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Killing two birds with one stone: Board reforms in the Japanese electronics industry

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ABSTRACT

This paper combines insights from A Behavioral Theory of the Firm and Neo-Institutional Theory to provide a more comprehensive understanding of how new practices are adopted and transformed. The setting is the spread of the Executive Officer System (EOS) in the Japanese electronics industry. While this system, based on the Anglo-American system of governance, was designed to separate executive and monitoring, in reality, firms that reduced the size of the board only, leaving membership heavily weighted to executive officers. Based on a combination of qualitative and quantitative studies, we argue that this is not merely decoupling or symbolic management; rather, the legitimacy of the EOS system made it readily accessible and salient to firms searching for a solution to problems in decision-making. The legitimacy of EOS as the "global standard" of corporate governance enabled top executives to frame difficult board reforms to internal actors. Through adoption of EOS, firms were able to "kill two birds with one stone" by appealing to investors as well as solving internal problems. This research contributes to our understanding of diffusion and variation, the nature of decoupling, global spread of Anglo-American corporate governance, and NIT and BTF accounts of diffusion of new practices.

Key words: behavioral theory of the firm, neo institutional theory, practice diffusion, corporate governance

INTRODUCTION

Over the last two decades, Neo-institutional Theory has become the dominant perspective in understanding how organizations change through diffusion and adoption of new practices (Fiss & Zajac, 2004). A fundamental insight is that the value of new practices is socially constructed: organizations adopt them not only because they are effective, but also because they are legitimate and taken for granted (Burns and Wholey, 1993; Davis, 1991; DiMaggio and Powell, 1983; Palmer, Jennings, and Zhou, 1993). Organizations deal with the mismatch between technical and institutional demands through decoupling (Meyer and Rowan, 1977; Tolbert and Zucker, 1983), in other words, adopting a practice in name but keeping it at a safe distance from its technical core (Thompson, 2003). This perspective cases a cynical eye in adoptions of new practices, suggesting that the rhetoric of change may be more than the reality (Zbaracki, 1998). New practices may be only symbolic, announced with great fanfare, but adopted in part or not at all (Zajac and Westphal, 1994, 1998; Zbaracki, 1998). These diffusion and adoption processes result in isomorphism, in which organizations in a field grow more similar over time (DiMaggio and Powell, 1983).

While early diffusion studies tended to treat organizations as passive actors, more recent research attributes organizations with more agency (DiMaggio, 1988; Garud, Hardy, and Maguire, 2007; Greenwood and Suddaby, 2006; Maguire, Hardy, and Lawrence, 2004), and shows that organizational actors not only decide to adopt new practices based on internal and external factors, but adapt them in a process that can lead to greater variation. Organizations may adapt a practice to fit technical needs or to fit their interpretation and framing of the practice and their motivation to adopt it (Kennedy and Fiss, 2009). Ansari and colleagues (2010) present a conceptual model in which actors vary the fidelity and extensiveness of a practice depending on technical, cultural and political environments. This research demonstrates that the diffusion process can lead to variation, that decoupling is a matter of degree, and that organizations balance the technical and institutional

demands they face in different ways, depending on organizational, population and environmental factors. Yet, it also remains consistent with basic principles of Neo-institutional Theory—that institutional and technical demands are distinct and organizations deal with them in different ways; responding to institutional pressures through symbolic adoptions and decoupling, and to technical pressures in a more thorough, thoughtful, and rational way.

A Behavioral Theory of the Firm (Argote and Greve, 2007; Cyert and March, 1963) provides a different perspective on how practices vary through the diffusion process. According to this perspective, firms identify problems and search for their solutions in a process shaped by cognitive limits and internal political dynamics. Although elements including local search, aspirations, and problemistic search have already provided a basis for a theory of diffusion from a learning perspective (Greve, 1998; Levitt and March, 1988; Miner and Haunschild, 1995), several less studied insights are also important in understanding diffusion processes: One is that both problem and solution may occur simultaneously, and their match may be subject to interpretation and adjustment or may even be at random (Cohen, March, and Olsen, 1972; Cyert and March, 1963). Another is that the legitimacy of a practice makes it not only more salient and available in local search by boundedly rational actors (Argote and Greve, 2007; Hausnchild and Miner, 1997), but also makes it more appealing to internal actors, especially in situations that are politically fraught. These insights suggest additional mechanisms by which practices come to vary in the adoption process: that organizations may adopt solutions that are legitimate not only because they are more salient and available, and but also because they are easier to "sell" internally. Because the match between problem and solution is fluid, and because both are subject to reinterpretation and revision, it is conceivable that an organization will adopt a practice to solve a problem for which it was not originally intended. What appears to be decoupling may simply be that the practice has been called in as a solution for a different problem. Variation occurs as an organization alters that practice or redefines the problem for a better fit.

We combine these insights from A Behavioral Theory of the Firm (BTF), with Neo-institutional Theory (NIT), to provide a fuller model of diffusion, adoption, and adaption of a corporate governance practice in Japan, the Executive Officer System (EOS), and to better understand how this practice came to diverge from its original intention as a large number of Japanese companies adopted it in the 1990's and 2000's. The EOS was inspired by an agency theory view of governance (Jensen and Meckling, 1976), in which a board of directors consisted largely of non-executives who monitored the executive officers, in the style of a US company. The system contrasted sharply with Japanese boards of directors, which tended to be very large, dominated by executive directors, and responsible for both monitoring and execution (Ahmadjian and Okumura, 2005). Sony was the first to adopt the EOS in 1997, and the practice diffused widely among Japanese firms. However, despite the great fanfare around adoptions of the "U.S.-style" EOS, and much talk about how this system was to "separate execution and monitoring," boards remained dominated by executive directors and independent outside directors remained rare. The main effect of EOS adoption was a significant reduction in the board size of listed Japanese firms, but, at least in terms of the original intentions of the practice, little else.

At first glance, the adoption of the EOS looks very much like a case of decoupling and symbolic management of shareholders, very much as seen in the U.S. (Westphal and Zajac, 1994, 1998) and in other places where U.S.-style governance practices were transported (Fiss and Zajac, 2004). But, was the EOS simply a non-native governance practice, adopted in word but not in deed? In this paper, we demonstrate that firms not only adopted the EOS to appeal to shareholders, but also to make changes in a slow, unwieldy, consensus-based decision-making. Firms altered the EOS to address this problem of decision-making, and turned "separation of execution and monitoring" into "strengthening of execution" without any change in monitoring. Firms reframed problems in decision-making as corporate governance problems that could be solved by the EOS, or at least a version of it. They used the EOS to "kill two birds with one stone," to please shareholders at the

same time to legitimate difficult board restructuring and changes in decision-making processes.

Research on diffusion and adoption of new practices, both from perspectives of NIT and BTF-influenced learning, has largely consisted of statistical analysis of large samples, in which adoption is a dichotomous variable. This approach has been criticized for not being able to identify the micro-processes within firms, by which problems are identified, and solutions are selected and adapted (Boxenbaum and Jonsson, 2008). Yet, qualitative, firm level research on adoption remains rare (see as an exception, Zbracki, 1998, and Crilly, Zollo, and Hansen, forthcoming, for extensive interviews to find reasons for adoption). In this paper, we first conduct an exploratory qualitative study, using interviews and archival material for 10 firms to explore the reasons that firms themselves give for adopting the EOS. Next, combining these observations with insights from NIT and BTF, we propose a set of hypotheses that comprise a model of adoption that combines legitimacy seeking and problem solving, and then test these hypotheses on a sample of listed firms from the electronics industry.

Through this research, we seek to both address an empirical problem and to further develop theory. The question of practices adopted symbolically but not substantively is particularly important in the study of corporate governance, especially the study of diffusion of corporate governance practices around the world (Fiss and Zajac, 2004; Yoshikawa, Tsui-Auch, and McGuire, 2007). We find that simply attributing incomplete or imperfect implementation as decoupling may not tell the whole story of how organizations fit solutions to problems. Diffusion of foreign, specifically Anglo-American style, corporate governance practices may result in real changes, though perhaps not those anticipated. Our study further proposes a way to combine insights from NIT and BTF to provide a fuller accounting of the diffusion process. While researchers have addressed diffusion through both NIT and BTF perspectives, there have been few attempts to combine, integrate, or even contrast these perspectives (Haunschild and Chandler, 2008). Furthermore, though BTF has already simulated a vast and rich body of research, it continues to

yield insights that have been under-exploited in organizations research (Argote and Greve, 2007). We show that through combining insights from BTF on the imperfect match between problems and solutions and on the role of intra firm political dynamics, with notions of legitimacy from NIT, we can better understand the process of diffusion, adaptation, and increasing variety.

THE CORPORATE EXECUTIVE OFFICER SYSTEM: AN EXPLORATORY QUALITATIVE STUDY

Overview of the EOS system The Japanese board of directors in the postwar period contrasted sharply with the Anglo-American version. Boards of 30-40 members were not unusual (Abegglan and Stalk, 1985) and they were dominated by executive officers, including the heads of key functions, factories, operating divisions, and other positions that the company deemed important to company decisions. Occasional outside directors came from important customers, banks, or government industries (Kaplan & Minton, 1994; Sheard, 1994) to cement relationships between firms and their partners and stakeholders, and to watch for the interests of their own institutions. With their large size, strict hierarchy, diverse representation and an emphasis on consensus in decision-making, boards were often more symbolic and real decisions were made in management committees. Yet, even as a rubber stamp, the board was highly symbolic, and sent important messages about the company: that in the life-time employment system, all management track employees could aspire to be board members, important decisions required the agreement of the all functions and units of the company, and that the inside, executive directors on the board knew what was best for the company and its employees, and could be trusted to make the right decisions.

