1-1-1992

Problems of International Joint Ventures in Japan

Zenichi Shishido

Berkeley Law

Follow this and additional works at: https://scholarship.law.berkeley.edu/facpubs

Part of the Law Commons

Recommended Citation
Problems of International Joint Ventures in Japan, 26 Int'l Law. 65 (1992)

This Article is brought to you for free and open access by Berkeley Law Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Berkeley Law Scholarship Repository. For more information, please contact jcera@law.berkeley.edu.
Problems of International Joint Ventures in Japan**

Japan is one of the most misunderstood countries as a host of foreign direct investments. Many foreign companies consider Japan to be unfriendly to foreign investments, both in government and private enterprise circles. In fact, governmental restrictions on foreign capital are a matter of past history; most Japanese companies desire trade with foreign companies, and many foreign companies are successful in Japan. Japan is a more attractive market for foreign capital than commonly assumed. The purpose of this article is to focus on the business, corporate, and tax aspects of foreign business in Japan.

The synergistic effects of joint ventures make them popular among foreign direct investments in Japan. However, a foreign investor considering a joint venture in Japan must pay careful regard to the Japanese corporate law regulations. Japanese corporate laws differ greatly from those in the United States, and shareholder agreements may have enforceability problems when ventures sour.

I. General Background of Foreign Direct Investments in Japan

An American guidebook on international joint ventures states, "Japan can be described, at best, as a reluctant host to foreign direct investment." This is a typical misperception of the Japanese market. Foreign investors tend to believe that the Japanese Government restricts foreign capital through laws or "administrative guidances," that Japanese companies only reluctantly trade with foreign companies, and that the Japanese market harbors little chance for a foreign

---

*Zenichi Shishido*

**Problems of International Joint Ventures in Japan**

Japan is one of the most misunderstood countries as a host of foreign direct investments. Many foreign companies consider Japan to be unfriendly to foreign investments, both in government and private enterprise circles. In fact, governmental restrictions on foreign capital are a matter of past history; most Japanese companies desire trade with foreign companies, and many foreign companies are successful in Japan. Japan is a more attractive market for foreign capital than commonly assumed. The purpose of this article is to focus on the business, corporate, and tax aspects of foreign business in Japan.

The synergistic effects of joint ventures make them popular among foreign direct investments in Japan. However, a foreign investor considering a joint venture in Japan must pay careful regard to the Japanese corporate law regulations. Japanese corporate laws differ greatly from those in the United States, and shareholder agreements may have enforceability problems when ventures sour.

I. General Background of Foreign Direct Investments in Japan

An American guidebook on international joint ventures states, "Japan can be described, at best, as a reluctant host to foreign direct investment." This is a typical misperception of the Japanese market. Foreign investors tend to believe that the Japanese Government restricts foreign capital through laws or "administrative guidances," that Japanese companies only reluctantly trade with foreign companies, and that the Japanese market harbors little chance for a foreign

---

*Associate Professor of Law, Seikei University, Tokyo, Japan.

**This article is a revised version of a paper the author presented at the Montreal Convention of International Comparative Law on August 18, 1990. The author would like to express his gratitude for the encouragement and helpful comments received on an earlier draft of this article from Professor Richard M. Buxbaum.

The Editorial Reviewer for the article was James A. DeMent, Jr.

company to make big earnings. This section attempts to correct these misunderstandings and to show that the Japanese market has many opportunities for foreign investors.

A. Historical Restrictions on Foreign Capital

1. 1945-1964

Historically, Japan was a reluctant host to foreign direct investments, particularly in the twenty years after World War II. The war destroyed most Japanese industries and western technologies were far ahead of Japan's. The Japanese Government felt that it had to protect domestic infant industries against strong foreign competitors. As a result, government policy on foreign direct investment was to admit only foreign capital that would contribute to Japanese industries' growth and independence. International joint ventures played important roles in both introducing western technologies and protecting domestic companies.

In 1950, Japan passed the Foreign Investment Act (FIA) to implement this government policy. Under the FIA, all foreign investment and technical assistance agreements had to be approved by the appropriate ministry. The FIA was initially strictly enforced through stringent governmental screening and so-called “administrative guidance.”

2. 1964-1980

As the competitiveness of Japanese firms and the Japanese economy strengthened, so did international pressure on the Japanese Government to liberalize the market for foreign capital. Particularly in 1964, after Japan acceded to the International Monetary Fund’s (IMF) article VIII, which prohibits exchange restrictions, and joined the Organization for Economic Cooperation and Development (OECD), which, in principle, prohibits restrictions on direct foreign investment, the Japanese Government was forced to liberalize its policy on foreign capital investments. The Japanese Government gradually opened the market along with its foreign capital investment liberalization schedules in 1967, 1969, 1970, 1971, 1973, and 1975.

---

4. Foreign Investment Act (Act No. 163) of May 10, 1950 [hereinafter FIA]; see supra note 2, § 4.01[1].
5. "Approval" (Ninka) is a term of art meaning governmental permission on a private action necessary to give it legal effect. The government still retains the power to deny the application. Id. § 4.03[3].
7. For an explanation of "administrative guidance" (gyōsei shidō), see 6 Doing Business in Japan, supra note 2, § 4.01[1] n.4.
8. Id. §§ 4.01[1], 4.04[6].
As a result, foreign direct investment in all but four restricted industries was approved as a matter of course.\(^9\) The government policy shifted from probation in principle to approval in principle. However, the government still retained its discretion to deny applications.

**B. ENCOURAGING FOREIGN INVESTMENTS TODAY**

In 1979, the Japanese Government abolished the FIA. The Revised Foreign Exchange and Foreign Trade Control Act (Revised FECA)\(^10\) took its place the next year. With this change, the automatic approval system was transformed into a prior notification system.\(^11\) The Japanese Government surrendered its discretionary power over foreign capital, except for the four excepted industries\(^12\) and industries connected with national security,\(^13\) retaining only the right to prior notification.

Although under the Revised FECA a foreign investor has to wait thirty days after filing the notification\(^14\) (certain exceptions require up to five months\(^15\)), a governmental directive\(^16\) shortened the waiting period to two weeks for the four excepted industries and the national security-related industries, and eliminated the waiting period for all other industries.

In special cases, the government can suggest or order\(^17\) a change or stop the foreign direct investment. It has, however, never made such a suggestion or order, including in the excepted industries, since the FECA was revised in 1980. Also, the Revised FECA has no restriction on the foreign capital ratio, except in a limited number of specified industries, such as telecommunications.

Today, with only prior notification, foreign capital may be invested freely in most industries in Japan. Indeed, the current climate for foreign direct investments is encouraging. The economic conflicts between Japan and the United States or European countries include not only trade, but also direct investment. The United States particularly insists on "reciprocity," meaning that U.S. companies should be able to invest as freely in Japan as Japanese firms may in the United States. Under such pressures, the Japanese Government is taking several measures to encourage foreign direct investments. For example, the Japan De-

---

9. The four categories in which foreign investment is restricted are agriculture, mining, petroleum, and leather. *Id.*
10. Act No. 22B of 1979 (hereinafter Revised FECA).
11. *Id.* § 26.
12. See supra note 9.
13. Industries connected with national security are the aerospace, weaponry, explosives, and atomic energy fields.
14. Revised FECA § 27 IV.
15. *Id.* § 27.
17. Revised FECA § 27 II.
18. *Id.* § 27 VII.

