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Bank Executives on Japanese Corporate Boards

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This paper adds to the growing empirical literature on the role of banks in corporate monitoring and governance in Japan by analyzing the role of bank executives on Japanese corporate boards. Japanese corporate boards comprise the top executive officers of the corporation and the majority of directors are internally promoted managerial employees. However, data is assembled showing that new entrants to the board, or outside directors as defined in this paper, come mainly from firms and banks with leading equity and lending positions in the firm. A probit model of whether a firm has bank executives on its board or not is estimated for all first-section listed firms. It is found that firms are more likely to have bank executives on their board the more they rely on bank borrowings, the larger the loan share of the top lender, and the greater the discrepancy in loan shares among top lenders, and less likely when there is a dominant shareholder, when there is residual family control over management, and the larger, older, and more profitable they are. Overall the results provide support for the thesis that the movement of executives from banks to corporate boards is an integral aspect of the operation of the secondary top executive managerial labor market in Japan and closely related to the role of banks in capital market oversight and governance.

I. Introduction

Recently, there has been increased academic and policy interest in the role of large banks and other intermediaries in capital market monitoring and corporate governance. Traditionally economists saw the takeover mechanism as exerting both ex ante and, when that failed, ex post discipline on management teams.[1] Takeovers were seen as an important part of the "market for corporate control", the stock market-based arena in which actors competed for the rights to manage corporate resources. Recently, it has been realized that various mechanisms exist for coping with the agency and control problems

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[1] *See* Manne (1965) for an early statement and Jensen and Ruback (1983) for elaboration.

associated with the pursuit of economies through the modern corporate form. A focus of increasing interest has been the role played by "incumbent" agents of corporate control who take up or occupy strategic prior positions in the firm (large shareholders,banks, boards) as opposed to "new entrants" (corporate raiders, takeover agents, green-mailers) who react to arbitrage opportunities created by decentralized activity in the stock market.[2]

The role played by "main banks" in the corporate governance of large Japanese firms exemplifies this point. Although an Anglo-American form of takeover mechanism hardly operates in Japan, monitoring and governance activities are carried out by large banks who maintain significant equity and loan positions in client firms. This is particularly so in financial distress when intervention by the main bank seems to closely approximate the disciplinary and allocative functions attributed to the takeover and bankruptcy mechanisms.[3] Attention has focused on the role of the main bank as a kind of "delegated monitor" for the capital market as a whole, and the fact that the whole system of corporate governance is buttressed by extensive share interlocks among coalitions of inside "stable shareholders"(*antei kabunushi*).[4]

It is well known that banks also supply executives to the boards of client firms. This occurs most visibly in extraordinary times when the bank launches a rescue-cum-reorganization operation in a distressed firm, but banks also frequently supply mid- and late-career executives to client firms in the normal course of events. Such bank executive placements are usually seen as one important element of the close bank-firm links thought to characterize Japanese corporate organization, and are not limited to cases of poor performers.[5]

Until recently, however, there has been little systematic investigation of the role of bank executive placements on Japanese corporate boards and its relation to other aspects of bank-firm ties. Recent studies by Kaplan and Minton (1994), Morck and Nakamura (1992), Lincoln, Gerlach, and Takahashi (1992) and Lincoln, Gerlach, and Ahmadjian (1993) start to redress this gap in the literature (*see* also Taki,1992). This paper adds to the growing empirical literature on the determinants of bank executives serving on Japanese corporate boards.

The main motivation for the paper is to examine whether director ties are systematically related to variables that proxy for the role of banks in corporate monitoring and governance. It is sometimes suggested by the banks themselves, perhaps eager to avoid

[2]*See* for example Coffee (1991), Gilson (1990), Morck, Shleifer, and Vishny (1989), and Stiglitz (1985).

[3]*See* for example Sheard (1989, 1994c) and for careful empirical studies Kaplan (1994), Kaplan and Minton (1994), and Morck and Nakamura (1992).

[4]*See* for instance Aoki, Patrick, and Sheard (1994), Prowse (1990), Sheard (1994a, 1994b).

[5]For instance, the influential publication *Keiretsu no Kenkyu* uses director placements alongside equity, lending, and historical ties to classify listed firms into various affiliated groups (Keizai Chosa Kyokai, various issues).

the charge that they attempt to exercise influence over independent corporations, that bank "director despatches" (*yakuin haken*) are inconsequential. It is of interest to know, however, whether bank executive placements are integral to the role of banks in capital market monitoring and corporate governance, or whether they are unrelated to those presumed roles. This has relevance for the ongoing policy debate in Japan relating to perceived weaknesses in capital market oversight of corporate managers; it is also relevant to similar debates in the U.S. and elsewhere, as the Japanese system of corporate governance is increasingly cited as a benchmark of comparison, if not a model to be emulated.[6]

The analysis is complementary to recent papers by Kaplan and Minton (1994) and Morck and Nakamura (1992), but differs in a number of ways. The latter studies investigate the determinants of new bank appointments to corporate boards. Kaplan and Minton use a sample of the largest (by sales) 119 publicly traded industrial firms for 1980-88, and find that the likelihood of a new bank appointment to the board is negatively related to stock performance and low earnings and positively related to the borrowings-to-asset ratio and the largest lender's loan share. They also find that corporate appointments are strongly related to share ownership, and that outside appointments coincide with abnormally high executive turnover. Morck and Nakamura use a sample of the largest 383 manufacturing firms for 1981-87, and find that the likelihood of bank intervention is negatively related to various measures of firm performance and positively related to loan exposure. They also find that accounting performance improves following bank intervention. Both studies report results that are consistent with the view that bank and intercorporate relations substitute for the absence of a more active external market for corporate control in Japan (Sheard, 1989).

This study treats firms having one or more bank directors as being qualitatively different from firms which do not have bank executives on their boards. Rather than focus on new placements per se, the presence of a former (or in some cases concurrently-serving) bank executive on the board is viewed as a characteristic of the firm. This cross-sectional approach is taken in order to investigate a wider set of determinants of bank executive presence and to do so over a larger sample, namely all non-financial firms listed on the first section of the Tokyo and Osaka stock exchanges (up to 949 firms).[7] Of course, the stock and flow approaches are closely related: in order for a firm to have a bank director there must have been an entry event in the past. However there are some important differences. A flow approach, as in Kaplan and Minton and Morck and Nakamura, seems to be suited to investigating the bank intervention hypothesis—the ex post monitoring role of banks in Aoki, Patrick, and Sheard's (1994) terms—but in the

[6]*See*, for instance, Aoki and Patrick (1994), Coffee (1991), Gilson and Roe (1993), Grundfest (1990), and Roe (1993).

[7]A data set of 1064 first-section listed firms was compiled (1149 for some variables) but in the regressions reported the sample varies from 678 to 949, due to data unavailability for certain variables and observations.

case of zero observations (no new placement) it does not distinguish between firms that already have a bank executive and those that do not. The cross-sectional approach does and so seems better suited to asking questions about why some firms have bank executives on their boards and others do not, an inquiry that extends to consideration of the ex ante and interim monitoring roles of banks as well.

A further innovation of this paper is to take into account a key governance aspect of firms that has tended to be overlooked in the literature, namely whether an inside owner figure is present or not. An entrepreneurial owner-manager figure is present in many large firms in Japan. In the sample of 1064 first-section listed firms, it was possible to identify the presence of an inside owner in 36% of cases. This does not mean that a single family figure runs the firm and controls its decision-making. In some cases, the inside owner may be quite marginal in the firm's corporate decision-making and control. However, it was found that in 25% of cases the president was an inside owner and in 16% of cases the chairman was. Moreover, in 12% of cases the top shareholder was an inside owner.

Rather than explicitly consider inside-owner controlled firms, the literature has tended to focus on alleged differences in financial structure by focusing on the, perhaps overdrawn, "group-affiliated" versus "independent firm" dichotomy, where the definitions follow the Keizai Chosa Kyokai listings or some variant thereof.[8] One problem with this approach is that it is not clear what economic behavior the "independents" category is capturing; this is because this category is not generated directly from any set of first principles but rather it falls out as a residual category, namely those firms not found to belong to a particular group.[9] From a theory of the firm or corporate governance viewpoint, one important economic characteristic suggestive of an "independent firm" is the presence of an inside owner (absence implying a more complete separation of ownership and control). Rather than rely on an indirect residual category, it would be desirable to obtain a direct measure of inside family ownership or control. An innovation in this paper then is to measure this dimension of independence directly and control for its effects.