In the mid-1990's, an increase in foreign investors, an economic malaise, and news of the spread of Anglo-American corporate governance around the world, sparked a debate on whether Japanese firms should adopt Anglo-American style corporate governance reforms

(Ahmadjian and Okumura, 2005). Anglo-American style, or, as commonly referred to in Japan, American style, referred to a separation of execution from monitoring, dominance of the board by independent directors, and the idea of the board was to take care of shareholders. Investor groups such as CalPERS and some executives including members of the Corporate Governance Forum of Japan advocated reforms, in particular, an increase in independent directors. Others, such as Keidanren, the primary big business lobbying group, defended the status quo (Ahmadjian and Okumura, 2005).

Sony was the first to announce Anglo-American style governance reforms with its adoption of a system that it named the Corporate Executive Officer System. It reduced its board from 38 to 10 members, and renamed the directors removed from the board "Executive Officers." Sony said that the move was to "separate execution from monitoring" and to reflect the "global standard." The EOS diffused rapidly, and by 2009, almost half of listed companies had adopted it (Tokyo Stock Exchange, 2009). However, adoption was not accompanied by an increase in independent, outside directors to improve monitoring: according to the Tokyo Stock Exchange, less of half of listed companies had even one outside director, and of those companies that did, the average was less than 2 (Tokyo Stock Exchange, 2009). Furthermore, most of the inside directors remaining on the shrunken boards retained executive officer status and execution responsibilities. Because the EOS system had no legal status, firms could define it any way they wanted, and they defined the EOS system as reducing board size, re-titling the removed directors as "executive officers" and perhaps adding one or two outside directors.

Methodology We begin our inquiry into adoption of EOS with an exploratory qualitative study, incorporating interviews and archival material. We examine the 10 largest firms, by sales, in the electronics industry. Among the largest 10 firms, there is considerable variation, in whether firms adopted the practice or not, timing of adoption, and in the

characteristics of firms themselves, including size and foreign market exposure. We interviewed members of boards of directors of each of these firms, asking about the circumstances under which the EOS and other governance reforms were adopted (see Appendix 1 for more detail). We also reviewed annual reports, securities filings (*yūka shōuken hōkokusho*) and newspaper articles in the Nikkei (Japan's top business newspaper) for statements on EOS adoption. Table 1 lists key characteristics of these 10 firms.

TABLE 1 ABOUT HERE

Adoption and adaptation of EOS: Table 2 shows that of the largest 10 electronics firms, seven adopted the system. Table 2 shows the actual configuration of the boards before and after adoption of EOS, and shows that while the EOS system resulted in a reduction of board size, separation of execution and monitoring was less evident. While Sony changed the mix of executives and non-executives to the point that it looked much like a U.S. board, at other firms, executive directors remained dominant. For most firms, the EOS removed some executive directors from the board but not others—resulting in a reshuffling and redistribution of responsibility among insiders that affected execution far more than monitoring.

TABLE 2 ABOUT HERE

Why EOS? While EOS, in its actual adopted form, may have done little to improve monitoring, and even less to free the board from executive responsibilities, firms explained their adoption of this system very much in terms of "separation of execution and monitoring." Especially in written materials and newspaper reports, firms justified adoption in terms of the original intentions of the practice: to reestablish the board as a mechanism to monitor the

agents (executive officers). As Toshiba explained in its annual report, it adopted the EOS: “to separate directors from executive officers, directors focus on corporate decision-making that emphasizes profits to shareholders and monitor the executive officers, while the executive officers make strategy from the perspective of each business unit.” Interview respondents echoed these more public statements: as one respondent put it: “A critical issue in the firm is the separation of ownership and control, and therefore, firms must separate monitoring and execution.”

TABLE 3 ABOUT HERE

To examine firms’ motivations for adoptions of the EOS and their perception of the benefits of the EOS, we reviewed transcripts from interviews and archival materials, and extracted sentences concerning EOS adoption. From this, we identified eight themes related to motivations to adopt EOS and perceived benefits of this system, as shown in Table 3.

Firms said that they adopted the EOS to respond to globalization. They suggested that increased speed and competition due to globalization required firms to make decisions faster. They also suggested that EOS was the “global standard” and adoption of this practice would bring them in line with practices predominant around the world. For example, one respondent noted that with global business, foreign shareholders, and a New York listing, they had to adopt the “global standard” as much as possible. Anglo-American style corporate governance reforms were, at this time, controversial among Japanese firms, in particular, the introduction of outside directors and there was much debate about whether or not this practice was appropriate in Japan (Ahmadjian and Okumura, 2005). However, there was considerable agreement that U.S.-style corporate governance practices were the “global standard” (and this word was very popular in the corporate governance debate at the time). The EOS allowed firms to adopt what they saw as “the global standard” without the less palatable requirement

of adopting outside directors.

Firms also reported that they had adopted the EOS to please shareholders, though most were also quick to point out that shareholders were one of several important stakeholders. One said, “There is plenty of debate as to whether or not shareholders own the firm, but there is no doubt that they are important.” Another explained: “The board represents shareholders, community, employees, and customers. Probably, the shareholders come first in this list, but we have to consider all the stakeholders. But, we have to say that shareholders are most important.”

Firms also adopted the EOS to respond to performance gaps. One respondent noted that they his company been performing poorly, and “there was a feeling that we had to do something.” Another said that the burst of the “IT bubble” made restructuring inevitable. Respondents noted that to respond to poor performance and the challenges of global competition, they had introduced changes in organizational structure designed to increase autonomy of business units, and to track profits, give incentives, and manage human resources more independently by each unit. A number of our respondents suggested that adoption of the EOS went along with these organizational reforms. One noted that with the EOS, “… the board makes decision related to corporate profits, considering the shareholders, and monitors the executive officers, while the executive officers, who are responsible for each business unit, set and execute strategy on the business unit level.” Another said that the EOS was adopted “to strengthen corporate governance by increasing transparency in setting compensation and making HR decisions in the heavy electrical machinery, consumer electronics, semiconductor and other businesses, and to clarify responsibility for executing operations.”

Firms also noted that reorganization into clearly distinct and independent business units enabled them to “choose and focus:” to spin off or close unnecessary or undesirable

businesses. “Choose and focus” was a prevalent theme in the Japanese business press during this period (Schaede, 2008) and was a painful process for companies that had grown rapidly through diversification. One respondent described the benefits of the EOS in facilitating difficult restructuring: "When the IT bubble burst, we could no longer employ people with permanent employment, and restructuring became necessary. To do this, we needed to make decisions, but it is hard to make decisions with a board of 30 people." A board of 30 inevitably contained members directly affected by, and probably opposed to, restructuring. The EOS reduced the size of the board, and sent a message that a smaller group of top executives would make these decisions.

Benefits of the EOS. Firms highlighted the benefits of the EOS in terms of enhancing speed and transparency of decision-making and improving effectiveness of management. One respondent described the situation before introduction of the EOS: “In 1991, there were 38 directors. I was the youngest, and I sat at the very edge. It was a huge, smoky room, and I could barely see the face of the chairman.” Another commented: “With 30 or more board members in the past, it was hard to get anything done in the board meeting—it was like an elementary school class.” He noted that decisions were made in informal meetings beforehand, and that there was no documentation on how the decisions were actually made.

Pushing executive decision-making downwards, and limiting the number of decisions that the board of directors had to make enabled more decisions to be made on the spot, by those who best knew the situation. The system also brought transparency to what had been an informal and opaque system. As one firm reported: “The objective is to make responsibility for business execution clear, to increase the transparency of management, and to increase the speed of decision-making.” Respondents also noted benefits of the EOS in terms of managerial effectiveness, suggesting that the EOS would bring “vitality” and “agility”

to management. This is not to say that there were no references to monitoring, but it is striking that while firms talked about the EOS as a means to separate execution from monitoring, they saw the benefits of this separation more in terms of making execution speedier, more transparent, agile and vital.

The non-adopters. Three firms among the top 10 did not adopt the EOS. Several themes emerged in the interviews and analysis of archival material of the non-adopters. First, non-adopters tended to have strong influence of their founders, even when they were no longer family owned (as in the case of Panasonic). They were smaller and less diversified, with fewer subsidiaries. One noted, "Our current system of decision-making is fast… Of course, the scale is different, as we are much smaller than Hitachi." Another noted that the decentralized decision-making of the EOS reduced firm-wide communication, but at his firm, communication across all business units was central to strategy and culture. In many ways, the rationales of non-adopters further supported the findings for the adopters. Firms adopted the EOS when they felt a need to streamline and clarify decision-making; firms that did not feel this need did not adopt it. Firms adopted the EOS when they were trying to push responsibility for decision-making down to distinct and independent business units—firms that had not made these structural reforms, or firms that believed that they were unnecessary or even counter-productive, did not make these reforms.