SPRING 1992
velopment Bank provides a foreign newcomer with lower-rate financing for a Foreign Direct Investment Encouraging Loan. Also, the Japan Exterior Trade Research Organization (JETRO) provides essential information to foreign companies on direct investments in Japan.

Every form of direct investment is welcome. Neither law nor administrative guidance contains a preference between a one hundred percent subsidiary and a joint venture. Moreover, because of differences in two areas of U.S. and Japanese law, the Japanese market is more accessible for foreign capital than the American market. The first area is that of antitrust. In the United States large-scale direct investments in the form of mergers and acquisitions or joint ventures require prior notification to the Federal Trade Commission and the Justice Department for scrutiny of potential antitrust violations. These agencies view joint ventures with particular suspicion as possible cartels. Although Japan has an Antimonopoly Law, the Japanese Federal Trade Commission enforces it less stringently than is the case in the United States. In addition, the Japanese initiate very few private actions for damages because the law lacks the incentive of multiple damage recoveries and because the plaintiff must prove the amount of damage, which is quite difficult to do. The risk of antitrust problems is thus much smaller in Japan than in the United States.

The second area of law that favors the Japanese market over the American market is that of products liability. In the United States products liability suits are numerous and the damage amounts large. The risk of products liability may discourage foreign companies from investing directly in the United States. In Japan, however, both the number of products liability suits and any resulting damage amounts are still small.

C. SOME STATISTICS ON FOREIGN DIRECT INVESTMENTS AND INTERNATIONAL JOINT VENTURES IN JAPAN

It is difficult to determine exactly the number and amount of investments of foreign companies or joint ventures in Japan. It is also difficult to determine whether foreign investments are successful in sales volume, earnings, or market shares, and their importance in the Japanese economy. Nevertheless, a statistical evaluation shows that although the impact of foreign direct investments to the Japanese economy is still not important, the investment amounts are now rapidly increasing. Many foreign companies are successful in the Japanese market, and joint ventures play an important role in foreign direct investments.

The most reliable and thorough statistic is the total of reported amounts of foreign direct investments disclosed each year by the Ministry of Finance. Table 1 demonstrates the rapid increase in foreign direct investments in terms of dollars in 1987 and 1988.

Table 2 analyzes foreign companies' shares of sales in 1987. As the table indicates, total sales of foreign companies were more than 10 trillion yen (about U.S. $67 billion, calculated at 150 yen to a dollar) in 1987. Manufacturing was worth 7.35 trillion yen (U.S. $4.9 billion). Retail was worth more than 2.9 trillion yen (U.S. $1.93 billion). Market share is still small: 0.9 percent in all industries, and 2.3 percent in manufacturing. However, in petroleum and coal products, foreign firms have a significant 27.4 percent share.

Table 3 delineates the earnings-sales ratios of foreign companies. The figures show that foreign companies tend to be highly profitable in the Japanese market.

---

22. Revised FECA § 26 III.
23. Another source of statistics on foreign companies is the Ministry of International Trade and Industry (MITI)'s Survey of Foreign Companies in Japan. The annual research questionnaires are sent by MITI to foreign companies that have 50 percent or more of foreign capital. The survey does not include firms in finance, insurance, transportation, telecommunications, construction, and agriculture. The return rate of the survey is about 50 percent.
TABLE 3
EARNINGS-SALE RATIOS OF FOREIGN COMPANIES

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All Companies</td>
<td>3.5%</td>
<td>3.4%</td>
<td>4.2%</td>
<td>5.3%</td>
<td>6.1%</td>
</tr>
<tr>
<td>Japanese Average</td>
<td>1.8%</td>
<td>2.1%</td>
<td>2.0%</td>
<td>2.0%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>4.3%</td>
<td>3.7%</td>
<td>5.4%</td>
<td>5.7%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Japanese Average</td>
<td>2.9%</td>
<td>3.6%</td>
<td>3.2%</td>
<td>2.8%</td>
<td>3.7%</td>
</tr>
</tbody>
</table>

The earnings-sale ratio of foreign companies (6.1 percent in all industries and 6.9 percent in manufacturing in 1987) is higher than comparable Japanese averages (2.5 percent overall and 3.7 percent in manufacturing) for several years.

Research and development activities of foreign companies in Japan have rapidly expanded recently. The number of foreign-owned research laboratories has increased 40 percent (137 in 1987); the staffing has increased 85 percent (5,551 people in 1987); and research and development costs have increased 31 percent, to 80.4 billion yen (U.S. $536 million) in the three-year period ending in 1987.27

Joint ventures in Japan are difficult to quantify because the definition of joint venture is ambiguous and because complete statistics are not available on the equity ratios of foreign companies. One can, however, estimate how important joint ventures are to foreign direct investments in Japan from the MITI Survey.

Table 4 discloses that 100 percent foreign capital subsidiaries comprise less than half of all foreign companies. “Foreign companies” do not include enterprises with less than 50 percent foreign capital. Clearly, the joint venture form is frequently used in foreign direct investments in Japan. The joint venture percentage in foreign direct investments is likely to be higher than normal for a country without restrictions on foreign capital ratios. Surprisingly, the ratio of fifty-fifty joint ventures is high—more than thirty percent in manufacturing.29

Finally, the statistics in Table 5 indicate that Japan is the most popular host country for U.S. multinationals’ joint venture activities, particularly as a percentage of those based in high-income countries.

26. Id.
27. Id.
28. Id.
29. The most convenient source of statistics on foreign companies in Japan is GAISHIKEI KIGYO SORAN [FOREIGN AFFILIATED COMPANIES IN JAPAN—A COMPREHENSIVE DIRECTORY] published by TOYO KEIZAI [EASTERN ECONOMICS] every year, even though it is unofficial and the statistics are incomplete. Its 1991 version also shows the rapid growth of foreign direct investment in Japan in the 1980s and the importance of joint ventures, especially in manufacturing. Id. at 107.
TABLE 4
DISTRIBUTION OF FOREIGN COMPANIES BY INDUSTRIES, COUNTRIES, AND EQUITY RATIOS