The rest of the paper is organized as follows. Section II presents some data on Japanese corporate boards and the place of outside directors on them, focusing in particular on directors that have entered from banks. Section III describes a probit regression analysis of the determinants of bank executives being present on Japanese corporate boards, and explains the variables used and why they are included (further details are in the appendix). Sections IV and V present the empirical results of the study. Section VI contains a concluding discussion.

[8]Starting with Nakatani (1984), there is now an extensive line of studies in this vein, including Hoshi, Kashyap, and Scharfstein (1990, 1991), Lawrence (1991), Prowse (1992), and Weinstein and Yafeh (1992).

[9]In fact, the Keizai Chosa Kyokai publication defines these firms as "affiliation unknown" (*fumei*), rather than as "independent" which carries a somewhat different and stronger connotation.

II. Composition of Japanese Corporate Boards

Board members in Japan are the top executive officers of the corporation, and in most cases work full-time for the firm. They fall into two categories as regards their background: directors who have worked for the firm for a long period, in many cases since entering the workforce as graduates, and have been promoted up through the ranks, and directors who have entered from outside the firm in mid- or late-career either directly as directors with executive duties or in senior management positions with a view to being promoted to the board in due course. It is convenient to term the former "inside directors" and the latter "outside directors", although this usage differs somewhat from that in the U.S. literature where an outside director refers to a part-time director, typically having multiple board memberships, who is not an officer of the firm (Black, 1992, p. 841). In this paper, "outside" refers to the background of the director, rather

Table 1
Composition of Boards of Directors of Listed Japanese Firms by Position and Background, 1991

POSITION	BACKGROUND OF BOARD MEMBER				
	Inside firm	Outside firm			
		Bank[1]	Other firm[2]	Government[3]	Total
Chairman[4]	678	68	296	61	1103
	(61.5)	(6.2)	(26.8)	(5.5)	(100.0)
President	1328	131	561	66	2086
	(63.7)	(6.3)	(26.9)	(3.2)	(100.0)
Vice-president	1010	122	215	77	1424
	(70.9)	(8.6)	(15.1)	(5.4)	(100.0)
Executive director (*Senmu*)	2651	285	490	141	3567
	(74.3)	(8.0)	(13.4)	(4.0)	(100.0)
Managing director (*Jomu*)	5843	434	1013	271	7561
	(77.3)	(5.7)	(13.7)	(3.4)	(100.0)
Director[5]	14368	555	2656	265	17844
	(80.5)	(3.1)	(14.9)	(1.5)	(100.0)
Auditor	3936	500	1312	149	5897
	(66.7)	(8.5)	(22.2)	(2.6)	(100.0)
Total	29814	2095	6543	1030	39482
	(75.5)	(5.3)	(16.6)	(2.6)	(100.0)

Notes: 1. city, long-term credit, trust, and regional banks
2. including insurance companies, other financial institutions, and miscellaneous categories
3. government ministries and agencies
4. including 87 vice-chairmen
5. including 325 director-advisors

Source: Toyo Keizai Shinposha (1991), *Kigyo keiretsu soran* [Corporate affiliations annual], Tokyo, Toyo Keizai Shinposha, p.90.

than his/her current status..Most outside directors are full-time managers of the firm who no longer have a formal employment relationship with the firm or bank that arranged their entry to the firm. Even though they are no longer employed by the original firm, relocating executives may still have retirement benefits vested with the firm, and under the Japanese "lifetime" employment system can be expected to continue to identify strongly with the interests of the source firm. In the sample used for data analysis, of the 2095 bank executives identified as being corporate board members, 1905 were full-time corporate directors; only 190 (9.1%) held part-time appointments, and most of these (84%) were in the "junior" director and auditor positions.

Table 1 provides information on the composition of corporate boards in Japan broken down by position and inside/outside director status. In 1991,the 2086 firms listed on Japanese stock exchanges had a total of 39,482 directors, an average of 18.9 per firm. Three quarters (75.5%) of all directors were inside directors and one quarter (24.5%) outside directors who entered firms from banks (5.3% of all directors), other firms (16.6%), and government ministries and agencies (2.6%).

Table 2 provides information on the kinds of positions that outside directors occupy. Japanese boards typically comprise a rank hierarchy of positions: statutory auditor (*kansayaku*), director (*torishimariyaku*), managing director (*jomu*), executive director (*senmu*), vice-president (*fuku-shacho*), president (*shacho*), and chairman (*kaicho*), with the president being the chief executive. The auditor is not a director as such but an officer charged with oversight of the discharge of duties by the directors. In most cases (95% according to one comprehensive survey) the auditor attends meetings of directors (Tokyo Bengoshikai Kaishahobu, 1986, p. 28), and in about half of cases receives regular reports from directors (Shoji Homu Kenkyukai, 1989, p. 48). In most cases (81% of the total) the

Table 2
Indexes of Distribution of Board Positions by Background Status[1]

Position	Outside/ total	Outside/ inside	Bank/ total	Bank/ insider	Bank/ other firm
Chairman	1.57	1.94	1.14	1.43	0.71
President	1.49	1.77	1.19	1.41	0.73
Vice-president	1.19	1.27	1.61	1.72	1.76
Executive director	1.06	1.07	1.51	1.53	1.81
Managing director	0.93	0.91	1.06	1.06	1.33
Director	0.80	0.75	0.59	0.55	0.27
Auditor	1.37	1.53	1.60	1.81	1.18

Note: 1. Each index is constructed as the ratio of the respective category's fraction of directors in that position.

Source: Compiled from Table 1.

auditor is an internally promoted employee of the corporation, most commonly having been a director (28% of such cases) or a departmental or section chief (28%); the most common source of auditors entering from outside the firm is financial institutions (38% of such cases) and parent firms (20%) (Shoji Homu Kenkyukai, 1989, pp. 31-35).

Outside directors compared to inside directors are relatively more concentrated in senior management positions of vice-president and above and as auditors (Table 2). Bank directors compared to inside directors are proportionately more concentrated in senior management positions particularly executive director and vice-president and as auditors. Relative to outside directors from other firms, bank directors are proportionately more concentrated in senior management positions below president, particularly executive director and vice-president. Bank directors are most under-represented in the most common (45% of board positions) ordinary director position.

Table 3 shows the distribution of bank-firm director ties by major bank both on a stock and flow (new supply) basis. In 1992 about 4% of total listed firm directors were former (or current) executives of the twelve major banks shown. In that year, there were 185 instances of bank executives becoming directors or auditors of listed firms. In most cases (93%), this involved the executive leaving employment with the bank and entering the firm as a full-time executive; in 7% of the cases the executive held part-time appointments jointly with their bank position. Allowing for some overlap, this represents an upper limit of 10% as the proportion of listed firms that received a new bank executive in that year. While there is some variation, the ten years' series of data shows a fairly stable pattern of bank executives leaving the banks in late career to take up director or auditor positions in listed firms. During the ten years from 1983, on average there were 166 instances per year of bank executives becoming directors or auditors of listed firms, and the proportion of total directors accounted for by executives from these twelve banks remained fairly stable at around 4.5%.

It is worth noting that the flow of executives is almost entirely from banks to corporate clients, there being almost no flow in the reverse direction. The twelve major banks shown in Table 3 had a total of 538 directors in 1991, of which all but 18 were internally promoted "inside directors". Most of these (12) came from the Bank of Japan or the Ministry of Finance; four were from other financial institutions. Tokai Bank was the only bank to have outside directors from non-financial corporations, having two such part-time directors (one being from Toyota, the bank's top shareholder) (Toyo Keizai Shinposha, 1991, pp. 591-594).

