 116  
 probability < .0001

Table 13

The Board of Directors of this company should not be actively involved in its day-to-day operations.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	57.75	33.80	4.23	1.41
Japanese Sample	28.00	32.00	8.00	8.00

$\chi^2 = 16.32$   
 n = 96  
 probability < .01

Table 14

This firm's Board of Directors primarily represents its shareholders' interests and concerns by ensuring that the firm's activities all create value.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	42.86	44.29	1.43	-0-
Japanese Sample	2.33	20.93	30.23	20.93

$\chi^2 = 55.72$   
 n = 113  
 probability < .0001

Table 15



This firm's performance is evaluated primarily through increases in its stock price and dividend payments to investors.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	4.23	30.99	33.80	5.63
Japanese Sample	14.29	66.67	-0-	-0-

$\chi^2 = 27.97$   
 n = 113  
 probability < .0001

Table 16

This firm's investments in new lines of business are evaluated primarily on the basis of revenue growth and payback.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	12.50	41.67	11.11	4.17
Japanese Sample	2.27	27.27	31.82	2.27

$\chi^2 = 11.62$   
 n = 116  
 probability < .05

Table 17

This company's future value is evaluated primarily in terms of revenue growth and outlook for industry-wide profit margins.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	5.63	50.70	16.90	4.23
Japanese Sample	2.27	38.64	29.55	6.82

$\chi^2 = 3.91$   
 n = 115  
 probability not statistically significant

Table 18

This firm's attractiveness as an investment is evaluated primarily in terms its success at maintaining stable employment.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	1.45	2.90	44.93	39.13
Japanese Sample	19.05	14.29	14.29	38.10

$\chi^2 = 22.18$   
 n = 111  
 probability < .001

Table 19

This company's Board of Directors divests under-performing lines of business that cannot be turned around successfully to meet its performance targets.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	14.08	29.58	18.31	1.41
Japanese Sample	29.27	7.32	4.88	56.10

$\chi^2 = 61.44$   
 n = 112  
 probability < .0001

Table 20

This firm will not get out of an unprofitable line of business until it has recovered its investment.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	-0-	1.43	48.57	34.29
Japanese Sample	2.33	23.26	18.60	4.65

$\chi^2 = 42.73$   
 n = 113  
 probability < .0001

Table 21

This company will not get out of an unprofitable line of business if it holds a large market share in that market.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	-0-	7.58	42.42	21.21
Japanese Sample	2.27	47.73	18.18	6.82

$\chi^2 = 27.92$   
 n = 110  
 probability < .0001

Table 22

This company will not get out of an unprofitable line of business if many employees will lose their jobs.

	Strongly Agree	Agree	Disagree	Strongly Disagree
U.S. Sample	-0-	2.99	43.28	38.81
Japanese Sample	4.76	14.29	30.95	7.14

$\chi^2 = 26.27$   
 n = 109  
 probability < .0001