<table>
<thead>
<tr>
<th>(All industries)</th>
<th>(Companies)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Manufacturing</td>
</tr>
<tr>
<td>North America</td>
<td>296</td>
</tr>
<tr>
<td>U.S.A.</td>
<td>291</td>
</tr>
<tr>
<td>Europe</td>
<td>221</td>
</tr>
<tr>
<td>West Germany</td>
<td>61</td>
</tr>
<tr>
<td>England</td>
<td>38</td>
</tr>
<tr>
<td>Switzerland</td>
<td>33</td>
</tr>
<tr>
<td>France</td>
<td>22</td>
</tr>
<tr>
<td>Asia</td>
<td>22</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>7</td>
</tr>
<tr>
<td>Others</td>
<td>8</td>
</tr>
<tr>
<td>Total</td>
<td>547</td>
</tr>
<tr>
<td>50%</td>
<td>217</td>
</tr>
<tr>
<td>50-100%</td>
<td>105</td>
</tr>
<tr>
<td>100%</td>
<td>225</td>
</tr>
<tr>
<td>Total</td>
<td>547</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(Manufacturing)</th>
<th>(Companies)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Manufacturing (without oil)</td>
</tr>
<tr>
<td>North America</td>
<td>286</td>
</tr>
<tr>
<td>U.S.A.</td>
<td>281</td>
</tr>
<tr>
<td>Europe</td>
<td>215</td>
</tr>
<tr>
<td>West Germany</td>
<td>59</td>
</tr>
<tr>
<td>England</td>
<td>36</td>
</tr>
<tr>
<td>Switzerland</td>
<td>33</td>
</tr>
<tr>
<td>France</td>
<td>22</td>
</tr>
<tr>
<td>Asia</td>
<td>22</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>7</td>
</tr>
<tr>
<td>Others</td>
<td>8</td>
</tr>
<tr>
<td>Total</td>
<td>531</td>
</tr>
<tr>
<td>50%</td>
<td>209</td>
</tr>
<tr>
<td>50-100%</td>
<td>101</td>
</tr>
<tr>
<td>100%</td>
<td>221</td>
</tr>
<tr>
<td>Total</td>
<td>531</td>
</tr>
</tbody>
</table>

TABLE 5
THE NUMBER OF U.S.-FOREIGN JOINT VENTURES LOCATED IN JAPAN AND IN HIGH-INCOME COUNTRIES

<table>
<thead>
<tr>
<th>Location</th>
<th>'74</th>
<th>'75</th>
<th>'76</th>
<th>'77</th>
<th>'78</th>
<th>'79</th>
<th>'80</th>
<th>'81</th>
<th>'82</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Japan</td>
<td>14</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>8</td>
<td>8</td>
<td>11</td>
<td>15</td>
<td>73</td>
</tr>
<tr>
<td>In high-income countries</td>
<td>37</td>
<td>14</td>
<td>16</td>
<td>15</td>
<td>14</td>
<td>27</td>
<td>34</td>
<td>40</td>
<td>35</td>
<td>232</td>
</tr>
<tr>
<td>% of high-income countries</td>
<td>38</td>
<td>29</td>
<td>31</td>
<td>27</td>
<td>29</td>
<td>30</td>
<td>24</td>
<td>28</td>
<td>43</td>
<td>31</td>
</tr>
</tbody>
</table>
II. International Joint Ventures in Japan
from a Business Point of View

A. Synergistic Effects and Give-and-Take Relationships

Generally, creating international joint ventures involves seven types of synergism. The first is the lower investment cost to each participant, thereby reducing risk. Although every joint venture has this effect, it is significant when the enterprise costs too much for a single company to fund, for example, the development of a new airplane.

The second effect is the reduced waste through sharing of facilities, such as factories, dealer and computer networks, and research and development laboratories.

The third factor lies in combining the competitive advantages of each partner, for example, creating a joint venture between a company with good technology and a company with a wide dealer network. This is the most typical synergistic effect of a joint venture.

The fourth effect is the exchanging of information or the mutual learning of the other partners’ processes or know-how. Although the essential knowledge could be obtained by a licensing agreement, it is much more efficient through a joint venture because both parties can exchange information on a give-and-take basis. Both sides can learn more by operating a business together. Nevertheless, this exchange of information involves a risk of technology transfer that could continue to benefit a partner after the dissolution of the joint venture. It could thus be considered a drawback of joint ventures.

The fifth effect is the entry into developing countries that would otherwise have restrictions on foreign capital, common among many developing and socialist countries. In these countries, a joint venture is the only opportunity for a foreign company to make a direct investment. The sixth effect is the reduced awareness of the foreign presence. It is difficult to define a fifty-fifty joint venture as either a foreign company or a domestic one. The joint venture form of


35. The archetype of this is the joint venture between Toyota and GM in Fremont, California. See generally SHISHIDO & KUSANO, supra note 31.
business thus tends to lessen national economic conflicts, particularly when a 
Japanese company makes a direct investment in the United States or Europe. 36

When creating an international joint venture in Japan, however, the fifth and 
sixth synergistic effects of a joint venture have no significance because Japan has 
no restriction on foreign capital and the foreign presence may be advantageous.

The final effect of the international joint venture is to create alliances among 
enterprises. Currently, in many industries, such as those producing automobiles, 
computers, semiconductors, or airplanes, the competitive market is worldwide. 
Creating alliances among such competitors is therefore now an influential reason 
for establishing an international joint venture. 37

In summary, an international joint venture in Japan may result in one or more 
of five types of synergistic effects: risk reduction, reduced waste through sharing 
of facilities, combining competitive advantages, the mutual learning effect, or 
competitive alliances. Not all international joint ventures, however, enjoy this 
synergism. Indeed, there are many failing, or at least unsuccessful, joint ventures 
both in Japan and worldwide. 38 One of the most important reasons for failing 
joint ventures is a lack of the give-and-take relationship between the venture 
partners. For example, many domestic partners in developing countries have 
nothing to contribute to international joint ventures. These joint ventures will 
often never create a real synergistic effect. 39 To create a successful joint venture 
and to enjoy the resulting synergism, the joint venturers must have a give-and-
take relationship. Both parent companies should have some bargaining leverage 
and maintain that leverage during the joint venture. 40

B. WHY DO FOREIGN COMPANIES SEEK JAPANESE PARTNERS?

Major American and European companies increasingly have noticed the oppor-
tunities of the Japanese market. They are not only exporting their products, 
but also are trying to establish base camps in Japan through direct investments. 
These firms, however, are still reluctant to make direct investments in Japan in

36. Most Japanese auto parts makers are formed as joint ventures when they begin manufac-
turing in the United States.

37. E.g., NIHON KEIZAI SHINBUN, Jan. 1, 1987, at 63 (a joint venture between Toshiba and 
Motorola for manufacturing semiconductors in Japan); Richard L. Hudson & Janet Guyon, GTE, 
SIEMENS Venture Could Become Power in Digital Phone Exchange Sales, WALL ST. J., Jan. 20, 
1986 (joint venture between GTE and Siemens for manufacturing digital telephones to compete with 
AT&T).

38. See Jonathan B. Levine & John A. Bryne, Corporate Odd Couples, BUS. WEEK, July 21, 
1986, at 100.

22 (joint venture between Japan and China in developing oil deposits). See Zenichi Shishido, Nihon 
Kigyō no Tai Ajia Chokusetsu-tōshi no Senryaku-Gijutsu Iten o Chūshin to Shito [Direct Investment 
Strategy in Asia by Japanese Industries—Focusing on Technology Transfer], Final Report of the 
Research Group on “Direct Foreign Investment” of Foundation for Advanced Information and 
Research 13 (1991) [English summary is available].