Table 4 presents the results of an analysis of the relationship between the presence of directors from outside the firm and ownership and financing ties between the firm and the source of outside directors. Specifically, for each listed firm, outside sources of directors were identified, and the total shareholding in the firm and total share of loans to the firm of those source firms were computed. The analysis shows that, although outside directors form a minority of directors overall (albeit a substantial one), most firms have outside

Table 3

Stock and Flow of Bank Executives on Boards of Listed Japanese Firms: Major Banks, 1983-92[1]

Name of bank	Year 1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
DKB	187	177	183	187	195	204	202	229	239	236
	28	15	n.a.	13	12	15	27	24	31	26
Mitsubishi	156	151	169	172	165	170	171	181	178	183
	22	13	n.a.	13	23	23	17	20	20	15
Fuji	143	146	144	152	161	168	175	173	176	183
	18	17	n.a.	11	21	16	15	14	18	17
Sakura[2]	142	132	141	153	150	153	150	165	182	181
	16	6	n.a.	11	21	12	16	20	27	22
Sanwa	114	109	132	133	130	142	153	168	171	177
	15	5	n.a.	10	20	13	23	19	21	16
Sumitomo	133	130	141	152	148	161	167	188	178	170
	14	8	n.a.	18	13	18	16	26	23	15
IBJ	171	162	151	156	149	143	141	138	149	143
	18	8	n.a.	16	13	13	18	11	25	6
Tokai	94	93	100	101	94	117	126	137	144	142
	n.a.	7	n.a.	8	n.a.	14	20	13	18	13
Asahi[3]	79	79	76	82	77	80	81	82	77	81
	n.a.	11	n.a.	n.a.	n.a.	n.a.	5	13	8	14
Daiwa	70	63	68	69	65	67	71	71	75	80
	9	2	n.a.	n.a.	n.a.	n.a.	4	9	9	11
LTCB	45	44	51	53	51	56	62	76	76	78
	9	4	n.a.	8	n.a.	n.a.	13	11	7	23
Tokyo	50	56	53	55	58	61	60	60	56	55
	7	12	n.a.	n.a.	n.a.	9	9	5	6	7
Total (as % of all directors)	1384 (4.6)	1342 (4.4)	1409 (4.5)	1465 (4.6)	1443 (4.4)	1522 (4.5)	1559 (4.3)	1668 (4.4)	1701 (4.3)	1709 (4.3)
(as % of all listed firms)[4]	156 (8.8)	108 (6.0)	n.a. (n.a.)	108 (5.9)	123 (6.5)	133 (6.9)	183 (9.2)	185 (9.1)	213 (10.2)	185 (10.1)

Notes: 1. Upper row: total number of former or current executives of bank on a listed firm's board as of July of that year
Lower row: number of executives of bank who became director or auditor of a listed firm during that year
2. formerly Mitsui Taiyo-Kobe Bank; pre-merger series combined
3. formerly Kyowa-Saitama Bank; pre-merger series combined
4. because some firms receive more than one director this is an upper bound on the proportion of listed firms that received a bank executive onto their board in that year

n.a.: not available

Source: Compiled from Toyo Keizai Shinposha (various issues), *Kigyo Keiretsu Soran* [Corporate affiliations annual], Tokyo, Toyo Keizai Shinposha.

Table 4

Distribution of Listed Firms in Japan According to Total Shareholdings and Total Loan Shares in Firm of Firms Identified as Being Outside Source of Full or Part-time Directors, 1991

Total shareholding of source firm(s) (%)	Total loan share of source firm(s) (%)											No outside directors	Row total	Cumulative percentage total
	90< ≤100	80< ≤90	70< ≤80	60< ≤70	50< ≤60	40< ≤50	30< ≤40	20< ≤30	10< ≤20	0< ≤10	0			
70< ≤80	1	0	0	0	0	0	0	0	0	0	3		4	0.2
60< ≤70	0	0	2	1	0	1	1	0	2	1	36		44	2.5
50< ≤60	1	1	2	0	6	9	8	7	8	2	100		144	9.8
40< ≤50	0	0	2	0	3	3	13	12	11	1	100		145	17.2
30< ≤40	1	1	2	4	5	6	12	15	6	7	88		147	24.8
20< ≤30	3	0	2	1	4	14	18	27	28	7	108		212	35.6
10< ≤20	3	2	9	11	24	22	44	55	39	10	100		319	51.9
5< ≤10	1	2	2	5	20	20	24	35	17	23	64		213	62.8
0< ≤5	2	4	2	5	15	24	51	77	66	16	104		366	81.5
0	0	0	0	0	0	0	1	1	0	4	192		198	91.7
No outside directors												163	163	100.0
Column total	12	10	23	27	77	99	172	229	177	71	895	163	1955	
Cumulative percentage total	0.6	1.1	2.3	3.7	7.6	12.7	21.5	33.1	42.2	45.9	91.7	100.0		

Source: Compiled from Toyo Keizai Shinposha (1991), *Kigyo Keiretsu Soran* [Corporate affiliations annual], Tokyo, Toyo Keizai Shinposha, pp.102-590.

directors on their board and these outside directors come predominantly from firms with leading financial ties to the firm.

Table 4 shows that 92% of all listed firms have one or more outside director; only 163 or 8% of listed firms have boards comprised only of insiders. Moreover outside directors come mainly from leading shareholders and lenders. In only 192 (8.9%) of the 1792 cases where outside directors were present did the director connection appear unrelated to financial ties, in the sense that one or more of the source firms did not appear as a top 20 shareholder or principal lender to the firm. For 25% of all firms, firms supplying outside directors held more than 30% of the firm's shares; for 52% of firms, source firms held more than 10% of shares. On the lending side, for 21% of all firms, source firms (principally banks) supplied more than 30% of loans; for 42% of firms, source firms supplied more than 10% of loans.

Close to half (46%) of all listed firms had outside directors from firms (mainly banks) that held shares in the firm (as a top 20 shareholder) and were listed as a principal supplier of loans. For 23% of listed firms, firms supplying outsider directors held in total more than 10% of shares and supplied more than 10% of loans. These data strongly suggest that the flow of senior executives between firms in Japan is closely associated with ownership and financing ties, a pattern that would not be expected if late entries to senior management occurred in the context of an open competitive external managerial labor market.

Table 5 presents the results of an analysis of the financial links that banks maintain with the firms to which they supply directors. Specifically, for every listed firm director identified as being a former (or current) bank executive, it was checked whether the bank held shares in and/or supplied loans to that firm. Table 5 provides strong evidence that the flow of executives from banks to corporate boards occurs between banks and firms that have close financial and shareholding ties.

As of the end of the 1990 financial year, 1320 cases of former (or current) executives serving on listed firm boards could be identified. In 87% of cases, the bank was listed as a principal lender to the firm; in 8% of cases the firm had no borrowings and in only 5% of cases did the firm have borrowings but not from the source bank. In 57% of cases the bank had the largest loan share and in 79% of cases it was one of the top three lenders. In 10% of cases the bank was the number one shareholder and in 56% it was the number one shareholder among banks; in 50% of cases the bank was one of the top three shareholders and in 86% of cases it was one of the top three shareholders among banks.

In 88% of cases, the bank was either a top three lender or top five shareholder, and in 65% of cases it was both a top three lender and a top five shareholder. In only 32 or 2% of cases was the bank neither a top 20 shareholder nor lender to the firm.

The above analysis provides a general picture of bank-firm ties through the supply of executives to corporate boards. The data confirm two things in particular: banks supply executives to corporate boards on an extensive scale, and the flow of executives is far

Table 5

Distribution of Bank Executives on Boards According to Bank's Shareholding and Loan Share Rank for All Listed Firms in Japan,1991

Shareholding rank (top) / Among banks (bottom)	Loan share rank in firm of bank having executive on firm's board												Firm has no borrowings	Row total	Cumulative percentage total
	1	2	3	4	5	6	7	8	9	10	lower than 10	no loans to firm			
1	81 535	11 80	6 26	3 14	2 8	– 4	1 1	– –	– –	– –	– –	2 18	3 55	109 741	9.8 56.1
2	181 158	39 71	12 25	4 5	2 4	2 4	1 1	– –	– –	– –	1 1	5 10	22 21	269 300	28.6 78.9
3	185 31	36 25	15 10	7 9	2 2	4 2	– –	– –	– –	– –	– 1	8 9	28 9	285 98	50.2 86.3
4	147 15	38 5	10 17	5 5	1 4	1 1	1 1	– –	– 1	– –	– –	9 –	14 6	226 55	67.4 90.5
5	68 2	19 4	8 8	2 3	3 2	1 3	– –	– 1	– 3	– –	1 –	10 2	9 1	121 29	76.6 92.7
6	41 3	16 3	7 2	5 2	2 –	2 1	– –	– –	– –	– –	– 2	3 1	7 2	83 16	82.9 93.9
7	12 1	9 1	13 3	4 2	2 –	– –	– –	– 1	– –	– 1	– –	– 1	5 3	45 13	86.2 94.8
8	8 1	8 –	5 –	3 –	– –	1 –	– –	– –	– –	– –	1 1	1 –	1 –	28 2	88.3 95.0
9	9 –	5 –	2 1	2 –	3 1	2 1	– –	– –	1 –	– –	2 1	– –	3 –	29 4	90.5 95.3
10	5 1	– –	7 –	2 –	1 –	1 –	– –	1 –	– –	– –	1 –	1 –	– –	19 1	92.0 95.4
11-20	10 –	8 –	7 –	3 –	3 –	2 –	– –	1 –	3 –	1 –	– –	2 –	6 1	46 1	95.5 95.5
not listed in top 20[1]	4 4	4 4	1 1	4 4	1 1	4 4	2 2	– –	1 1	3 3	4 4	27 27	5 5	60 60	100.0 100.0
Column total	751 751	193 193	93 93	44 44	22 22	20 20	5 5	2 2	5 5	4 4	10 10	68 68	103 103	1320 1320	
Cumulative percentage total	56.9 56.9	71.6 71.6	78.6 78.6	81.9 81.9	83.6 83.6	85.1 85.1	85.5 85.5	85.6 85.6	86.0 86.0	86.3 86.3	87.1 87.1	92.2 92.2	100.0 100.0		

Note: 1. In some cases top ten shareholders.