NIT AND BTF PERSPECTIVES ON ADOPTION OF THE EOS

The exploratory qualitative study suggests that firms did adopt the EOS to please shareholders. They described the EOS as the "global standard" and used rhetoric of Anglo-American corporate governance to describe the practice as separating execution from monitoring, while implementing it only partially, reducing board size but leaving the board dominated by executive directors. However, though the EOS as adopted lost much of its

original essence, its adoption was not merely decoupling. Firms used it to reduce board size and push operational decision-making downwards while concentrating strategic decision-making in the hands of a much smaller number of executive directors. The EOS appeared to offer a justification for some difficult and politically fraught changes in who made decisions. It is clear that a NIT perspective does not provide a full explanation of how the EOS diffused and was adopted by firms. Yet, it is also clear that legitimacy of the EOS, as something that companies called "the global standard," is also an important influence in the diffusion process. In this section, we combine insights from NIT and BTF to develop a model as to how legitimacy and problem solving interact, and to propose a set of hypotheses to test whether this can be generalized to a wider population.

NIT and legitimacy-based diffusion. At the heart of the NIT perspective on adoption of new practices is the notion of legitimacy (Boxenbaum and Jonsson, 2008; Deephouse and Suchman, 2008). Legitimacy is not a simple construct; rather, there are different varieties, depending on the situation, the nature of the organizational environment, and practice that is being adopted (Deephouse and Suchman, 2008). Aldrich and Fiol (1994) identify two types, cognitive and sociopolitical legitimacy, or legitimacy as defined by taken-for-grantedness versus that related to external pressures.

In our interviews, it was clear that sociopolitical legitimacy was a strong impetus for adoption of EOS; firms adopted to please shareholders. Particularly important were foreign shareholders, who had increased their presence in Japan dramatically from the early 1990's, and brought with them Anglo-American notions of corporate governance (Ahmadjian and Robbins, 2005). Foreign investors have been found to influence adoption of Anglo-American style corporate governance practices in various parts of the world (Fiss and Westphal, 2004), and their influence in Japan has been strong in areas such as adoption of incentive based pay (Colpan and Yoshikawa, 2012) and downsizing (Ahmadjian and Robbins,

2005; Ahmadjian and Robinson, 2001).

H1: The higher the percentage of foreign ownership, the more likely a firm will adopt the EOS.

Corporate governance practices are not only important to investors, but also to foreign business partners, employees, and other overseas stakeholders (Khanna and Palepu, 2004). Firms that sell abroad are likely to learn about global corporate governance practices through their employees, customers, suppliers and alliance partners and adopt practices that are more familiar to them (Yoshikawa and Rasheed, 2009). As one of the respondents in the exploratory qualitative study noted, it was important to adopt a "global standard" since "we can't just talk about Japan." We expect that firms that do significant business abroad will also have a reason to seek sociopolitical legitimacy through adopting the EOS.

H2: The greater the percentage of international sales, the more likely a firm will adopt the EOS.

Another form of legitimacy comes in the taken-for-granted beliefs of actors in what is appropriate, in the words of Aldrich and Fiol (1994), cognitive legitimacy. Research in the NIT perspective generally measures cognitive legitimacy as higher rates of adoption within the population (Boxenbaum and Jonsson, 2008; Tolbert and Zucker, 1983). High rates of adoption in the population signal to organizations that a practice is appropriate and correct, especially when there is uncertainty over the benefits of the practice.

H3: The more firms in the field adopt EOS, the less likely foreign ownership and international sales will affect the adoption of EOS.

Early research in the NIT perspective suggested that organizations faced technical and institutional pressures, and the strength of these institutional pressures increased as a practice was more widely adopted. This resulted in a two-stage process (Tolbert and Zucker,

1983) in which the technical motivations for adoption gave way to institutional ones, as a practice became more widely taken for granted. Subsequent research suggested that technical and institutional pressures could occur at any time in the process, depending on motivations for adoption, requirements of the firm, and external pressures (Ansari et al., 2010; Kennedy and Fiss, 2009).

Less studied is the process by which one form of legitimacy may give way to another or coexist over time. We predicted that adoption of EOS would be driven by pressures from foreign shareholders but would also become more likely as EOS became more common and taken-for-granted. It is likely that as the practice became more taken-for-granted, the influence from foreigners would be less apparent. Firms that were under pressure for adoption by foreign shareholders would adopt in early stages, and as a practice became taken-for-granted, it became more obvious and available to all firms, even those firms that could not quite see the benefits of the practice.

H4: The more adoptions of the EOS in the population, the weaker the effect of foreign ownership and foreign sales on adoption of the EOS.

A BTF perspective on adoption: The exploratory study shows that while firms adopted the EOS to appear more attractive to shareholders, they also saw it as a way to improve performance by making decision-making faster and more transparent and to make management more effective. Legitimacy concerns co-existed with problem solving, and theory of adoption needs to consider how these two motives might either interact, or exist in parallel.

In the NIT perspective, legitimacy concerns and problem solving tend to be treated separately, as related to separate institutional and technical pressures. This can be seen very clearly in the two-stage model of diffusion, where in the early stages, firms adopted a practice

to solve technical problems while in later stages, legitimacy concerns took over (Tolbert and Zucker, 1983; Westphal, Gulati, and Shortell, 1997). Even research that does not consider a time- or population adoption-dependent process tends to consider institutional and technical pressures as distinct. In the BTF perspective, technical and institutional pressures are less distinct, and are, in fact, closely interrelated. There is less focus on legitimacy—in fact the notion that firms seek legitimacy, that they adopt new practices not because of technical needs but because they are taken-for-granted—does not appear in Cyert and March (1963). On the other hand, legitimacy as a motive for adoption can fit easily into the framework. According to BTF, uncertainty is an important influence on how firms search for solutions, and consistent with NIT, legitimacy can be seen as something that makes a practice salient and available under uncertainty (Argote and Greve, 2007; Haunschild and Miner, 1997).

Combining NIT and BTF, we suggest that legitimacy of a practice makes it more available to firms that are searching for the solution to problems. We saw above that EOS had two different types of legitimacy. The first was sociopolitical legitimacy due to the fact that it was the global standard of corporate governance, adopted around the world (at least, Japanese managers appeared to believe that this was the case) and promoted by foreign investors. The second was cognitive legitimacy, as the practice became more taken-for-granted and more and more firms adopted it. Under both types of legitimacy, the EOS and other issues related to corporate governance received considerable attention in the media, company officials attended corporate governance seminars and conferences, and investors asked investor relations departments and CEOs about it. For firms searching for a solution for its problems during the early 1990's and 2000's, corporate governance reform—however that was defined—was a very available, prominent and legitimate solution.

While NIT focuses on how organizations relate to the external environment, and respond to both demands by external stakeholders as well as to behavior of competitors, BTF

emphasizes that adoption of new practices also involves dynamics within the firm. Firms are coalitions of individuals and groups, and political dynamics are important. The identification of problems and acceptance of solutions depends on the interests and attention of who holds power (Cyert and March, 1963; March, 1962: Pettigrew, 1973). Whether a solution is accepted or not within the firm depends on how effectively it is framed to get acceptance and buy-in from internal actors (Kaplan, 2008). Legitimacy is likely to play a role here as well. If a practice can be framed as legitimate, it is more likely to be accepted within the firm.

Our exploratory study suggests that the changes wrought by the EOS were politically difficult—again, evidence that this was not merely symbolic. A widely-circulated story at the time of Sony's adoption of EOS was that the chairman wrote letters to wives of the directors retitled "corporate executive officers" to tell them that their change in status was not a demotion. But, while the change in status may not have been a demotion, and may not have involved a change in pay or perquisites such as company cars, it was a change in power, as these executives were removed from the center of corporate decision-making. It would have been very difficult for a firm to make these sorts of changes unless it could justify it by framing it as a legitimate and widely accepted innovation. The EOS provided the perfect opportunity: a firm could introduce difficult and painful changes in board structure and decision-making systems by justifying them as part of the "global standard" and something that would greatly please shareholders, and make the company appear more global and up to date.

One more insight from BTF helps us to understand how a reinterpreted EOS came to be used to solve the problem of slow and unwieldy decision-making. The BTF perspective notes that the process of problem solving is not necessarily a rational and linear one. According to the Garbage Can Model (Cohen, March, and Olsen, 1972), problems and their solutions exist concurrently, and their match can even be random. The BTF perspective

allows that solutions may determine problems, and that the identification of a problem is subject to attention, cognitive limits, and politics within the firm (Cyert and March, 1963; March, 1962). This insight helps explain how the EOS came to be matched with the problems of decision-making and execution. Corporate governance reform was a hot topic at the same time that firms were looking at ways to "choose and focus," to make decisions and measure performance on a business unit level, and to sell or close businesses that did not fit. Note that "choose and focus" did not mean the large scale chopping up of the conglomerate that was seen in the U.S. (Davis and Thompson, 1994) but yet meant a new approach for Japanese firms. Figure 1 shows the number of mentions of "choose and focus," "corporate governance" and "global standard" in headlines of the Nikkei, Japan's leading business daily between 1990 and 2006. It shows that corporate governance suddenly became a much-mentioned topic in 1997, with Sony's reforms. "Choose and focus" reached a peak in 1999, a few years later. Mentions of "global standard" increased along with "corporate governance" because especially in the early days of corporate governance reform, Anglo-American style reforms tended to be justified as the "global standard." This usage quickly lost fashion, as shown in the graph.