40. See SHISHIDO & KUSANO, supra note 31.
view of its complicated market system. Indeed, some foreign companies are abandoning their business in Japan. Nevertheless, many successful foreign companies in Japan have come to understand the Japanese market and how to succeed in it.41

A joint venture may be a wise option of entry into the Japanese market for four reasons. The first is the opportunity to learn and understand the Japanese market. The foreign company could learn how to do business in Japan from its Japanese partner. Although this type of learning is always important for a foreign partner of any international joint venture, it is particularly important when a foreign company enters the Japanese market. Many Japanese business customs are not easily understandable for western managers. While they might learn these customs from a consulting firm, doing business together with a Japanese company with expertise in the particular business will provide the greatest opportunity to learn.

The most notable characteristic of Japanese business custom is the emphasis on long-term relationships in both intra- and intercorporate relations.42 This leads to the second and third reasons why a foreign company would seek a Japanese partner.

The second reason is to utilize the credibility or the reputation of a Japanese partner in Japanese business society, which would otherwise take time to achieve. Particularly when a foreign partner has a large Japanese partner, such as Shinnittetsu (Nippon Steel) or Mitsui Co., this advantage would be larger than the foreign partner imagined. Every transaction by the joint venture in Japanese business society would work more smoothly than a transaction by a foreign company alone.43

The third advantage of having a Japanese partner is to use its distribution network. In Japan, creating a new distribution network is difficult because every retailer has strong ties with a particular manufacturer or wholesaler. Therefore, the foreign company seeking a substantial market share in Japan needs a Japanese partner in order to use its distribution network. At the very least, this is the best way to save time.44

The final reason for having a Japanese partner is to lessen waste by sharing facilities, particularly factories or office buildings. The high cost of land in Japan

41. There are approximately three thousand companies whose capital is not less than fifty percent foreign. The tax-reported incomes of the top two hundred of these firms have increased fifty-five percent, from 828.4 billion yen in 1983 to 1283.4 billion yen in 1988. DAIYAMONDO [DIAMOND], July 8, 1989, at 76.

42. See HIROYUKI ITAMI, JINPOSHUGI KIGYO [HUMANISTIC CORPORATIONS] (1988).

43. NIKKEI SANGYO SHINBUN [JAPAN ECONOMIC INDUSTRY NEWSPAPER], June 23, 1988, at 14, 15.

makes building a new factory or renting office space prohibitive. Sharing facilities with a Japanese partner is far more affordable.\footnote{E.g., \textit{Nihon Keizai Shinbun}, May 18, 1988, at 9 (joint venture between Michelin and Okamoto will use an Okamoto factory in Gumma prefecture).}

To summarize, the most common reasons for a foreign company to seek a Japanese partner are: learning how to do business in Japan, utilizing the credibility of the Japanese partner, sharing the distribution network, and sharing real estate facilities. These factors will also be bargaining leverages for the Japanese partner.

C. \textbf{Why Do Japanese Companies Seek Foreign Partners?}

What could be the bargaining leverages of the foreign partner in an international joint venture? Japanese partners in the main look for three things from their foreign partners: technologies, brand names, and alliances.

Generally speaking, Japanese companies have been eager to learn foreign technologies. The principal reason for removing the restrictions on foreign capital was to obtain western technologies more advanced than domestic technologies in most industries. Even after Japanese companies have obtained strong competitiveness in world markets, they are still eager to learn other technologies. Thus, learning foreign technology is still one of the most important reasons why Japanese companies create joint ventures with foreign partners.\footnote{E.g., \textit{Nihon Keizai Shinbun}, Mar. 30, 1988, at 9 (joint venture between Hoffman-LaRoche and Dainihon Inki (DIC) for manufacturing and selling liquid crystal); \textit{see also supra} note 44 (joint venture between Bull and Dainihon Insatsu).}

On the consumer level, many European and American brand names are attractive in Japan. Trading companies, large retailers, and even competitors that have tough battles with stronger competitors in the Japanese market want good foreign brand names. This need gives strong leverage to foreign firms with good brand names when they wish to create joint ventures in Japan.\footnote{An example of this is the joint venture between GFT, an Italian fashion conglomerate with notable brand names like “Ungara” or “Valentine,” and Ito Chu, a large Japanese trading firm. \textit{Nihon Keizai Shinbun}, June 27, 1989, at 13. \textit{See also Daiyamondo}, July 8, 1989, at 65; \textit{Daiyamondo}, July 8, 1989, at 85 (joint venture between Hermès and Seibu Department Store); \textit{Daiyamondo}, July 8, 1989, at 85 (joint venture between Brooks Brothers and Daido Ltd., a large Japanese apparel maker).}

Currently, Japanese companies tend to use international joint ventures as strategic alliances in two ways. One is to obtain a competitive edge in the Japanese market. A company lagging in an industry may want the help of a large foreign competitor to become a front-runner.\footnote{E.g., \textit{Nikkei Sangyo Shinbun}, June 7, 1989, at 15 (joint venture between Nestle and Fujiya in the food business); \textit{see also supra} note 15 (joint venture between Michelin and Okamoto).} Another is to create a long-term, strategic, worldwide alliance, particularly between large Japanese and foreign competitors.\footnote{See, e.g., \textit{supra} note 37 (joint venture between Toshiba and Motorola); \textit{see also Nihon Keizai Shinbun}, Oct. 13, 1988, at 17 (joint venture between Suntory and Allied for liquor distribution).}
D. PATTERNS OF INTERNATIONAL JOINT VENTURES IN JAPAN

A corollary to the foregoing review of what foreign and Japanese partners each want from a joint venture is an examination of what kinds of combinations arise from both sides’ needs. Japan seems to have six patterns of combinations in international joint ventures.

The first pattern is between a foreign company that has an established brand name and a Japanese trading company or large retailer. The second pattern is between a foreign company that has good technology and a Japanese competitor with a good distribution network. The third pattern of joint ventures is between firms, each having special technologies. The combination would create a synergistic effect. The fourth pattern is between a giant foreign firm wishing to expand into Japan and a Japanese mid-size competitor needing the help of a foreign partner to compete with stronger Japanese competitors. The fifth pattern is between a relatively small foreign company with good technology and a giant Japanese company wishing to diversify into that industry. Finally, the sixth pattern is between giant foreign and Japanese companies in making a strategic alliance from a worldwide perspective.

50. E.g., DAIYAMONDO, July 8, 1989, at 83 (joint venture between Unisys Corp. and Mitsui Co. on computers); NIHON KEIZAI SHINBUN, Feb. 13, 1988, at 8 (joint venture between West Germany’s Lamda Physic, the world’s largest laser maker, and Marubun, a Japanese electronics trading firm); GAISHIKEI KIGYO SORAN 1991, supra note 29, at 468 (joint venture between Royal Copenagen and Takashimaya Department Store); id. at 486 (joint venture between Nina Ricci Parfums and Okamoto Trading Co.); id. at 495 (joint venture between Williams-Sonoma Inc. and Tōkyō Department Store); supra note 47 (joint ventures between GFT and Itochu and between Hèrmes and Seibu Department Store).