Source: Compiled from Toyo Keizai Shinposha (1991), *Kigyo Keiretsu Soran* [Corporate affiliations annual], Tokyo, Toyo Keizai shinposha, pp.102-590.

from random, as might be expected were it purely a manifestation of final (from the bank's point of view) employment separation and arms-length re-hiring in the competitive managerial labor market, but rather occurs between banks and firms with close financial (equity and loan) ties.

The literature on corporate governance has argued that managers in Japan are relatively autonomous, given that most promotions are made from an internal pool of managers and the external takeover mechanism is not active. It has also been argued that a form of insider corporate governance system, latent in normal times but triggered particularly by worsening corporate performance, works to check and discipline managerial excesses.[10] The data on outside directors presented here is strongly consistent with this characterization as it shows institutional owners and financiers of firms to be substantially "represented" on corporate boards.

III. Determinants of Bank Executives Serving on Corporate Boards

Two broad economic hypotheses concerning bank executives on corporate boards can be identified. One hypothesis focuses on the managerial labor market in Japan, the other on monitoring and corporate governance. The managerial labor market hypothesis would view bank executive placements as reflecting the operation of the mid- to late-career managerial labor market in Japan. The major banks are among the most prestigious of corporate employers in Japan. Competition among graduates for entry to these banks is intense, and so is competition for promotion to senior management positions in the banks. Managers who by their late-forties to early-fifties are not likely to reach the board of the bank, or having reached lower director levels are not likely to reach much higher, are liable to have their employment terminated with the bank, but be assisted by the bank to find reemployment with the bank's corporate customers. Firms for their part may value the human resources that the bank executive embodies, particularly specialist financial or banking expertise. The movement of a bank executive into the board of a corporation then represents a labor market "match".

The monitoring hypothesis would argue that banks and firms use director placements to maintain ties, specifically that director placements facilitate information gathering and monitoring by the bank (or voluntary disclosure by the firm) or the bank's role in corporate governance, notably intervention in financial distress (from the firm's viewpoint, particularly the managers and employees not disadvantaged by the bank's intervention, accepting a trouble-shooter can be viewed as facilitating a "rescue operation").

While it is useful conceptually to distinguish these two hypotheses, it is important to

[10]For this line of argument, *see* Aoki (1989), Aoki, Patrick, and Sheard (1994), Kaplan (1994), Kaplan and Minton (1994), Lincoln, Gerlach, and Ahmadjian (1993), and Sheard (1994b, 1994c).

note that the two hypotheses are not competing ones, rather that the mechanisms involved may be quite complementary. It may be that bank director placements reflect both the operation of the top executive managerial labor market (and the bank's own incentive system) as well as facilitating the bank's role in monitoring and corporate governance. When a bank places one of its executives with a client firm, it may be "killing three birds with one stone", namely implementing a separation as part of its own internal incentive and promotion system (relieving itself of one of its lifetime employees and creating a vacancy in its hierarchy which can be used to induce the next round of internal competition), supplying human resources to a firm that values them, and facilitating its information links with that firm.

Bankers may perceive the third point more in terms of maximizing their commercial advantage vis-a-vis the firm. Having a former colleague in the firm may make it easier for executives in the bank to do financial business with the firm. This is true, but it may be that what economists label "monitoring" is itself an information-intensive activity that is highly complementary to, and almost an integral part of, what bank executives would perceive of as their "normal commercial activities". For example, Aoki, Patrick, and Sheard (1994) identify the fact that the main bank operates a large part of the settlement accounts of its client firms as being an important aspect of the day-to-day monitoring of cash-flow, allowing, for example, the bank to detect deteriorating performance and emerging financial difficulties ahead of time. Bankers are more likely to perceive this as part of a strategy to maximize their commercial advantage in selling a range of banking services to the firm. But the two are complementary: the information about cash flows that the bank acquires and uses to position itself favorably in its commercial dealings is also information that can be used to monitor the firm's financial position and assess the level of its own risk exposure.

The fact that the labor market and informational effects are complementary makes it difficult to distinguish them empirically, particularly at the level of firm data as in the analysis here. However, it is possible to test a limiting form of the labor market hypothesis, namely that the movement of bank executives into firms reflects labor market matches that are unrelated to, or at least not driven by, bank-firm relational considerations. Under this hypothesis, we should not find strong effects on variables that most strongly proxy bank-firm relations, such as financial dependency variables.

A description of the variables, and the justification for including them, follows.

DEPENDENT VARIABLE

Whether a bank executive is present on a firm's board or not is a zero-one event. The dependent variable in the probit regression is 1 if the firm has a bank executive on its board in a particular capacity at the end of the 1991 financial year and 0 otherwise.[11]

[11]This formulation assumes that there is a qualitative difference between having and not having bank presence on the board, and is in line with the notion that monitoring involves lumpiness or indivisibilities:

Three models are estimated corresponding to different definitions of the dependent variable. DEPVAR(1), the broadest definition of bank presence on the board, is 1 if Toyo Keizai Shinposha's (1991) *Kigyo keiretsu soran* lists the firm as having a former or concurrently-serving bank executive on its board in a position of director (*torishimariyaku*) or above (including auditor) as of mid-1991. In the sample of 1064 listed firms, 55.0% are identified as having a bank executive on the board; 45.0% as not. DEPVAR(2) restricts attention to cases where there is one or more bank executive in a position of managing director (*jomu*) or above (34.4% of cases), and DEPVAR(3) to cases where one or more bank executive is executive director (*senmu*) or above (25.2% of cases). The aim is to see whether there are different influences depending on the "importance" of the bank director in the managerial hierarchy.[12]

The following explanatory variables are included.

LEVERAGE is measured as the percentage ratio of total borrowings to total assets. Banks are argued to be information intermediaries that specialize in monitoring the lower tail of the distribution of profit state outcomes. All other things equal, firms with higher borrowings face a higher probability of having to default on or renegotiate hard budget contraints (debt repayments), and supply of monitoring services by banks should be high. If the supply of executives to corporate boards contains a monitoring component, the probability should rise with the amount of bank debt. The expected sign then is positive and a strong effect of this variable would be expected under the monitoring hypothesis.

The literature on Japanese corporate governance has emphasized the fact that banks can hold equity, up to a limit of 5% (unless an exemption is sought), as well as supply loans. There is clear evidence that top lenders also tend to be top shareholders, particularly in the case of the main bank but also for other principal lenders. It is widely felt that bank shareholdings of this kind facilitate main bank interventions in cases of financial distress and help to minimize the kinds of agency costs and conflicts of interest between equity- and debt-holders discussed in the U.S. finance literature.[13]

The focus on bank shareholding may be most appropriate when banks or other financial institutions (notably insurance companies) occupy the top shareholder positions. In many cases, however, a large block of a firm's shares (e.g. more than 10%) is

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having one person monitor may make a difference but having an additional person monitor may make little difference in many circumstances (Sheard, 1994a). An alternative way to formulate the dependent variable would be as a count variable — the *number* of bank executives — or as a continuous variable — the *fraction* of board members who were (or are concurrently) bank executives. The latter approach was tried in work-in-progress, with similar results being found (Sheard, 1994e).