The EOS was not initially intended to make decision-making speedier, but rather to separate execution and monitoring to facilitate monitoring by independent outside directors. Yet, it was a convenient way to justify reforms in board structure and decision-making that firms were searching for, in the face of a need to improve performance, "choose and focus" and operate more quickly and flexibly in an increasingly competitive global environment. The EOS was particularly useful because it was not a legally mandated or regulated form, and firms could adjust it as they liked. Firms reshaped the EOS as a practice of reducing board size, concentrating strategic decision-making in the hands of a small number of executive officers, and pushing execution as much as possible down to the business unit level. Firms

redefined the problem they were facing, of slow decision-making, too much consensus, and decisions being made on the wrong level, as a corporate governance problem.

Problem solving and the diffusion of EOS: Based on the above, we argue that firms adopted EOS in order to improve the speed of decision-making, facilitate "choose and focus" strategies, and to address declining performance. In other words, firms that needed to move from unwieldy, consensus based, top-heavy decision-making, and firms that had to make major strategic reorientations due to poor performance and need to restructure were more likely to adopt the EOS.

A BTF perspective on adoption begins with identification of a problem through a performance gap. When firms find their performance lagging their own aspirations, vis-a-vis their historical performance or that of their competitors, they begin a search for solutions (Baum and Dahlin, 2007; Greve, 1998, 2003). We predict that this performance gap simulated the search the led to many firms adopting the EOS.

H5: The lower its ROA, the more likely a firm is to adopt the EOS.

The exploratory study suggests that firms who adopted the EOS did so to address the problem of opaque and unwieldy decision-making structures due to large boards and unclear accountability. One firm characteristic that is likely to lead firms to want to seek a more streamlined decision-making system is size. In our exploratory qualitative study, it was the smaller firms that did not introduce this system. The notion that size magnified the problem of big boards and slow decision-making was manifested especially in the interviews of the non-adopters, several who said that they did not need to streamline decision making by pushing it down to the executive level, simply because they were small. As one said, "Of course, the scale is different—we are much smaller than Hitachi." Research in organization theory suggests that organizational size is associated with greater complexity (Blau, 1970;

Haveman, 1993) and organizations attempt to deal with this through hierarchy and limited span of control, all of which serve to control information flow and clarify responsibility for decision-making. Thus, larger firms are more likely to institute reforms to change their decision-making systems.

H6: The larger a firm, the more likely it will be to adopt the EOS.

One of our respondents told us that his company had adopted the EOS and other board reforms because foreign investors kept asking questions about how it could manage its hundreds of consolidated subsidiaries with a large board, dominated by executive officers with operating responsibilities. A large number of subsidiaries are another source of complexity, and several respondents in the exploratory qualitative study noted that better management of subsidiaries was one of the objectives of adoption of the EOS. Furthermore, firms that had many subsidiaries were more likely to be faced with the challenge to choose and focus. A relatively small board, devoted to monitoring and oversight would be better able to craft a strategy for the group, and then watch over the subsidiaries.

H7: The more consolidated subsidiaries it has, the more likely a firm is to adopt the EOS.

In interviews and archival materials, firms suggested that introduction of EOS was related to diversification. Respondents noted that it was difficult to make decisions at the board level about unrelated and diverse business units. Firms with very different businesses, therefore, would have benefit more from decentralizing decision-making and pushing it down to business units, maintaining the board of directors as a central body for monitoring the performance of these units. It is interesting to note that two of the least diversified of the electronics firms, Sharp and Canon, did not introduce the EOS. Research on firm structure and strategy has long found a relationship between diversification and structure, as firms that

are diversified are more likely to adopt a firm structure that enables decision-making to be made on the business unit level, and enables the center to monitor the performance of each business unit in relationship to strategy (Hoskisson, Hill, and Kim, 1993; Markides and Williamson, 1996). Following a similar logic, we might expect that firms that diversified are more able to benefit from board reforms that push decision-making away from the center.

H8: The more diversified it is, the more likely a firm is to adopt the EOS.

Research on corporate governance has found that the structure of ownership in corporate governance is important in determining adoption of practices, and researchers have found a curvilinear relationship between ownership structure and governance, arguing that at high levels of concentration, owners are unlikely to add practices that will improve monitoring, and that at low levels shareholders are unlikely to demand changes (Tuschke and Sanders, 2003). Here, we predict that the level of concentration of ownership also is related to speed of decision-making, and this will affect the likelihood of adopting the EOS. Furthermore, the need to introduce reforms under the legitimate guise of corporate governance is likely to be stronger when a firm does not have a strong decision-maker or a group with the political clout and status to make decisions. Ownership structure of a firm is likely to affect both of these. Firms with concentrated ownership are likely to be able to make quick decisions, and can implement necessary changes in decision-making without having to appeal to the legitimacy of a system such as the EOS.

H9: The more concentrated the ownership is, the more likely a firm is to adopt the EOS.

Population adoptions and problem solving: We argued that the EOS showed two types of legitimacy, sociopolitical legitimacy in the eyes of foreign investors and cognitive legitimacy as the practice became increasingly widely adopted. Interest by foreign investors

in Anglo-American corporate governance reforms helped to give the EOS higher salience, and caused ut to be associated with "the global standard" from its very first introduction. What about increased cognitive legitimacy, as the practice was adopted more widely? One possibility is that widespread adoptions make the practice even more salient and hence greater opportunities for other firms to learn about it (Haunschild and Chandler, 2008), and even more useful as a justification for reform, under the guise of "everyone else is doing it."

H10a: The more adoptions of the EOS in the population, the stronger the effect of size, number of consolidated subsidiaries, diversification, concentration of ownership and performance will be on adoption of the EOS.

On the other hand, mounting adoptions may make the practice so taken for granted that any firm, not only firms that had existing problems in decision-making structures or need for speed and transparency, would be more likely to adopt the practice. The fact that from initial adoptions, the EOS was stripped of the difficult and controversial parts—in other words, outside directors—made it a relatively easy to adopt, as compared to other governance practices. Reducing board size was still difficult, but as smaller boards became more common, was less likely to be opposed than in the earliest days.

H10b: The more adoptions of the EOS in the population, the weaker the effect of size, number of consolidated subsidiaries, diversification, concentration of ownership and performance will be on adoption of the EOS.

METHOD

Sample: We test the above on a sample consisting of all 335 publicly listed firms in the electrical machinery industry category for the period from 1997, the initial year of adoption, to 2007.

Dependent Variables: We measure adoption of the EOS in two different ways. First is *EOS adoption*. This takes the value of 1 if the firm has reduced the number of directors by 3 or more in a single year, and 0 otherwise. We chose the reduction of board size of 3 directors or more based on our examination of the data: while board size varied from year to year by one or 2, reduction of 3 members represented a distinct discontinuity in board size. We also operationalized the dependent variable in a second way, as *stated EOS adoption*. This takes the value of 1 if the firm reports that it adopted the EOS system in its *yūka shōuken hōkokusho* (securities filing equivalent to U.S. 10-K), and 0 otherwise. Because EOS has no legal status, reporting of adoption of the system is optional, and as seen in Figure 2, the number of firms that reduce their board size is somewhat greater than those that actually announce EOS adoption, though both increase at approximately the same rate over time.

FIGURE 2 ABOUT HERE

Independent Variables: Performance (ROA) is the return on assets lagged by 1 year. The log of assets, lagged by one year, captures a firm size (LGASSET). Foreign ownership (FORSHARE) is the percentage of a firm's shares held by foreign investors, lagged by 1 year. The percentage of international sales (FORSALES) is ratio of foreign sales to total sales, lagged by 1 year. The number of subsidiaries (SUBS) is the log of total number of consolidated subsidiaries divided by total assets and then multiplied by 100, lagged by one year. Measuring diversification is problematic for Japanese firms, since there is no requirement to report lines of business and during this time, no common definition on how this should be reported for firms that did report lines of business. Some firms report sales by business area based on very board definitions, while others based on very narrow product definitions. We count the number of segments a firm reported in 1997 to create a variable called SEGMENTS. While this does not measure diversification in any absolute sense, it

does offer a rough representation as to how a firm thinks about and manages its businesses, and the degree to which it thinks as different business areas as separate segments or a single one. Note that because not all firms report segments, the size of the sample for estimates including SEGMENTS is smaller. Concentration of ownership (TOP3) is the percentage of shares held by the top 3 shareholders. As a control variable, we include the log of a firm's age (AGE). The variable SUMADOPT is the log of the cumulative sum of adoptions of the EOS lagged by 1 year.

We use discrete time event history analysis. The risk set consists of all firms that have yet not adopted EOS. We estimate the models with robust standard errors, clustering on firm.

RESULTS

Table 4 presents descriptive statistics and correlations for the sample for adoption of the EOS. Table 5 presents discrete time event history analyses of the adoption of the EOS as measured by reduction in board size by 3 or more. Table 6 presents analyses in which the dependent variable is stated adoption of the EOS. Note that since diversification could only be calculated for a subset of firms, this variable is not included in most of the models, and is limited to Model 8, in which we examine the effect of number of business segments. Table 7 summarizes the hypotheses and the empirical results.

TABLE 4 ABOUT HERE

We first consider Table 5, which presents estimates of models in which the dependent variable is adoptions of the EOS as measured by reductions in board size by 3 or more. In Model 1, with the main effects only, the results are mixed. Foreign ownership

(FORSHAR) has no significant relationship to adoption of the EOS. Foreign sales (FORSAL) is positively associated with EOS. Poorer performing firms (ROA) are more likely to adopt. Firm size (LGASSET) is positively related to adoption. The relationship of number of subsidiaries (SUBS) is not significant, and neither is the relationship between concentration of ownership (TOP3) and adoption of the EOS system. The control variable, AGE, is positive and significant, suggesting that older firms are more likely to adopt the EOS.