51. See e.g., supra note 17 (joint venture between Brooks Brothers and Daido Ltd.); supra note 44 (joint venture between Bull and Dainihon Insatsu); supra note 44 (joint venture between Allied Signal and Nihon Gosei Gomu (JSR)); see also NIHON KEIZAI SHINBUN, Dec. 11, 1988, at 5 (joint venture between Cookson, an English metal chemical products maker and Honjo Chemical, a metal chemical products maker in Japan, for selling printing material, etc.).

52. See, e.g., NIHON KEIZAI SHINBUN, Jan. 13, 1989, at 1 (joint venture between Sears Roebuck and Seibu Saison); NIHON KEIZAI SHINBUN, Dec. 21, 1988, at 8 (joint venture between Young & Rubicam, of the United States, the world’s largest advertising firm, and Dentsu, Japan’s largest advertising firm); NIHON KEIZAI SHINBUN, Jan. 12, 1988, at 9 (joint venture between BBC (now ABB), a West German heavy electronics maker, and Nihon Gaishi for developing heavy batteries); supra note 46 (joint venture between Hoffman-LaRoche and Dainihon Inki (DIC)).

53. See supra note 45 (joint venture between Michelin, the second largest tire maker in the world, and Omekoto, the sixth largest tire maker in Japan); supra note 48 (joint venture between Nestle and Fujisa).

54. E.g., NIHON KEIZAI SHINBUN, Dec. 7, 1987, at 9 (joint venture between Megatest, an American IC tester maker, and Kobe Seikosho, a large Japanese iron maker, for providing IC testing services in Japan); NIKKEI KINRYU SHINBUN [JAPAN ECONOMICS FINANCIAL NEWSPAPER], Nov. 13, 1990, at 5 (joint venture between Babcock & Brown, American leveraged buyout experts, and Nomura Securities).

55. See, e.g., supra note 37 (joint venture between Toshiba and Motorola); supra note 49 (joint venture between Suntory and Allied); GAISHIKEI KIGYO SORAN 1991, supra note 29, at 308 (joint venture between Yokokawa Electronics and Hewlett-Packard); see also NIKKEI SANGYO SHINBUN, June 29, 1989, at 28 (joint venture between Yokokawa Electronics and GE).
III. Japanese Corporation Law and Joint Ventures in Japan

Japanese law has no special statutes for joint ventures. A joint venture is regulated as an enterprise created in Japan. This section reviews Japanese corporation law regarding joint ventures, particularly in comparison with American law.

A. LEGAL FORMS FOR A JOINT VENTURE AND CORPORATION LAWS

Japan has seven types of enterprises, the most popular of which are kabushikigaisha and yugengaisha. Kabushikigaisha is known as a corporation in the United States and Aktien Gesellschaft in Germany. Yugengaisha is equivalent to the German Gesellschaft mit beschreknem Haftung (GmbH). The United States has no equivalent form.

Kabushikigaisha is the only corporate form suited for large publicly held corporations. The remaining six categories, including yugengaisha, are intended to be used by small enterprises, typically family enterprises. In Japan, however, entrepreneurs have ignored the intention of their legislators. Many small enterprises have chosen the kabushikigaisha form, although it is not suitable for closely held corporations. Roughly speaking, besides proprietorships, approximately half of all existing small enterprises in Japan are kabushikigaisha and the remaining half are yugengaisha. The number of other forms are negligible.

Japanese legislators are currently planning to divide the corporate form (kabushikigaisha) into a large corporation form and a small corporation form. Once this new law is implemented, small enterprises seeking limited liability will have a choice of two alternatives: the yugengaisha and the small kabushikigaisha.

The major corporate difference between Japan and the United States is the existence of many partnerships in the United States, but few in Japan. This contrast results from the different tax treatment afforded the corporate forms. In Japan, the corporate forms (gomeigaisha, goshigaisha, yugengaisha, and kubushikigaisha) normally have tax advantages over the noncorporate forms (kojin,
kigyo, kumiai, and tokumeikumiai). Income tax rates on individuals increase as the income level rises, with the maximum rate at 50 percent.\textsuperscript{60} In contrast, there is only one income tax rate for corporations, 37.5 percent.\textsuperscript{61} These tax advantages for corporate forms over noncorporate forms are not present in the United States. Since the Tax Reform Act of 1986, the maximum income tax rate for corporations (34 percent)\textsuperscript{62} is higher than the maximum tax rate for individuals (28 percent).\textsuperscript{63}

Most international joint ventures in Japan are created as corporations. The following sections survey the general regulations on corporations within the Commercial Code.\textsuperscript{64}

1. Creation of a Corporation

At least seven promoters,\textsuperscript{65} personally responsible should the corporation fail,\textsuperscript{66} are necessary to create a corporation in Japan. Currently, there is no minimum capital requirement for creating a corporation.\textsuperscript{67} However, the Tentative Draft of the Commercial Code has several provisions on the use of stated capital to protect corporate creditors.\textsuperscript{68}

First, the draft tries to close existing loopholes regarding minimum levels of stated capital by creating criminal sanctions for disguised investments,\textsuperscript{69} and by prohibiting loans from corporations to their shareholders for a certain period after

\begin{itemize}
\item \textsuperscript{60} SHOTOKUZEIHO [INDIVIDUAL INCOME TAX CODE] § 89. Before April 1989, the maximum tax rate was 75%.
\item \textsuperscript{61} HÔJÎNZEIHO [CORPORATE INCOME TAX CODE] § 66. There is a preferred rate of 28% applicable only to small corporations with income of less than 8 million yen (approx. $53,000 at a rate of 150 yen per U.S. $1 (this article will use that rate of exchange from this point onward)). Before April 1989, these rates were 42% and 30% respectively.
\item \textsuperscript{62} 26 U.S.C. § 11(b) (1988).
\item \textsuperscript{63} Id. § 1. Subchapter S is also used by many small corporations to lower the effective tax rate and to eliminate double taxation. The maximum average tax rate for an individual is 28%, although persons at certain income levels may be taxed at 33%.
\item \textsuperscript{64} The Commercial Code was revised April 1, 1991, partially in accordance with the Tentative Draft, supra note 58. The following survey is on the regulations prior to the revision.
\item \textsuperscript{65} SHÔHO [COMMERCIAL CODE] § 165.
\item \textsuperscript{66} Id. § 194. The Tentative Draft allows one-person corporations to be created by abandoning the current rule requiring seven promoters. TENTATIVE DRAFT, supra note 58, § 1-1. The former rule caused the "phantom stock" phenomenon and often led to later internal disputes.
\item \textsuperscript{67} Cf. Yugengaisha Hô [GmbH Act] § 9.
\item \textsuperscript{68} The Draft sets the minimum level for stated capital at 20 million yen (approx. $133,000) for kabushikigaisha and 5 million yen (approx. $33,000) for yugengaisha. In addition, it requires kabushikigaisha to have a "safe harbor" level of capitalization consisting of stated capital plus an additional amount of earned surplus, for a balance of 50 million yen (approx. $333,000). These minimum levels of capitalization are prerequisites to limited liability. TENTATIVE DRAFT, supra note 58, § 1 20.
\item \textsuperscript{69} Id. § I 11. Disguised investments are attempts to present false capitalization. These investments are actually without substance. Usually, an investor borrows money from Bank A and deposits it in Bank B which then issues a certificate of capital deposit. Soon thereafter, the investor withdraws money from Bank B and returns it to Bank A.
\end{itemize}
the creation of the corporation. 70 Second, the Tentative Draft requires more of the corporate profit to be reserved to supplement the stated capital. 71