[12]For 40 firms, the only bank director(s) was a concurrently-serving one. Regressions were run restricting the dependent variables to exclude these cases, but the results obtained were qualitatively very similar to the ones reported.

[13]For arguments along these lines, *see* for instance Aoki, Patrick, and Sheard (1994), Prowse (1990, 1992), and Roe (1993), and for empirical evidence on main bank shareholding *see* Flath (1993) and Sheard (1989, 1994b, 1994d).

held by one or more large parent firms such as a large listed industrial or trading company. Whether there is a large blockholder present or not would seem to be an important potential influence in corporate governance, and on the role played by banks. Indicative of this are some statistics from the sample: 580 firms (50.5%) had directors who had entered from the top shareholder, and in 61.5% of the 338 cases where the president was from outside the firm the source was the top shareholder.

Table 6 presents evidence on the distribution of listed firms in the sample by the size of the largest shareholding, and shows that qualitatively there are two kinds of listed firms: firms with relatively diversified top shareholding positions (although still concentrated by U.S. standards; *see* Prowse, 1992), in most cases the top shareholder being a financial institution, and firms that are affiliated with a large parent-firm blockholder. Specifically, while 14.0% of listed firms had a top shareholder with less than 5% (mostly 4-5%), and a further 44.0% between 5 and 10%, for 25.7% of listed firms, the top shareholder had a 20% or more holding and for 42.1% the top shareholder had a holding of 10% or more (Table 6). TOPSHARE is the percentage shareholding of the top shareholder. Banks may supply directors even if a dominant shareholder is present, but as suggested by theory and Kaplan and Minton's (1994) results, monitoring by banks and

Table 6

Distribution of Listed Japanese Firms According to Size of Top Shareholder's Shareholding and Top Lender's Loan Share, 1991

Range	Top shareholder's shareholding[1]	Top lender's loan share[2]
less than 3%	0.2	0.2
3% or more, less than 4%	1.5	0.2
4% or more, less than 5%	12.3	0.1
5% or more, less than 10%	44.0	3.5
less than 10%	58.0	3.9
10% or more, less than 20%	16.4	27.9
20% or more, less than 30%	11.9	29.1
30% or more, less than 40%	5.2	13.7
40% or more, less than 50%	3.9	5.5
50% or more	4.7	7.0
no borrowings		12.8
Total	100.0	100.0

unit: percent fraction of firms falling in category.

Notes: 1. sample of 1149 firms listed on first section of Tokyo and Osaka stock exchanges.
2. sample of 1108 firms (data unavailabe for 41 firms).

Source: Compiled from data set.

by the dominant shareholder can be expected to be substitutes, suggesting a negative sign if bank director placements serve a monitoring or intervention purpose.

PROFIT, measured as the percentage ratio of operating income to total assets for the financial year in which the latest entry of a bank executive occurred, is a crude measure of return on assets, and is the variable intended to capture the effect of poor performance or financial distress. Case studies, theory, and the two quantitative studies cited earlier suggest that banks despatch executives as on-the-spot monitors, discipliners, and trouble-shooters when client firms are in financial difficulty. The expected sign is negative, and a strong effect is expected under the monitoring hypothesis. This is one variable where one version of the labor market hypothesis can be distinguished, as it suggests a positive sign on the coefficient. If, as is sometimes suggested, there is little more to the phenomenon than members of the bank executive elite descending into lucrative pre-retirement director slots as part of a cosy top executive cartel, poorly performing firms would not be expected to be a favored destination.

INSIDEOWNER is a dummy variable which is 1 when the top shareholder is a founding entrepreneur or a member of the founder's family (in many cases a non-listed firm or foundation is used as the vehicle for this shareholding).[14] Two effects may be anticipated. One, coming from the firm side, is that a firm subject to strong incumbent control by an owner-manager may resist external monitoring and perceived intrusion by its banks. In keeping with the intuitive notion of "independence" discussed earlier, an "owner"-controlled firm may be prone to keep a more arms-length stance vis-a-vis its banks. A second effect going in the opposite direction, coming from the bank's side, is that banks may be more intent on monitoring such firms because of a possible greater risk of misappropriation of internal resources and free cash flow (Jensen, 1986) or of internal control failures (so-called *wanman keiei*, literally "one-man management", effect). Given that a bank can only send an executive if the firm agrees, however, it might be expected that the first effect would dominate, suggesting a negative sign on the coefficient.

Because INSIDEOWNER is a dummy variable, a negative sign would indicate a shift in the intercept of the regression, that is, an overall lowering of the likelihood of bank directors independent of the particular values taken on by the other explanatory variables. However, interactive effects may be important also, that is, the slopes of the other coefficients may be affected by the presence of INSIDEOWNER. Variables constructed as the product of INSIDEOWNER and other explanatory variables capture such effects.

One such variable of particular interest is PROFIT * INSIDE, which is the product of PROFIT and INSIDEOWNER. The idea is to investigate whether, in the case that an inside owner is present, the presence of a bank director is sensitive to the performance of the firm. Significance of this variable would provide evidence that the way in which bank

[14] A number of other measures of inside ownership were developed. *See* the data appendix for details.

director presence varies with profitability—a key aspect of contingent corporate governance—differs between the two sets of firms, those with active or residual entrepreneurial/family influence and those without.

A priori, however, the expected sign on this variable is unclear. A negative sign would indicate that, relative to other firms, the presence of a bank director is more sensitive to corporate profitability, a positive sign that it is less sensitive. Plausible explanations for either result exist. A negative sign, combined with a negative sign on INSIDEOWNER, would be consistent with the view that firms with inside owners try to maintain more independence from banks, but their capacity to do so depends on the strength of their relative bargaining position which is closely correlated with financial health, as measured by profitability here. A positive sign might indicate that the contingent corporate governance aspect is muted in the case of inside-owner firms. This might be because, whereas other firms readily accept bank director intervention when performance deteriorates, firms with residual inside ownership more fiercely guard their independence; from the bank side, it might reflect the fact that banks are less likely to perform their ex post intervention role or are more discriminating in doing so.

Two variables are constructed to capture presence of a major supplier of loans. LOANSHARE(1) is defined as the percent of total loans supplied by the top lender. TOPLENDER is defined as the percentage ratio of borrowings from the top lender to total assets. Higher values of LOANSHARE(1) indicate a higher degree of exclusivity or "dependence" in the bilateral relationship (particularly on the firm's side) which might increase the likelihood of the bank supplying a director. On the other hand, if the main bank system operates as per the delegated monitoring hypothesis the loan share of the top lender should not be an important factor per se, because what matters more is the banks' total financial exposure, captured by LEVERAGE. TOPLENDER measures the importance of the top lender relative to total assets. LOANSHARE(1) could be quite high even though TOPLENDER is low, if the firm has few borrowings but obtains these from a few, or even one source. In fact, TOPLENDER is also the interactive variable LOANSHARE(1)* LEVERAGE. Morck and Nakamura (1992) do not find an effect for TOPLENDER and drop it from their regressions.

LOANSHARE(1) measures the importance of the top lender relative to all lenders. Another measure of relative exclusivity would be the importance of the top lender relative to other top lenders. To measure this effect, LOANSHARE (2-3), the combined loan share of the second and third top lenders, is included. There are two possible effects to consider. On the one hand, it might be thought that larger values would indicate the presence of other important lenders, and that one or more of these might also supply directors. This possibility is suggested by the fact that in the sample of all first-section listed firms (1149 firms), in 68.0% of cases where the firm was identified as having one or more bank directors the directors came from a single bank, in 25.3% of cases directors came from two banks, and in 6.6% of cases directors came from three or more. A

positive sign would be expected under this line of reasoning. On the other hand, larger values of LOANSHARE (2-3) may indicate attempts by firms to achieve more diversification in major lending sources, such an "independent" strategy also being associated with the non-acceptance of former bank directors into the senior ranks of the firm's management; this would suggest a negative sign. The coefficient on LOANSHARE (2-3) may also speak to the delegated monitoring hypothesis: a positive sign would be consistent with the notion that the banks monitor independently, while a negative sign would be consistent more with the delegated monitoring notion.