TABLE 5 ABOUT HERE

Models 2-10 add interactions between the above explanatory variables and population adoptions. The interactions between explanatory variables are tests, specifically, of H4, and H10a and H10b. However, addition of these interactions also increases significance of several of the main effects, suggesting that these main effects are conditioned on population adoptions. Model 2 adds SUMADOPT, the log of the cumulative number of adoptions of the EOS in the population. This is positive and significant, indicating that EOS adoptions in the population increase a firm's likelihood of adopting the EOS itself, consistent with H3. In Model 3, the interaction between foreign ownership and EOS adoptions is negative and significant, and the main effect of foreign ownership becomes significant at the .10 level. Note that in Model 10, when all interactions are added, the main effect of foreign ownership is positive and significant at the .05 level. This supports H1 and H4: foreign ownership is associated with adoption of the EOS, but as adoptions increase in the population, this association weakens. This suggests that as cognitive legitimacy of EOS increases, it is adopted more widely, and not only by firms pressured by foreign investors. Model 4 includes an interaction between foreign sales and adoptions. While the main effect remains significant, the interaction with adoptions is not significant, though it is in the predicted negative direction. The significant main effect supports H2, with weak support for

H4, that the effect of foreign sales lessens as cognitive legitimacy through population adoptions increases.

Model 5 includes the interaction between adoptions and ROA. Consistent with H5, firms with low ROA are more likely to adopt the EOS. Consistent with H10b, this relationship weakens (turns to the opposite relationship) as adoptions in the population increase. Model 6 introduces the interaction between population adoption and firm size. Larger firms are more likely to adopt the EOS, consistent with H6. This association becomes significantly stronger as adoptions increase in the population, supporting H10a. In Model 7, the main effect of number of subsidiaries is positive and significant, supporting H7. This positive association decreases with population adoptions, consistent with H10a.

Model 8 includes the number of segments reported by each firm. Note that reports of the number of segments are not required in Japan, and therefore, we could only include firms that reported this information, reducing the n to 1107 observations. Furthermore, the definition of segments is up to each company, and so while it shows how companies think about their businesses, it does not map onto any consistent categorization of industry segments. There is no significant main effect or interaction effect for segments, and therefore, H8 is not supported. Model 9 includes the interaction between ownership concentration and adoptions. With the addition of the interaction with population adoption, ownership concentration is negatively related to the adoption of the EOS, consistent with H9. This relationship weakens as adoptions increase, consistent with H10b. Finally, Model 10 includes all the interactions terms. The most obvious difference is that the interaction between foreign sales and adoption decreases to nearly 0, and the size and significance of the main effect also decreases. Further analyses not included here suggest that this is the result of adding the interaction between foreign ownership and adoptions, reflecting the relatively high correlation between foreign ownership and foreign sales.

TABLES 6 AND 7 ABOUT HERE

Table 6 presents results for analyses of the stated adoption of the EOS. One of the most striking differences from Table 5 is that the estimate for the main effect of foreign ownership as well as the interaction between foreign ownership and population adoptions is substantially higher than in Table 6. However, we do not observe this effect for foreign sales. It is interesting to note that the main effects of ROA and number of subsidiaries are stronger for the reduction of board size by 3 than for stated adoptions. However, the effect of concentrated ownership is stronger for stated adoptions. The effect of diversification on adoption is marginally significant. In general, stated adoptions show similar patterns to adoptions as measured by reduction of board size by 3 or more, with adoptions initially related to measures corresponding to NIT and BTF predictions, and the effect of these measures weakening as population adoptions increase. It is not surprising that the effect of foreign ownership on EOS adoption would be stronger in the case of stated adoption than board size reductions in general. We argued that firms respond to demands of foreign investors by adopting the EOS—and if this is the case, firms would be sure to announce that they have adopted the practice. This is further support that firms react to legitimacy pressures by adopting the EOS. It is also interesting that the effect of ownership concentration is stronger with stated EOS. This may also mean that firms with less concentrated ownership are more liable to face difficult political dynamics, of internal constituencies—and for this reason, announcing the adoption of EOS, the so-called “global standard” makes it easier to justify difficult board reforms to these internal constituencies.

DISCUSSION AND CONCLUSION

We combined insights from NIT and BTF to identify two intertwined processes that shape adoption and adaptation of the EOS among Japanese firms. Figure 3 presents a model of this combined framework. Legitimacy-based adoption, consistent with NIT, occurred as firms signaled their conformance with a "global standard" of corporate governance, and increasingly imitated by others in the industry. Firms facing sociopolitical pressure for conformity, due to a high level of foreign ownership or foreign sales were more likely to adopt the EOS when it was first introduced. At the same time, consistent with BTF, firms adopted EOS to solve problems not related to the original purpose of EOS, which was to shape the board into a monitoring body consistent with the agency theory principles of Anglo-American corporate governance. Firms during the period in which the EOS was first introduced were seeking a way to "choose and focus" in order to streamline management of subsidiaries and business units, and to speed up decision-making and move away from the consensus-based, centralized decision-making systems of the past. EOS provided the materials for reforms—an excuse to reduce board size and rethink decision-making, in the guise of adopting "the global standard" of governance and pleasing investors. Our empirical results show that poor performance was a trigger for adoption, and suggest that firms most likely to have unwieldy decision-making structures, because they were large, had many subsidiaries, or had diffuse ownership, were more likely to adopt the practice. There was also weak support for the relationship between diversification and adoption.

FIGURE 3 ABOUT HERE

The effects of institutional pressures, in the form of foreign ownership and sales, as well as impetus for problem-solving, in the form of poor performance and unwieldy decision-making systems, were more apparent in the early stages of adoption: as population

adoptions increased, mimetic isomorphism also appeared to increase, and specific firm characteristics became less important as determinants of adoption. Consistent with Aldrich and Fiol (1994), we identified two types of institutional pressures for adoption, sociopolitical due to large foreign ownership and international sales exposure, and cognitive, through adoptions in the population. Sociopolitical pressures were most apparent when the EOS first appeared; but over time, cognitive pressures appeared to take over. This finding evokes the two-stage adoption process that early institutional theorists detected. However, rather than a transition from technical to institutional pressures, we see a transition between two different types of institutional pressures.

Two different measures of adoption of the EOS, announced adoption and board size reduction, together suggest robustness of our findings, but also offer intriguing contrasts that merit further exploration. For example, the effect of foreign ownership appears to be stronger on stated adoption than actual board size reductions, consistent with the conjecture that firms are responding to external legitimacy pressures. Although we do not find evidence that firms stated that they adopted the EOS and then did not as we did not look at subsequent increases in board size, it is possible that firms pursuing only external legitimacy might temporarily decrease board size and then increase it again. It may also be that firms used the EOS to remove certain functions or individuals from the board, only to replace them with others. More research on actual board composition and how it changes after the adoption of the EOS would be useful.

Several variables had weaker or opposite than expected effects. The effect of diversification on adoption was weak to non-existent in the quantitative analysis, though the qualitative study suggested a link. This may be due to measurement problems: reporting of diversification is optional in Japan and so the sample was smaller, and firms can decide themselves how they measure their diversification. The measure is still of value, however,

because it reflects how firms themselves think of their diversification, the units in which they measure and manage their business internally. More precise measures of firm structure, for example, whether or not they have adopted a “company system” which is similar to the multidivisional structure would be useful, but since these are not uniformly reported, would require a survey or interview approach to data collection.

An anomaly in the results is that while the significance and size of the estimates of most of the variables related to firm characteristics weaken with population adoptions, the effect of firm size becomes stronger. The main effect of firm size is also significant, suggesting that even at the beginning of the diffusion process large firms are more likely to adopt. This suggests that perhaps large firms are constrained by inertia, or that they need more external evidence of adoption, and that without these inhibitors, adoptions would be even higher at the beginning.

Implications for theory While BTF and NIT have coexisted as explanations of diffusion of new practices, to a large extent, these two perspectives have on parallel tracks, and relatively little has been done to bring them together (Haunschild and Chandler, 2008). Our study identifies areas in which the two perspectives can be fruitfully combined to provide a richer and more thorough explanation of processes of diffusion and adaptation of new practices.

One important area in which NIT and BTF explanations for diffusion intertwine is in the concept of legitimacy. We found that in the adoption of the EOS, legitimacy and problem-solving motives for adoption occurred concurrently. The sociopolitical legitimacy—in other words, its legitimacy as the “global standard” of corporate governance, approved by foreign investors—made it not only more salient to firms seeking solutions to the problem of unwieldy decision-making and need to reform their boards, but also made the EOS an effective way to frame painful internal reforms. While legitimacy in NIT is generally

construed as a way for firms to signal appropriate behavior to the outside world, BTF, with its emphasis on factors within the firm, suggests that framing new practices in ways that enhance legitimacy within the firm is also a critical factor.