It is essential for practitioners creating a corporation to avoid a court's investigation. 72 Creating a corporation with only promoters and without shareholders (Hokki Setsuritsu), 73 or having several types of 'dangerous agreements,' such as investment in property, 74 requires a court to elect an inspector. 75 To avoid these investigations, most corporations are created as public placements (Boshu Setsuritsu) 76 by having some nominal shareholders and almost never taking the form of investment in property. The corporation may achieve the same effect by buying property from a promoter after the incorporation without prior contract. 77

The Tentative Draft, however, proposes to eliminate investigations by an inspector nominated by the court 78 where (1) only small amounts of investment in property are involved, and (2) a corporation contracts to buy small amounts of property from a promoter after the incorporation. 79 The current regulations have induced many fuzzy investments and attempts to evade the investigation rules.

2. Corporate Governance

A Japanese corporation has four indispensable organs: shareholder meetings; the board of directors; representative directors; and supervisors.

a. Shareholder Meetings

The most important functions of the shareholder meetings are electing directors and supervisors, 80 ratifying by majority vote 81 the dividend plan made by the board, 82 and deciding structural changes 83 by a two-thirds vote. 84 Dissenting shareholders have appraisal rights in certain structural changes. 85 Shareholders can decide other issues through the bylaws. 86

70. Id. § 112.
71. Id. § IV 13. Cf. SHÔHÔ § 290.
72. SHÔHÔ § 173.
73. Id. § 170.
74. Id. § 168.
75. Id. § 173.
76. Id. § 174.
77. Cf. id. § 168 l(5)(6). Shareholder ratification, however, with special voting requirements, is necessary when the corporation buys property for which the compensation is not less than 5% of the stated capital within two years of incorporation. Id. § 246.
78. Id. §§ 173, 168 l(5)(6).
79. TENTATIVE DRAFT, supra note 58, § I 4.
80. SHÔHÔ § 283.
81. Id. § 239.
82. Id. § 283.
83. E.g., id. § 245 (selling all corporate assets); id. § 342 (changing bylaws); id. § 404 (dissolution); id. § 408 (mergers).
84. Id. § 343.
85. Id. §§ 245-2, 349, 408-3.
86. Id. § 230-10.

SPRING 1992
b. Board of Directors

The board elects representative directors, makes important business decisions, ratifies financial statements made by representative directors, and decides on financing either by borrowing money, issuing bonds, or issuing new stocks. Particularly because of wide discretionary powers in issuing new stock and no preemptive right of shareholders, there is a risk of abuse by the board in using its authority to issue new stock to maintain its control. The Tentative Draft has a section that gives preemptive rights to all shareholders of the corporation whose bylaws restrict the transferability of stock.

c. Representative Directors

Representative directors, elected by the board of directors, represent the corporation and execute daily business.

d. Supervisors

Supervisors are elected at the shareholder meeting, and supervise the representative directors, particularly on accounting.

e. The Risk of Being a Director or a Supervisor

Being a director or a supervisor of a Japanese corporation is somewhat risky because of Commercial Code Section 266-3. This section was intended to make a director pay damages to third parties if the director did not use due diligence; it was not intended to modify the principle of limited liability of shareholders. However, it has become the Japanese version of piercing the corporate veil, since the controlling shareholder and the representative director are the same person in most closely held corporations. In addition to its role as the Japanese alternative to the doctrine of piercing the corporate veil, section 266-3 makes nonowner directors actual guarantors of the corporation.

---

87. Id. § 261.
88. Id. § 260 I.
89. Id. § 260 II.
90. Id. § 281.
91. Id. § 260 II(2).
92. Id. § 296.
93. Id. § 280-2.
95. Shōhō § 261.
96. Id. § 274.
97. Id. § 281 II.
98. See also id. § 280.
Moreover, the Tentative Draft tries to enlarge the personal liability of directors and managing shareholders. For example, a controlling shareholder otherwise protected from personal liability by the corporate form may be held personally liable when the stated capital of a corporation is below a certain amount. In that case, the controlling shareholder will be liable for any labor or tort debts of the corporation.

3. Corporate Finance and Dividend Policy

As mentioned above, corporate finance is a matter for the board, either by equity financing or debt financing.

a. Equity Financing

Because of the high appreciation of stock at the Tokyo Stock Exchange, equity financing through issuance of new stock by publicly held Japanese corporations has become common. Joint ventures, however, are mostly closely held corporations and have not benefitted from equity financing. Also, in a joint venture, every partner usually has veto power, or at least a preemptive right, on issuing new stock. Therefore, the only real possibility in a joint venture is reinvestment by the partners.

b. Debt Financing

In the United States, long-term debt financing is usually made by issuing bonds; bank loans are used for short-term financing. In Japan, however, a bank loan is also used for long-term financing. In the Japanese business world, borrowing money from a bank not only obtains financing, but also buys "insurance" in the so-called "main bank system." The main bank of the corporation will help the corporation in difficulty. By providing information to the main bank, the corporation can also obtain a cheaper bank loan.

Japanese corporations rarely issue straight bonds because of restrictions in the Commercial Code and the lack of an efficient bond market. Although many changeable bonds are issued, they should be included in equity financing.

Minshū 984; Misao Tatsuta, The Risks of Being an Ostensible Director under Japanese Law, 8 J. COMP. BUS. & CAP. MKT. L. 445 (1986).

101. Generally for kabushikigaisha, the legal minimum amount for stated capital (20 million yen) plus an additional amount of earned surplus to equal a total of 50 million yen. See supra note 58, 68 and accompanying text.

102. See also Tentative Draft, supra note 58, § III 14–16.

103. See supra notes 91–94 and accompanying text.


105. See infra note 124 and accompanying text.

106. Shōhō § 297.

SPRING 1992
c. Dividend Policy

Generally, accumulation of earnings is considered to be a way of financing. However, in Japan, as opposed to the United States, the final decision on what percentage of earnings are paid as dividends and what percentage is accumulated is made at the shareholder meeting, not by the board.\footnote{107}

Dividend policy is an area where conflicts of interest between partners frequently occur. Dividend policy is, at the same time, difficult to agree upon in contracts beforehand. Partners have no recourse but to balance their interests in the event of a conflict.\footnote{108}

B. Joint Venture Agreements and the Problem of Enforcement

The joint venture is a kind of closely held corporation because of the small number of stockholders and the consequent absence of a market for its stock.\footnote{109} In most countries, including Japan, the statutory corporate laws are best suited for publicly held corporations. When a closely held firm is incorporated, entrepreneurs naturally want to refashion the ready-made form created by the corporate statute into a custom-tailored form fitting the needs of the particular closely held corporation.