ASSETS, the total assets of the firm, is included as a measure of firm size.[15] Size of the firm might be thought to have an influence on whether bank executives sit on the board, although on theoretical grounds the sign of this effect is ambiguous. All other things equal, the larger the firm the more likely that bank executives will be present, particularly under the monitoring hypothesis. Larger firms will be also tend to be parent firms to other listed and non-listed subsidiary firms. If, as suggested by Kaplan and Minton (1994), there is an effective division of labor among large operating firms and banks in corporate governance activities, which TOPSHARE aims to capture, then it might be that banks will be more likely to have director links to larger firms, as these are the firms that stand at the pinnacle in ownership terms of corporate groups.[16] Put simply, while large parent firms oversee in corporate governance terms their listed affiliates, banks might be expected to specialize more in oversight of these large parent firms. Viewed in this light, ASSETS might be expected to have a positive sign. On the other hand, larger firms, as long as their performance is adequate, might be better able to keep banks at arms-length, suggesting that a negative sign on ASSETS might be expected. Another argument, related to the reemployment hypothesis and also suggesting a negative effect, is that larger firms may have accumulated better internal managerial resources and be in less need of acquiring the human capital services of former bank executives.

The age of the firm may influence the probability of a bank executive being present. Older firms might be thought to have accumulated better managerial resources; in terms of the human resource hypothesis then a negative sign would be expected. By the same token, banks are more likely to have already accumulated considerable information about older firms, and older firms will have established more reputational capital, suggesting a negative sign from the viewpoint of the monitoring hypothesis (Diamond, 1991). Two variables are employed to capture these effects: FIRMAGE is the year that the firm was established, and FIRMAGE(2) the year that the firm was first listed on the

[15]ASSET is a measure of size in terms of book rather than market value; it also enters the definition of PROFIT. However it is unlikely that this biases the results seriously as, to the extent that market value would be a better measure on theoretical grounds, book value is likely to be a good proxy for market value, with any measurement error being non-systematic and therefore captured in the error term.

[16]*See* Sheard (1987, p.70) for an earlier argument along these lines relating to the risk-sharing aspect of ownership and corporate group relations.

stock exchange.

BANKSHARE is the percentage total shareholding of financial institutions and is a measure of the role of banks in the equity side of the firm. By including this variable it is possible to see whether bank director links are driven more by loan or equity relations. FIRMSHARE is the percentage shareholding of non-financial domestic corporations, and DIRECTORSHARE is the shareholding ratio of directors. INSIDESHARE is the percentage total shareholding of individuals (among the top 20 shareholders) who are identified as being members of the founding family (including shareholdings of associated non-listed firms and foundations). It serves as another measure of the strength of inside family ownership. In the sample, this variable has an average value of 3.4%, but it ranges from zero (in most cases) to 64.0%. The former variable is readily available but the latter variable was constructed for this study (*See* the appendix for descriptive statistics for this and the other variables).

It is often claimed that bank director ties to firms are strong among firms associated with an enterprise grouping, and that such ties together with shareholding, lending, commercial, and historic ties define the essence of a grouping (*see* for example the definition employed by Keizai Chosa Kyokai [various issues]). The presidents' club is often taken in the literature as defining the core membership of the loosely-knit inter-market enterprise groupings. To test for such an effect, dummy variables are included for membership of the presidents' clubs of the six major enterprise groupings. PRESCLUB is a dummy variable for membership of any of the six presidents' clubs, while PRESCLUB(Z) restricts attention to the Mitsui, Mitsubishi, and Sumitomo groups, the three groups with antecedents in the prewar *zaibatsu* and usually thought to exhibit the greatest cohesion. The idea is to test whether group association is a factor explaining director ties or whether the effect goes away after controlling for other relevant variables. Finally, industry dummy variables are included to control for industry-specific effects.

IV. Results

Regression results corresponding to the three versions of the dependent variable are reported in Tables 7, 8, and 9 respectively. For each dependent variable, four sets of regression results are reported. First a model containing all of the explanatory variables was estimated (equation 4 in the tables).[17] Across the three specifications, TOPLEND-

[17]Various exploratory regressions were run, whose results are not reported. FIRMAGE and FIRMAGE (2) are highly correlated (0.56), but FIRMAGE was found to perform better than FIRMAGE (2) so the latter was discarded (including both in the regressions led to both being insignificant). Similarly TOPSHARE and FIRMSHARE are highly correlated (0.72), and only TOPSHARE was retained. DIRECTORSHARE and INSIDESHARE are highly correlated (0.67), as are both with INSIDEOWNER (0.57 and 0.73 respectively). However only INSIDEOWNER proved to be significant. Interactive variables other than INSIDE * PROFIT were tried but found not to be significant.

Table 7
Probit Regressions for Presence of Bank Executive on Board of Listed Japanese Firms

	7.1	7.2	7.3	7.4
CONSTANT	−0.0164	0.0844	−0.0956	−0.230
	(−0.101)	(0.463)	(−0.376)	(−0.618)
LEVERAGE	0.0168***	0.0171***	0.0180***	0.0133***
	(5.727)	(5.742)	(5.808)	(2.578)
TOPSHARE	−0.0320***	−0.0322***	−0.0330***	−0.0321***
	(−8.680)	(−8.635)	(−8.711)	(−6.697)
INSIDEOWNER	−0.623***	−0.672***	−0.669***	−0.636***
	(−2.576)	(−2.750)	(−2.727)	(−2.560)
LOANSHARE(1)	0.00623***	0.00832***	0.00920***	0.00710**
	(2.533)	(3.0559)	(3.289)	(2.109)
LOANSHARE(2-3)		−0.00487	−0.00549	−0.00484
		(−1.365)	(−1.519)	(−1.322)
ASSETS	−0.127**	−0.155**	−0.167**	−0.155**
	(−2.125)	(−2.486)	(−2.524)	(−2.296)
PROFIT	−0.0486***	−0.0511***	−0.0501***	−0.0490***
	(−3.586)	(−3.690)	(−3.613)	(−3.495)
FIRMAGE	0.00592**	0.00548**	0.00474*	0.00483*
	(2.104)	(1.917)	(1.605)	(1.623)
TOPLENDER				0.0231
				(1.140)
PROFIT * INSIDE	0.0667*	0.0693**	0.0666*	0.0624*
	(1.926)	(1.987)	(1.903)	(1.772)
BANKSHARE				0.00177
				(0.377)
PRESCLUB(M)		−0.691**	−0.700**	−0.698**
		(−2.0896)	(−2.0865)	(−2.0790)
PRESCLUB(MB)		1.228***	1.241***	1.234***
		(3.114)	(3.127)	(3.113)
PRESCLUB(S)		−0.911**	−0.953**	−0.941**
		(−2.447)	(−2.517)	(−2.483)
PRESCLUB(F)			0.421	0.412
			(1.312)	(1.274)
PRESCLUB(SA)		0.431	0.456*	0.453
		(1.580)	(1.645)	(1.633)
PRESCLUB(D)		0.444*	0.449*	0.451*
		(1.799)	(1.798)	(1.804)
PRESCLUB(1)	−0.729***			
	(−2.950)			
PRESCLUB(3)	0.602***			
	(3.569)			
FOOD			0.335	0.392
			(1.323)	(1.519)
MINING			0.441	0.509*
			(1.133)	(1.284)
CONSTRUCT		0.657***	0.862***	0.912***
		(4.0647)	(3.751)	(3.892)
TEXTILE			−0.330	−0.267
			(−1.240)	(−0.977)
CHEMICAL			0.240	0.306
			(1.191)	(1.462)
METAL		0.214***	0.661***	0.722***
		(2.764)	(2.840)	(3.0191)
MACHINE		0.214**	0.407**	0.454**
		(2.0263)	(2.0990)	(2.284)
COMMERCE			0.249	0.325
			(1.200)	(1.493)
SERVICE			0.349	0.427
			(1.258)	(1.497)
INDUSTRY(1)	0.321***			
	(3.552)			
log likelihood	−571.9	−558.0	−552.4	−551.7
R^2	0.165	0.181	0.190	0.191
pseudo−R^2	0.130	0.142	0.151	0.152
% correct predictions	66.7	68.2	68.4	68.6
observations	949	940	940	940

Notes: t-ratios in brackets.
*** significantly different from zero at 1% confidence level
** significant at 5% level
* significant at 10% level
In all regressions two-sided tests are reported for CONSTANT, LOANSHARE(2-3), ASSETS, PROFIT*INSIDE, and the presidents club and industry dummy variables, one-sided tests for all other variables.