BTF is an important complement to NIT in that it provides a fuller explanation of the "technical" part of the diffusion process. Theorists in NIT have struggled to explain the limits of institutional explanations, as it is not really conceivable that organizations are entirely dupes of institutional pressures. More sophisticated models, that suggest that technical and institutional factors interact, and are salient at various times of the adoption process depending on firm characteristics and motivations, have replaced the simple two stage model of technical to institutional. Nevertheless, these models also tend to consider technical and institutional as separate spheres. BTF, however, enhances our understanding of the technical—noting that even processes of organizational problem solving are subject to cognitive limits and political pressures.

BTF and NIT provide different explanations of why problems and solutions may not fit perfectly. According to NIT, firms decouple practice that do not fit technical needs, adopting them in name only and keeping them at a distance, or adopting them in only a cursory way. According to BTF, problems and solutions can be loosely coupled, and each adjusted in the process of adoption. Adoption of the EOS shows that these two explanations of misfit are not mutually exclusive. Sony, the original adopter of the EOS, adopted it in a way very much consistent with its origins in Anglo-American corporate governance, reducing board size and reorganizing the board as a body dominated by non-executives. Other firms, however, adopted the EOS only partially, reducing board size but not adding substantial numbers of non-executive directors. This is very much consistent with decoupling—firms signaled adoption of a practice that pleased shareholders, but did not really adopt it in the anticipated way. But we show here that the modified EOS was not entirely a toothless, merely

symbolic practice: rather, in its transformed version, it was a real solution to problems in decision-making. This suggests that it is necessary to be careful when attributing a mismatch in problem and solution as decoupling. It may be, as in the case of EOS, it is a solution for a different problem.

This process by which problems and solutions are adjusted in the adoption process through an interaction between problem solving and legitimacy seeking provides new insights into how practices vary as they diffuse. The EOS originated as an Anglo-American style corporate governance reform, but diffused in Japan as something very different. We did not look at how individual firms adapted the EOS, but rather how firms across an entire field did so, so that the version adopted in the Japanese electronics industry, and, in fact, in Japan more generally, diverged from the original version. Our investigation into this process offers further insights into the process by which innovations diffuse globally (Fiss and Zajac, 2004; Guillen, 2000). Researchers have suggested that these practices may become hybridized or translated as they encounter local institutions (Aoki and Jackson, 2008; Chizema and Kim, 2009; Sanders and Tuschke, 2007), and our research offers an additional explanation of how this variation may occur.

Limitations and areas for further research: This research has several limitations. We chose to use only one industry, electronics, as this enabled us to conduct interviews at 10 electronics firms with different characteristics, and rule out industry as a reason for the EOS adoption. The electronics industry was useful because it was the source of the first adopter, and showed considerable variation in governance practice. It is also a large industry with considerable variation in firm characteristics, including size, consolidated subsidiaries, and ownership structure. By limiting our data collection, which involved significant amounts of hand coding and search of firm records, to a single industry, we were able to study both large and small firms. We believe that although our research was limited to the electronics industry,

it is generalizable to other Japanese industries. The EOS spread widely across, and was adapted in the same way in other industries. Problems of decision-making were not limited to electronics. Cross-industry comparisons could be a useful way to measure the effects of factors such as diversification—for example the automotive industry is less diversified than electronics—as well as demands for speed and restructuring.

It would also be useful to distinguish even further between early adopters and later adopters. For example, did the earlier adopters adopt the EOS with greater fidelity than the later ones (although as we can see in the qualitative analysis, firms other than Sony diverged from U.S. practice significantly, even at the beginning)? As adoptions of the EOS increased due to cognitive pressures, and firm characteristics became less important in determining adoption, can we see more decoupling in the sense of NIT? Was the EOS increasingly adopted and not implemented at all to solve problems? Those are interesting questions to address.

Conclusion: Despite its limitations, we believe that this paper adds to our understanding of how new practices diffuse, and are adapted or converted, in their process of diffusion. EOS diffused in Japan, in a rather different form from its original intentions, both to signal legitimacy to the outside and inside, and to solve problems that Japanese firms were facing at the same time. If we had interpreted adoption of the EOS in Japan as yet another example of symbolic adoption and decoupling, we would have been partially correct, but we would have missed another part of the story. As the EOS diffused, boards changed significantly. They became smaller, and more focused around a more limited set of decision-makers. Consensus-style centralized decision-making did not disappear from Japanese firms, but the EOS represented a move away from it. In adopting a version of Anglo-Saxon corporate governance, Japanese firms did not come to look more like American firms. Nevertheless, the EOS marked an important change in Japanese corporate governance.

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Figure 1: Nikkei Headlines, 1992-2006

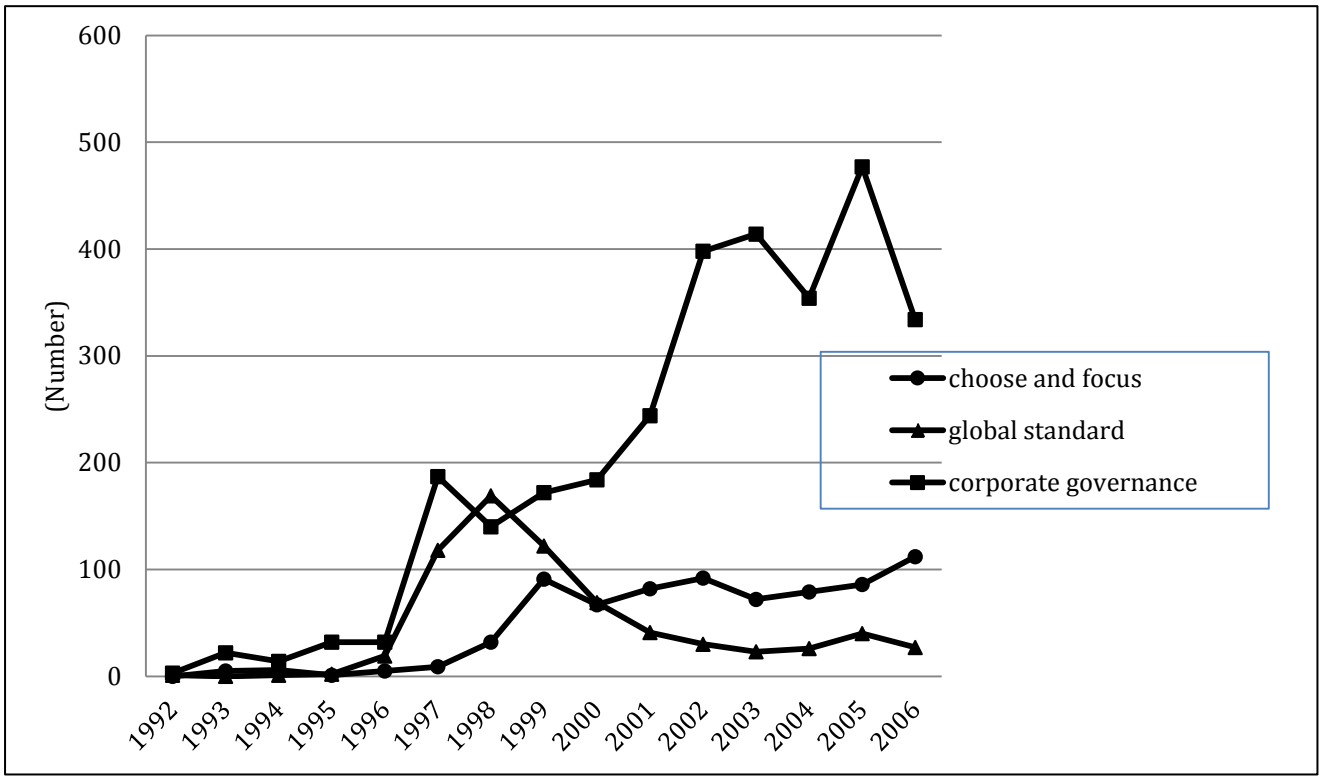

Figure 2: Cumulative Number of Adoptions of the EOS in the Japanese Electronics Industry 1997-2007

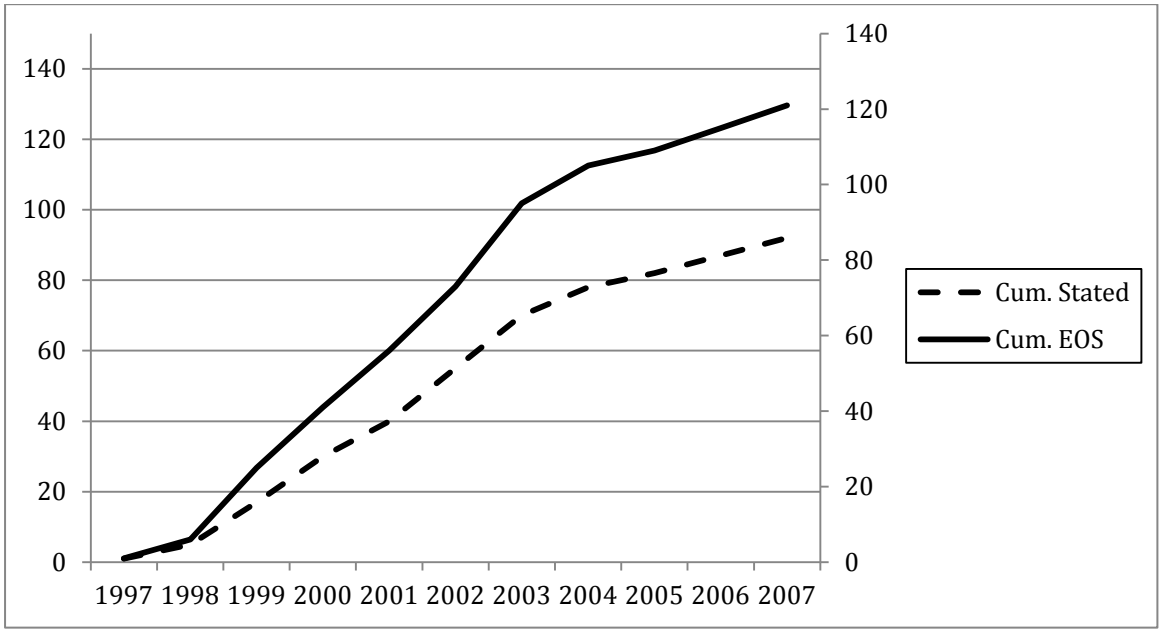

Table 1: Top 10 Electronics Firms, Board Reforms and Firm Characteristics

Name	EOS	Year of EOS introduction	Size (employees
	(2007)		(1999)
Hitachi	○	1999	323,827
Sony	○	1997	189,700
Toshiba	○	1998	190,870
Mitsubishi	○	2003	116,588
NEC	○	2000	154,787
Fujitsu	○	2002	188,053
Sanyo	○	1999	83,519
Matsushita	×		290,448
Sharp	×		81,009
Canon	×		49,748