This demand is particularly strong in a joint venture. Each shareholder (partner) of a joint venture is an enterprise sophisticated in business. Even a minority shareholder almost always participates in managing the joint venture. Therefore, at a minimum, special agreements are needed among the participating partners to prevent the majority shareholding partner from monopolizing the board of directors. This modifies the principle of stock majority.\footnote{110} Minority partners also use their bargaining leverage to obtain veto power in important decisions.\footnote{111} Other areas needing modification of the ready-made form in creating a closely held corporation, particularly a joint venture, are the principle of free stock transferability and the independent legal personality of a corporation and its corollary, corporate perpetuity.

In closely held corporations, all shareholders know each other, and most of them participate in managing the corporation in some way. Ownership and management are not separate. These shareholders naturally want to exclude outsiders. Although stock is not typically freely transferred in a closely held corporation, the shareholders may want to place legal restrictions on transfers in order to avoid possible disputes.

\footnote{107. Id. § 283 l.}
\footnote{109. Id. at 68.}
\footnote{110. Id. at 69; UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION (UNIDO), MANUAL ON THE ESTABLISHMENT OF INDUSTRIAL JOINT-VENTURE AGREEMENTS IN DEVELOPING COUNTRIES ch. 3, § 1(4) (1971) [hereinafter UNIDO].}
\footnote{111. Id. ch. 3, § 1(7).}
The most critical problem in closely held corporations is the lack of a stock market. A minority shareholder has no way of liquidating its investment. This situation tends to lead to "squeeze out" activities by the majority shareholder. Most international joint ventures have agreements on dispute resolution, such as dissolution, buyouts, and arbitration. Such a dissolution or buyout agreement, however, may be against the principle of corporate perpetuity or the independent legal personality of a corporation.

The legal responses to the pressure to modify the legal model have differed in the United States and Japan. United States law allows internal relationships to be modified by shareholder agreement. In contrast, the Japanese tend to provide several legal alternatives among which a corporation must choose, resulting in greater restrictions on the modification of internal relationships by shareholder agreement. The problem of creating a joint venture corporation in Japan is that the enforcement of the private orderings is not secured.

1. **Modification of the Principle of Stock Majority**

In a joint venture, a dispute between majority shareholders and minority shareholders over the modification of the principle of majority shareholder control or an argument over instituting "proportional representation" is almost always a major issue. A typical joint venture agreement includes several types of "proportional representation." First, the allotment of directors in proportion to the shares held by each partner is discussed. Second, veto powers on important decisions are agreed upon. If there were no contractual agreement, a majority partner could decide nearly everything and a minority partner would have no say. In most joint venture agreements, minority partners establish their veto powers not only over fundamental changes, but also over other important business decisions such as the issuance of new shares, large loans, or entry into new markets. Third, how minority partners will specifically be involved in management, in particular which management positions a minority partner is eligible to fill, is a major point for negotiation.

The enforcement of a shareholder agreement modifying majority control differs between the United States and Japan. In the United States one is basically


113. UNIDO, *supra* note 110, ch. 8.


116. In Japan, the Commercial Code requires there to be a special majority vote (two-thirds of shares present at the meeting) for some important decisions like mergers or amending bylaws. In the United States, most state statutes require only a simple majority vote even on such fundamental changes as mergers.


free to modify the principle of stock majority by shareholder agreement, and several legally enforceable forms (for example, voting trusts, or using different classes of stock) are available. In Japan there is no guarantee of legal enforcement of agreements modifying the corporate governance model of the Commercial Code. This absence of guarantee may create substantial problems for foreign corporations desiring to create joint ventures in Japan.

2. Restrictions on Transferability of Stock

Restricting transferability of stock is an almost indispensable clause of a joint venture agreement. The United States and Japan differ on how to achieve this restriction.

The permissibility of shareholder agreements allows U.S. shareholders to restrain transferability of stock in several ways. These include: first refusal, prohibiting a shareholder from selling his stock to a third party unless he offers the same price to the corporation or other shareholders; first options, where the stock price has been determined by the agreement creating the option; consent restraints, prohibiting a shareholder from selling his stock to a third party unless he has obtained the consent of the board or the other shareholders; buyback rights, where corporations retain the option to repurchase their stock when the employment relationship terminates, even if the shareholder does not want to sell; and buy-sell arrangements, setting the shareholder obligation to sell his stock and the corporate or other shareholder obligation to buy it in case of death or retirement.

In Japan, in contrast, basically only one way to restrict stock transferability is provided for in Commercial Code section 204-2 and the sections following. Under those provisions, a corporation may adopt a bylaw restricting stock trans-

---

122. Swisher, supra note 114, at 178–81.
123. William L. Cary & Melvin A. Eisenberg, Cases and Material on Corporations 421 (6th ed. 1988); Robert C. Clark, Corporate Law 765 (1986). This scheme is considered the least restrictive and such provisions are widely upheld. Cary & Eisenberg, supra, at 422.
124. Cary & Eisenberg, supra note 123, at 421; Clark, supra note 123, at 765. This issue lies in the divergence between the option price and a fair price. Cary & Eisenberg, supra note 123, at 422.
125. Cary & Eisenberg, supra note 123, at 421; Clark, supra note 123, at 765. This scheme is considered to be the most restrictive. Although some statutes and some cases are more tolerant of consent restraints, their validity remains uncertain. Cary & Eisenberg, supra note 123, at 422.
126. Cary & Eisenberg, supra note 123, at 423; Clark, supra note 123, at 765.
127. Cary & Eisenberg, supra note 123, at 423; Clark, supra note 123, at 765.
Under such a bylaw, if the board of directors rejects a potential buyer of a shareholder's stock, the board must appoint its own buyer to negotiate with the selling shareholder. If negotiations fail, the shareholder may request judicial assistance in valuing the stock. Although it is also possible to arrange various stock transferability restrictions through shareholder agreements, the penalty for violation of such a contract is only compensatory damages from the contracting party. The stock transfer will not be rescinded. Thus, although many joint ventures in Japan use the same type of contracts on restricting transferability of stock as the American joint ventures, they may have an enforceability problem once a dispute occurs.

3. Dispute Resolutions

Joint ventures generally have no market for their stock, and shareholders (partners) cannot easily liquidate their investments. Once a shareholder dispute or deadlock occurs, fair resolution is difficult to obtain. Thus, joint ventures require methods for their resolution, such as buyout contracts, dissolution contracts, and arbitration contracts similar to those used in general closely held corporations.

Before examining the dispute resolution contracts, the statutory means for recoupment of investments for minority shareholders are outlined. In Japan, virtually the only opportunities for minority shareholders of closely held corporations to obtain judicial intervention for recouping their investments are executing the appraisal right in case of structural changes, such as mergers or change of bylaws to restrict stock transferability, or requesting the nomination of an alternative buyer of their stocks when the corporation has a bylaw restricting stock transfer. The Tentative Draft tries to create new legal means for recoupment of investments for minority shareholders. For example, in a kabushiki-gaisha that has restrictions on stock transfer, and in a yugengaiha, the Tentative Draft allows shareholders to require the corporation to elect a transferee of their stocks "when there has been extremely unfair treatment of some of the shareholders."