Table 8

Probit Regressions for Bank Maaaging in Position of Managing Director or Above on Board of Listed Japanese Firms: Full Sample

	8.1	8.2	8.3	8.4
CONSTANT	−0.932***	−0.860***	−0.802***	−0.658*
	(−4.405)	(−3.717)	(−2.924)	(−1.676)
LEVERAGE	0.0171***	0.0181***	0.0179***	0.0192***
	(5.791)	(5.947)	(5.801)	(3.850)
TOPSHARE	−0.0277***	−0.0276***	−0.0290***	−0.0304***
	(−6.799)	(−6.717)	(−6.936)	(−5.878)
INSIDEOWNER			−0.437**	−0.457**
			(−1.703)	(−1.765)
LOANSHARE(1)	0.00500**	0.00706***	0.00679***	0.00735**
	(1.916)	(2.523)	(2.418)	(2.140)
LOANSHARE(2-3)		−0.00487	−0.00524	−0.00556
		(−1.286)	(−1.379)	(−1.443)
ASSETS	−0.215***	−0.259***	−0.246***	−0.246***
	(−2.925)	(−3.252)	(−2.995)	(−2.880)
PROFIT	−0.0596***	−0.0572***	−0.0638***	−0.0640***
	(−4.441)	(−4.161)	(−4.302)	(−4.293)
FIRMAGE	0.00678**	0.00531**	0.00575**	0.00560**
	(2.305)	(1.740)	(1.848)	(1.789)
TOPLENDER				−0.00609
				(−0.341)
PROFIT * INSIDE			0.0453	0.0467
			(1.182)	(1.214)
BANKSHARE				−0.00240
				(−0.494)
PRESCLUB(M)	−0.727*	−0.729*	−0.815**	−0.815**
	(−1.928)	(−1.903)	(−2.114)	(−2.109)
PRESCLUB(MB)			−0.463	−0.459
			(−1.189)	(−1.179)
PRESCLUB(S)			−0.291	−0.299
			(−0.748)	(−0.768)
PRESCLUB(F)		0.683**	0.617**	0.634**
		(2.204)	(1.978)	(2.0200)
PRESCLUB(SA)		0.756***	0.713***	0.722***
		(2.843)	(2.643)	(2.666)
PRESCLUB(D)		0.405*	0.350	0.358
		(1.715)	(1.475)	(1.501)
PRESCLUB(2)	0.516***			
	(3.209)			
FOOD		0.581***	0.593**	0.571**
		(2.490)	(2.234)	(2.120)
MINING			0.442	0.421
			(1.0762)	(1.0192)
CONSTRUCT		1.159***	1.209***	1.191***
		(5.765)	(5.118)	(4.986)
TEXTILE			−0.0793	−0.104
			(−0.275)	(−0.354)
CHEMICAL		0.412**	0.442**	0.417*
		(2.370)	(2.0629)	(1.889)
METAL		0.498**	0.536**	0.512**
		(2.389)	(2.210)	(2.0715)
MACHINE		0.585***	0.612***	0.599***
		(3.528)	(2.965)	(2.853)
COMMERCE		0.575***	0.597***	0.572**
		(3.145)	(2.731)	(2.518)
SERVICE		0.527**	0.556**	0.517*
		(2.0519)	(1.965)	(1.774)
INDUSTRY(2)	0.565***			
	(3.928)			
log likelihood	−531.0	−514.9	−511.9	−511.7
R^2	0.144	0.173	0.179	0.179
pseudo-R^2	0.123	0.143	0.148	0.148
% correct predictions	70.4	73.0	73.4	73.5
observations	949	940	940	940

Notes: t-ratios in brackets.
*** significantly different from zero at 1% confidence level
** significant at 5% level
* significant at 10% level

Table 9

Probit Regressions for Presence of Bank Executive in Position of Executive Director or Above on Board of Listed Japanese Firms: Full Sample

	9.1	9.2	9.3	9.4
CONSTANT	−0.968***	−0.957***	−1.234***	−1.178***
	(−4.245)	(−4.139)	(−4.0396)	(−2.753)
LEVERAGE	0.0185***	0.0188***	0.0191***	0.0224***
	(6.00175)	(5.917)	(5.925)	(4.352)
TOPSHARE	−0.0286***	−0.0293***	−0.0303***	−0.0306***
	(−6.231)	(−6.322)	(−6.360)	(−5.311)
INSIDEOWNER	−0.329**	−0.415***	−0.671***	−0.693***
	(−2.0832)	(−2.544)	(−2.373)	(−2.427)
LOANSHARE(1)	0.00439*	0.00410*	0.00423*	0.00596*
	(1.472)	(1.363)	(1.396)	(1.618)
LOANSHARE(2-3)	−0.00679*	−0.00655	−0.00571	−0.00622
	(−1.670)	(−1.584)	(−1.368)	(−1.473)
ASSETS	−0.123*	−0.153**	−0.177**	−0.191**
	(−1.832)	(−2.159)	(−2.188)	(−2.246)
PROFIT	−0.0535***	−0.0525***	−0.0580***	−0.0594***
	(−3.763)	(−3.638)	(−3.736)	(−3.797)
FIRMAGE			0.00496*	0.00499*
			(1.491)	(1.490)
TOPLENDER				−0.0152
				(−0.820)
PROFIT * INSIDE			0.0441	0.0472
			(1.0244)	(1.0907)
BANKSHARE				−0.000640
				(−0.123)
PRESCLUB(M)	−0.882**	−0.926**	−0.919**	−0.923**
	(−2.141)	(−2.163)	(−2.0983)	(−2.106)
PRESCLUB(MB)			−0.486	−0.484
			(−1.161)	(−1.154)
PRESCLUB(S)			−0.304	−0.311
			(−0.778)	(−0.794)
PRESCLUB(F)			0.429	0.436
			(1.360)	(1.375)
PRESCLUB(SA)			0.294	0.292
			(1.101)	(1.0895)
PRESCLUB(D)			0.293	0.294
			(1.195)	(1.195)
FOOD		0.560**	0.652**	0.611**
		(2.163)	(2.187)	(2.0215)
MINING			0.412	0.372
			(0.863)	(0.779)
CONSTRUCT		1.261***	1.347***	1.316***
		(5.920)	(5.183)	(5.00387)
TEXTILE			0.180	0.139
			(0.565)	(0.433)
CHEMICAL		0.621***	0.721***	0.675***
		(3.251)	(2.997)	(2.727)
METAL		0.772***	0.854***	0.814***
		(3.434)	(3.169)	(2.969)
MACHINE		0.673***	0.757***	0.724***
		(3.658)	(3.221)	(3.0381)
COMMERCE		0.860***	0.922***	0.867***
		(4.383)	(3.762)	(3.413)
SERVICE		0.742***	0.823***	0.773**
		(2.743)	(2.689)	(2.459)
INDUSTRY(2)	0.765***			
	(4.746)			
log likelihood	−454.2	−446.4	−441.4	−441.1
R^2	0.138	0.155	0.166	0.166
pseudo-R^2	0.128	0.143	0.152	0.153
% correct predictions	77.2	77.8	77.3	78.2
observations	940	940	940	940

Notes: t-ratios in brackets.
*** significantly different from zero at 1% confidence level
** significant at 5% level
* significant at 10% level

ER and BANKSHARE proved consistently to be insignificant, and the models were estimated again without these variables (equation 3 in the tables).[18] The models were estimated again, in most cases having dropped any variables that were not significant at the 10% level or higher (mainly presidents' club and industry dummies) (equation 2 in the tables). Finally, presidents' club and industry dummies showing similar effects were consolidated, and a reduced model in which only significant variables are retained was estimated (equation 1 in the tables).[19]

Overall the models performed reasonably well, although clearly much variation remained unexplained. For the full model, the pseudo-R^2's were around 0.15 (Davidson and MacKinnon, 1993, p.522); in terms of the log likelihood and percent correct predictions of the model, restricting the dependent variable to senior director positions produced better results.