Table 2: Top 10 Electronics Firms Board Characteristics

Company Name	# of directors before EOS	# of directors after EOS adoption	# of directors in 2003	# of outside directors in 2003
Hitachi	30	14	12	3
Sony	38	10	13	10
Toshiba	33	12	14	4
Mitsubishi	18	12	14	5
NEC	37	19	13	3
Fujitsu	32	7	9	2
Sanyo	28	13	4	2

Table 3: Stated Reasons for Adoption of EOS and Representative Quotes

Globalization	“With globalization and foreign shareholders, there was a need to adopt the global standard.”
Shareholders	“We are listed in New York, we can’t just think about Japan.”
Poor performance	“There was a feeling we had to do something. One of the ways was through governance reform.”
Enable group firm or division-related decisions to be made at appropriate level	“[Board reforms] were adopted along with the company system in 2000 – the company was split into three companies with different investment cycles, so they had to be ran independently.”
Speed up decision-making	"[The EOS system is intended to] reduce the number of directors and focus the board on monitoring. It assigns a broad range of decision-making rights to executive officers to speed up decision-making."
Increase transparency	"All decisions were made in informal meetings before the board meeting so there was no documentation on how the decisions were actually made."
Increase management effectiveness	"[The system was adopted to] to increase agility and transparency of management, to strengthen the function of monitoring and aim for sustainable growth."
Improve monitoring	"[The system was introduced to] reduce number of directors and focus the board on monitoring. It assigns a broad range of decision-making rights to executive officers to speed up decision-making and promote speedy management""

Table 4: Descriptive statistics for sample for EOS adoption, 1997-2007

	Variable name	description	Obs	Mean	SD	Min	Max	1	2	3	4	5	6	7	8	9	10	11
1	STATED EOS	stated adoption of EOS system (0/1)	2225	0.041	0.199	0.000	1.000	1.000										
2	EOS	adoption of EOS system (0/1)	2225	0.054	0.227	0.000	1.000	0.866	1.000									
3	ROA	return on assets (t-1)	2225	0.040	0.079	-2.069	0.287	-0.020	-0.051	1.000								
4	FORSHARE	% shares held by foreign investors (t-1)	2225	0.069	0.109	0.000	0.782	0.093	0.079	0.126	1.000							
5	FORSALES	% overseas sales (t-1)	2225	0.263	0.259	0.000	1.000	0.081	0.090	0.065	0.398	1.000						
6	LGASSET	logged assets (t-1)	2225	10.710	1.448	6.176	16.129	0.157	0.171	0.125	0.388	0.332	1.000					
7	SUBS	number of consolidated subsidiaries/assets (t-1)/ 100	2225	0.025	0.023	0.001	0.208	-0.045	-0.052	-0.207	-0.085	0.037	-0.486	1.000				
8	TOP3	concentration of top 3 shareholders (in 2000)	2225	0.314	0.184	0.000	0.939	-0.071	-0.044	0.019	-0.148	-0.039	-0.131	0.112	1.000			
9	AGE	log of age	2225	3.848	0.386	0.000	4.615	0.083	0.090	-0.127	-0.007	-0.035	0.326	0.128	-0.148	1.000		
10	SUMADOPT	log of total number of adoptions of EOS system(t-1)	2225	3.808	2.316	0.000	6.489	0.051	0.052	0.042	0.209	0.175	-0.205	0.216	0.016	-0.023	1.000	
11	SEGMENTS	number of segments in which firm reports business	1107	2.774	0.957	1	7	0.013	0.003	0.035	0.170	0.126	0.149	-0.061	-0.326	0.053	0.010	1.000

Table 5: Adoption of EOS (reduction in board size by 3 or more) 1997-2007. Logit with robust standard errors clustered on firm.

	1	2	3	4	5	6	7	8	9	10
FORSHARE	-0.013 (1.051)	-1.315 (1.277)	2.230+ (1.557)	-1.266 (1.270)	-1.341 (1.277)	-1.687 (1.368)	-1.422 (1.302)	-3.056* (1.635)	-1.280 (1.260)	3.994* (1.978)
FORSALES	0.949** (0.349)	0.619+ (0.390)	0.611+ (0.391)	1.182** (0.500)	0.555+ (0.386)	0.481 (0.401)	0.539+ (0.393)	0.497 (0.529)	0.634+ (0.387)	0.297 (0.592)
ROA	-2.591** (1.057)	-3.136** (0.998)	-3.124** (0.964)	-3.092** (0.991)	-9.421*** (2.839)	-3.182*** (0.987)	-3.256*** (0.968)	-3.107** (1.246)	-3.145** (0.997)	-8.880** (3.599)
LGASSET	0.333*** (0.081)	0.456*** (0.099)	0.454*** (0.101)	0.463*** (0.101)	0.460*** (0.097)	0.284* (0.133)	0.472*** (0.099)	0.537*** (0.119)	0.445*** (0.098)	0.187 (0.182)
SUBS	-2.182 (7.367)	-3.426 (8.162)	-3.629 (8.260)	-3.175 (8.041)	-3.221 (7.561)	-1.423 (7.870)	25.610** (9.695)	2.122 (12.011)	-3.768 (8.296)	12.120 (14.919)
SEGMENTS								0.099 (0.242)		
TOP3	-0.166 (0.540)	-0.394 (0.566)	-0.355 (0.568)	-0.377 (0.566)	-0.385 (0.560)	-0.459 (0.576)	-0.428 (0.568)	-1.137 (0.899)	-2.242* (1.267)	-2.732* (1.464)
AGE	0.806* (0.352)	0.538+ (0.340)	0.543+ (0.341)	0.537+ (0.339)	0.529+ (0.335)	0.496+ (0.344)	0.522+ (0.349)	0.199 (0.565)	0.512+ (0.336)	0.380 (0.338)
SUMADOPT		0.206*** (0.050)	0.267*** (0.058)	0.248*** (0.065)	0.164** (0.054)	-0.387+ (0.298)	0.323*** (0.064)	0.487** (0.179)	0.101 (0.082)	-0.767+ (0.487)
SUMADOPT* FORSHARE			-0.763** (0.287)							-1.298*** (0.409)
SUMADOPT* FORSALES				-0.140 (0.115)						-0.008 (0.137)
SUMADOPT* ROA					1.334** (0.559)					1.232* (0.672)
SUMADOPT* LGASSET						0.051* (0.026)				0.083* (0.039)
SUMADOPT* SUBS							-6.405*** (1.894)			-2.818 (2.915)
SUMADOPT*								-0.064		

SEGMENTS								(0.059)		
SUMADOPT* TOP3									0.004** (0.002)	0.005* (0.003)
CONSTANT	-9.838*** (1.387)	-10.666*** (1.481)	-10.935*** (1.473)	-10.919*** (1.511)	-10.490*** (1.443)	-8.414*** (1.742)	-11.245*** (1.480)	-10.712*** (2.429)	-9.974*** (1.519)	-6.659** (2.442)
Log pseudo-likelihood	-432.72	-424.79	-423.10	-424.46	-423.37	-423.14	-422.35	-241.01	-423.87	-415.60
n	2225	2225	2225	2225	225	2225	2225	1107	2225	2225

*** p < .001, **p<.01, *p<.05, +p<.10 (one-tailed tests)

Table 6: Stated Adoption of EOS 1997-2007. Logit with robust standard errors clustered on firm.