In a joint venture, several alternatives are available when planning dispute resolutions through contracts: asking a third party for binding arbitration, asking

---

128. Shōhō § 204 I.
129. Id. § 204-2.
130. Id. § 204-4.
131. 3 Shin Chūshaku Kaisha-hō [Corporate Law Annotated] 71 (Katsurō Ueyanagi) (new ed. 1986); Masahiro Maeda, Kēiyaku ni yoru Kabushiki no Jidoseigen [Restriction of Stock Transfer by Contracts] 121-1 Hōgakuronso 36 (1987); Swisher, supra note 114, at 172-73, 179-80.
132. See generally UNIDO, supra note 110, ch. 4; O'NEAL & THOMPSON, supra note 112, ch. 8.
133. Shōhō §§ 245-2, 369, 408.3.
134. Id. §§ 204-2 to 204-4.
135. Tentative Draft, supra note 58, § III 8, § VI 2a-c.
a swingman director to break the deadlock, or providing for the termination of
the joint venture relationship through some type of buyout. Although selling
the joint venture to a third party is another option, it is not suitable for a
contractual arrangement.

a. Arbitration

Incorporating an arbitration clause into a joint venture agreement is permis-
sible, even in Japan. The Japanese Code of Civil Procedure broadly permits
arbitration. Also advisable is making the joint venture corporation a party to
the arbitration agreement in the event the decision must be imposed on the joint
venture corporation. The arbitration clause is quite popular in Japanese joint
ventures.

b. Swingman Directors

The swingman director arranges to have a neutral director from the beginning
to avoid a deadlock in a fifty-fifty joint venture. Japanese corporate law does
not prohibit swingman directors in a joint venture corporation. Many in Japanese
management, however, consider the scheme too risky, thereby making it rare.

c. Buyouts

Two alternatives are available for contractually arranging for a partner to buy
the stock of another: agreements in a set with a restriction on stock transferabil-
ity, and agreements without such a restriction. Because the restraint on free
stock transferability significantly modifies an important principle of corporate
law, agreements restricting the transferability of stock are required to have some
means for recoupment of investments.

As already mentioned, the contractual restriction on stock transferability may
be difficult to enforce in Japan. Nevertheless, American-type agreements, such
as first refusal or first option, are used quite often in Japanese joint ventures.

A typical buyout arrangement without a restriction on stock transferability is
the buy-and-sell agreement. It can be used in a joint venture with only two
partners, particularly in a fifty-fifty joint venture. The agreement is that if a
partner makes a bid to sell stock at a certain price to another partner, the other
partner must either buy the stock with the bid price or sell his own stock at the

137. CODE OF CIVIL PROCEDURE § 786 (Japan).
138. Swisher, supra note 114, at 178.
139. Swisher argues:
    Arbitration of intracorporate disputes has had a painful history in the United States, and cannot yet be considered
    a reliable remedy, due largely to judicial reluctance to apply it to this field and to often-restrictive arbitration
    statutes. On the other hand, in Japan, with its stronger tradition of nonlitigious settlements of disputes of all sorts,
    the use of an effective arbitration clause seems quite practicable.
    Id. at 177–78.
140. Note, Joint Venture Corporation: Drafting the Corporate Papers, 78 HARV. L. REV. 393, 423
    (1964).
141. SHISHIDO & KUSANO, supra note 31, at 159.
142. See generally CLARK, supra note 123, at 767.
same price to the bidder. Such an arrangement is also called a "Russian roulette" agreement. Although the buy-and-sell agreement has no valuation problem, it is not popular in Japanese joint ventures because of its riskiness. It may also be difficult to enforce.

d. Dissolution

The most drastic dispute resolution is an agreement to dissolve the joint venture corporation in case of certain events or at the will of one of the partners. Although the dissolution agreement is often used in American closely held corporations, it is seldom used in Japan because of the risk involved.

e. Japanese Reluctance to Have a Divorce Clause

Most Japanese joint ventures currently have the same type of joint venture agreements as those of general international joint ventures, developed by American lawyers. Many Japanese managers, however, dislike such complicated contracts and are particularly reluctant to include dispute resolution clauses, or so-called "divorce clauses." Harmony is particularly emphasized, even in business, in Japan, and mutual trust gained through daily action is highly valued. It is incongruous for the Japanese to prepare divorce clauses at the moment when they begin the business partnership. For example, in the Fremont, California Toyota-General Motors (GM) joint venture, Toyota management rejected the GM lawyer's divorce clause proposal, leaving it out of the contract.

IV. Conclusion

Today, Japan has almost no statutory or governmental restriction on foreign direct investment. This openness does not mean, however, that it is easy for a foreign company to enter into the Japanese market. As is pointed out in the United States-Japan trade negotiations (the so-called "Structural Impediment Initiatives"), Japanese product markets between corporations, particularly the distribution networks, are closed against newcomers (even when they are Japanese companies). Most transactions between corporations are not spot transactions, but are executed within the framework of long-term relationships.

143. O'Neal & Thompson, supra note 109, § 8.04.
145. Shishido & Kusano, supra note 30, at 141.
147. Although long-term relationships create entrance barriers for newcomers, it does not necessarily mean there is no competition. See Motoshige Ito, Kigyōkankankei to Keizōkutekitorihi [Relationship Among Enterprises and Long-Term Transactions], in Nihon No Kigyō [ENTERPRISES IN JAPAN] 109, 121 (Kenichi Imai & Rūtarō Komiya eds., 1989).
The joint venture form is neither forced by the law nor recommended by informal governmental guidance. Nevertheless, when a foreign company decides to make a direct investment in Japan it would be well advised to find Japanese partners since they can provide the necessary easy access to long-term relationships and the know-how to do business in Japan. Empirical data shows that, generally speaking, foreign companies eager to learn the Japanese way of business and willing to modify their business habits accordingly are successful in Japan, while those companies that are rigid and try to force their way into the Japanese market are not.

Of course, just as with the joint venture in general, the successful joint venture in Japan needs some give and take among the partners. Each partner must have its bargaining leverage and maintain it throughout the joint venture relationship. Familiarity with the Japanese business system, essential to successful business investment in Japan, may provide the Japanese partners their bargaining leverage. At the same time, foreign companies can exert leverage through the possession of technologies or brand names appealing to Japanese investors. For foreign companies in this situation, the joint venture form may be recommended, particularly in the case of their first entry in Japanese markets.

Foreign business investors in Japan also should be aware that the Japanese concept of a contract is different from that of western countries, particularly the United States. Japanese business people consider mutual trust between the trading partners, which can only be developed by a long-term relationship, most important. Legal contracts are usually considered as suppletory, and complicated, long contracts may even be considered harmful. Therefore, foreign partners may expect some resistance by Japanese partners against the joint venture agreements the foreign partners prepare.

Even after the parties enter joint venture agreements, courts are reluctant to grant specific enforcement when the agreements modify the Commercial Code. In addition, foreign partners must be cognizant of the differences between Japanese and American corporation law.