	1	2	3	4	5	6	7	8	9	10
FORSHARE	0.663 (1.121)	-0.208 (1.359)	4.338** (1.523)	-0.144 (1.357)	-0.222 (1.372)	-0.186 (1.360)	-0.247 (1.380)	-2.126 (1.772)	-0.190 (1.345)	5.252** (1.759)
FORSALES	0.820* (0.418)	0.620+ (0.451)	0.620+ (0.452)	1.280** (0.521)	0.594+ (0.450)	0.628+ (0.453)	0.587+ (0.457)	0.871+ (0.614)	0.620+ (0.446)	0.072 (0.624)
ROA	-1.371+ (0.839)	-1.748* (0.844)	-1.756* (0.856)	-1.702* (0.840)	-5.189* (3.063)	-1.748* (0.843)	-1.743* (0.859)	-2.099* (1.128)	-1.754* (0.845)	-5.563+ (3.853)
LGASSET	0.282** (0.098)	0.355** (0.119)	0.362** (0.122)	0.361** (0.122)	0.357** (0.118)	0.370** (0.141)	0.36*** (0.121)	0.379** (0.139)	0.347** (0.117)	0.275+ (0.190)
SUBS	0.621 (5.949)	-0.435 (6.166)	-0.636 (6.207)	-0.273 (6.146)	-0.448 (6.056)	-0.576 (6.197)	13.543 (10.800)	-0.116 (9.300)	-0.654 (6.226)	13.896 (16.090)
SEGMENTS								0.254 (0.251)		
TOP3	-1.266* (0.725)	-1.419* (0.729)	-1.384* (0.728)	-1.401* (0.730)	-1.417* (0.724)	-1.414* (0.733)	-1.440* (0.732)	-2.533** (1.134)	-4.596** (1.686)	-4.149* (1.876)
AGE	0.783* (0.446)	0.576+ (0.431)	0.588+ (0.438)	0.572+ (0.430)	0.556+ (0.426)	0.579+ (0.430)	0.561 (0.438)	0.222 (0.671)	0.535 (0.425)	0.463 (0.434)
SUMADOPT		0.146** (0.055)	0.246*** (0.068)	0.195** (0.072)	0.119* (0.061)	0.194 (0.294)	0.198** (0.064)	0.537** (0.201)	-0.004 (0.089)	-0.181 (0.519)
SUMADOPT* FORSHARE			-1.011*** (0.280)							-1.293*** (0.379)
SUMADOPT* FORSALES				-0.161+ (0.123)						0.096 (0.147)
SUMADOPT* ROA					0.726 (0.605)					0.854 (0.750)
SUMADOPT* LGASSET						-0.004 (0.024)				0.027 (0.040)
SUMADOPT* SUBS							-2.944+ (2.058)			-2.891 (3.287)

SUMADOPT* SEGMENTS								-0.105+ (0.068)		
SUMADOPT* TOP3									0.007* (0.003)	0.006+ (0.003)
CONSTANT	-9.369*** (1.657)	-9.753*** (1.704)	-10.309*** (1.696)	-10.007*** (1.727)	-9.565*** (1.700)	-9.952*** (1.959)	-9.975*** (1.723)	-9.363** (2.748)	-8.788*** (1.687)	-8.171** (2.586)
Log pseudo-likelihood	-360.06	-356.73	-353.91	-356.38	-356.44	-356.73	-356.32	-209.684	-355.25	-351.34
N	2360	2360	2360	2360	2360	2360	2360	1189	2360	2360

*** p < .001, **p<.01, *p<.05, +p<.10(one-tailed tests)

Table 7: Hypotheses and Empirical Results

Hypothesis	EOS ADOPTION (Reduction in board size)	EOS ADOPTION (Stated)
H1: The higher the percentage of foreign ownership, the more likely a firm will adopt the EOS.		
H2: The greater the percentage of international sales, the more likely a firm will adopt the EOS.		
H3: The more firms that adopt the EOS, the greater the likelihood of EOS adoption.		
H4: The more adoptions of the EOS in the population, the weaker the effect of foreign ownership and foreign sales on adoption of the EOS.	Foreign ownership (not significant for foreign sales, but in predicted direction)	
H5: The lower the ROA, the more likely a firm is to adopt the EOS.		
H6: The larger a firm, the more likely it is to adopt the EOS.		
H7: The more consolidated subsidiaries it has, the more likely a firm is to adopt the EOS.		
H8: The more diversified it is, the more likely a firm is to adopt the EOS.		Marginally significant, predicted direction
H9: The more concentrated the ownership is, the less likely a firm is to adopt the EOS.		

H10a: The more adoptions of the EOS in the population, the stronger the effect of size, number of consolidated subsidiaries, diversification, concentration of ownership and performance will be on adoption of the EOS.	Support only for firm size	
H10b: The more adoptions of the EOS in the population, the weaker the effect of size, number of consolidated subsidiaries, diversification, concentration of ownership and performance will be on adoption of the EOS.	Support except for firm size and number of segments	Support except for ROA (not significant but in predicted direction) and firm size

 Means significance of at least the <.10 level

APPENDIX 1: Interview Procedures

For the interviews, we selected one key respondent at each firm (in several interviews, the key respondent was joined by a more junior official). This person was either a member of the board of directors (or board of statutory auditors) who was present at the time of board reform. If they were not on the board at that time, they were senior executives who were familiar with the decision-making process through which the practice was adopted. We identified the actual respondent through the personal contacts of a member of the project from which this research comes, who had been a member of the board of the National Association for Corporate Statutory Auditors, and was also an independent director on one of the most prominent boards in Japan.

The interviews were approximately 2 hours in length and were open-ended in structure, although we did have an interview guide containing questions related to board reform. Our main question was around the decision to adopt board reforms—including the EOS system. The interviews were conducted in Japanese and translated into English by one of the authors. The issue of board reform, in particular, introduction of independent directors and the internal working of boards of directors were at that time a highly controversial issue. Because we wanted our respondents to respond as honestly as possible to our questions about the reasons they adopted board reforms, we assured them confidentiality, and we did not record the interviews, but rather took notes throughout the interviews. The interviewers (one of the co-authors and another member of the research project) met immediately after the interviews to combine observations, and then immediately created a summary of each interview.
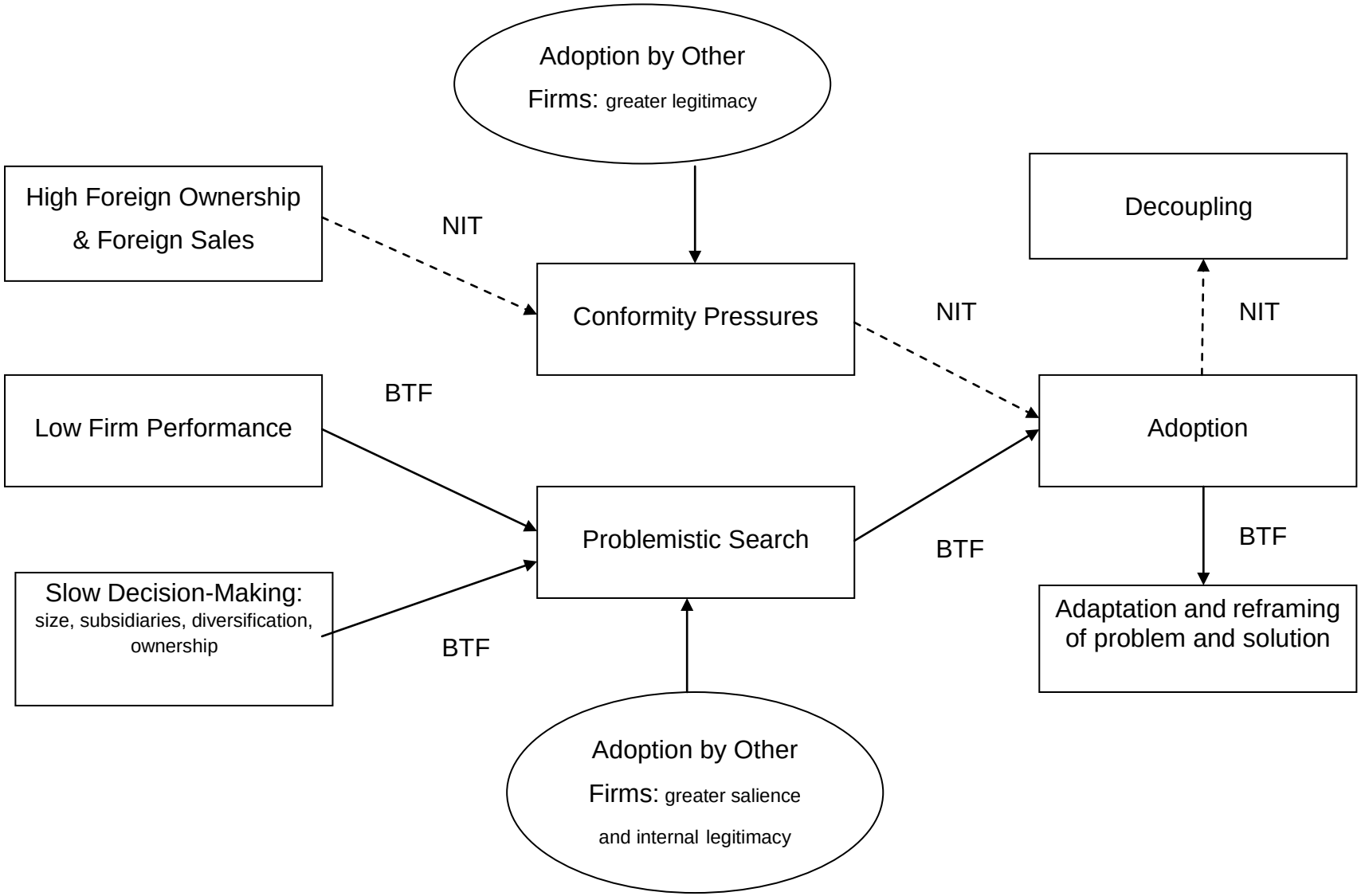
Figure 3: Model of Diffusion of EOS