For all three versions of the dependent variable and each of the four models estimated, the coefficients for LEVERAGE, TOPSHARE, LOANSHARE(1), and PROFIT are significant, usually at the 5% level at least and often at the 1% level, and the signs are as expected. The coefficient on ASSETS is also consistently significant, and the sign is negative. INSIDEOWNER and FIRMAGE are significant in most cases and always have the expected sign. In words, firms are more likely to have former bank executives on their boards the more they rely on bank borrowings and the larger the loan share of the top lender, and less likely when there is a dominant large shareholder, when there is residual family involvement in management and ownership, and the larger, older, and more profitable they are. LOANSHARE(2-3) consistently has a negative sign, suggesting that more discrepancy in loan shares among top lenders increases the likelihood of bank executives being present in senior positions, but is usually not significant. Overall the most significant variables are the LEVERAGE and TOPSHARE variables. This is consistent with the monitoring hypothesis and confirms Kaplan and Minton's (1994) result. Basically it says that banks tend to supply executives when financial (lending) exposure is high, but they do not when a dominant non-financial shareholder is present, a plausible explanation being that monitoring is performed by the parent firm in those cases.

The negative coefficient on ASSETS has a noteworthy implication, when viewed in

[18]Estimation was carried out using the probit option in TSP. The standard errors are computed from analytic second derivatives. T-statistics robust to heteroscedasticity in the error term were generally very close to those reported, and use of these would not have altered significance / non-significance judgements. For the 130 coefficient estimates in equation 4, the significance level varied in only 10 cases, increasing in eight and decreasing in two.

[19]As a check, equation 4 was also estimated by logit. The results in terms of signs and significance were almost identical to the results obtained under probit estimation, and the coefficient estimates in most cases varied by the expected factor of 1.6-1.8 (Davidson and MacKinnon, 1993, p.515). Equation 4 was also estimated by OLS with similar results in terms of coefficient signs and significance levels.

tandem with the result for TOPSHARE. It seems to be at odds with the notion of a hierarchical nesting of monitoring relations: banks specializing in the monitoring of large parent firms which in turn assume direct responsibility for their affiliates. Banks are more likely to supply directors to relatively smaller (listed) firms that are not affiliates of larger firms (but less so when there is family control), according to the result. On *a priori* grounds, banks should be more interested in monitoring larger firms, both because of the scale effect — their scarce resources are best allocated where the returns to monitoring are highest — and because of the fact that large firms tend not to be affiliates of parent firms, that is, not to have blockholder monitors. The result may be suggesting that, while the above is true, large firms are better able to keep banks at bay. Alternatively it may be that larger firms are better run (there may be more effective internal monitoring of managers by managers) (Fama, 1980) or, consistent with the labor market hypothesis, they have less need of outside managerial resources (they attract better managerial personnel to start with or there may be scale effects in the accumulation of internal managerial resources).

Two further points are important. First, banks monitor through a variety of means, director placements being only one. Second, there is still the effect of PROFIT: even though large firms may be less likely to be subject to internal monitoring in normal times, the intervention effect in financial crisis is still at work, consistent with what Kaplan and Minton (1994), Morck and Nakamura (1992), and Hoshi, Kashyap, and Scharfstein (1990) find and with the results in the case study literature (Sheard, 1985, 1989, 1994c).[20]

The failure of BANKSHARE to be significant is noteworthy. It seems to suggest, put too simply perhaps, that banks send directors as lenders rather than as shareholders.[21] One interpretation might be that it is large debt exposure that gives banks both the most incentive to monitor and the means to do so. However it would be a mistake to conclude from this that bank shareholding in client firms is irrelevant or unimportant. It may be that, as suggested by the fact it is so widespread, bank shareholding is important for banks to fulfill the roles that they do (particularly main banks) regardless of whether banks place executives on boards or not.[22]

The insignificance of TOPLENDER is also noteworthy. Alongside the results for

[20]When an interaction effect between ASSETS and PROFIT was also tested, some support for this notion was found. Among the five specifications of the dependent variable (including the two restricted sample versions described in section V), ASSETS remained significant only for DEPVAR(1). The coefficient on the interactive variable ASSETS * PROFIT was negative in sign and significant at the 5% level for both versions of DEPVAR(2) and at the 10% level for the restricted version of DEPVAR(3), but insignificant for DEPVAR(1) and DEPVAR(3). The results provide some suggestion that it is not size per se but its interaction with the firm's performance that is important, profitable large firms having less likelihood of bank directors, but unprofitable large ones having more perhaps because intervention is more likely to be triggered in such cases.

[21]Again, this is suggested by Kaplan and Minton (1994).

[22]Consistent with this, it should be noted that there is relatively little variation in BANKSHARE (*see* the descriptive statistics in the data appendix).

LEVERAGE and to a lesser extent LOANSHARE(2-3), it seems to provide some indirect evidence for the delegated monitoring hypothesis, namely that the main bank either implicitly or by default monitors on behalf of other lenders (or put another way, in monitoring and exercising contingent control as the largest creditor, the main bank supplies a form of local public good). Although in the majority of cases where firms have bank directors only one bank is involved, it is the share of total bank lending in assets rather than the share of the largest bank (almost always the bank supplying the director) that seems to drive the bank-firm director link.

The results for inside ownership are interesting. A number of measures were developed, including whether an inside owner is present on the board or on the share register and whether the president or chairman is an inside owner. In preliminary regressions, all of these measures were tried, including INSIDESHARE, but the only one which proved significant was INSIDEOWNER, measuring when the top shareholder is an inside owner. Intuitively, this variable can be seen as indicating qualitatively a strong form of internal control (occupying the top shareholder position). The other dummy variable measures identify wider sets of firms, and may pick up quite a few firms where in actual fact there is little or no residual family control. The result suggests that when a firm is under fairly strong family control banks are less likely to be able, or feel the need, to conduct inside monitoring. It is consistent with the conventional wisdom that inside owners try to keep banks, literally, at arms-length.

An interesting result is the positive sign on the interactive variable PROFIT * - INSIDE; it is significant in the DEPVAR(1) regression and in two versions of the restricted model for DEPVAR(2) but not for DEPVAR(3).Combined with the result for INSIDEOWNER, it suggests both that firms with inside owners are less likely to have bank executives on their boards and that this likelihood is less sensitive to profitability. The positive sign means that the tendency not to have bank executives on the board is accentuated when profitability is low but muted somewhat when profitability is high. As noted earlier, this might reflect a combination of two forces: on the firm side, that, relative to other firms, those with inside owners resist bank intervention and the intensification of external control that this implies when performance is poor, but are less prone to do so when performing well (when the attenuation of internal control associated with accepting an outside director itself is likely to be low). On the bank side, it may suggest that the banks are more discriminating in performing their ex post intervention role when it comes to more independent-oriented firms.

INSIDEOWNER is significant in most of the regressions, usually at the 1% level, whereas PROFIT * INSIDE is significant in only a small subset of the regressions and then usually at the 10% level. The main effect of inside-ownership seems to be to reduce the likelihood of bank director presence (the intercept) rather than alter the slopes of other coefficients. To test this more thoroughly, various tests of structural change in the intercept and slopes between the two samples of firms with inside ownership (as defined

by INSIDEOWNER) and those without were conducted. A likelihood ratio test that the intercept and slope coefficients on all of the variables in equation 4 (except the presidents' club and industry dummies) in the tables differed between the two samples was rejected at the 1% level. This suggests that the basic model is applicable to both samples, and vindicates the approach used here of treating inside-ownership as an additional effect within a single model. On the assumption that other slope coefficients did not vary, a test for no structural change in the intercept and on the slope coefficient of PROFIT was rejected at the 5% level for DEPVAR(1) and at the 1% level for DEPVAR(3), but accepted for DEPVAR(2). Overall then the results suggest an interesting qualitative difference in the role that banks play in corporate governance depending on whether a form of residual entrepreneurial or family control is in evidence.

Some interesting results are obtained for the presidents' club variable. In initial regressions (not reported), PRESCLUB was included but it was significant (and positive) only in the case of DEPVAR(1), and only then at the 10% level. PRESCLUB (Z) was tried also, but found not to be significant for DEPVAR(1), and significant at the 1% level but negative in sign for DEPVAR(2) and DEPVAR(3). Thus, contrary to the conventional wisdom, once other relevant factors were controlled for, membership of a presidents' club seemed to have no effect or to decrease the probability of a firm having a bank director in the case of the three groups usually thought to exhibit the most cohesion.

To investigate the presidents' club effect further, dummies for each of the presidents' clubs were included separately. Interestingly, the separate presidents' club dummies were usually significant but with mixed signs. In model 7.4, for instance, the coefficients on the Mitsui and the Sumitomo dummies were significant but negative in sign, while the coefficients on the Mitsubishi and Daiichi Kangin dummies were positive in sign and significant. Somewhat surprisingly, being in the Sumitomo or Mitsui presidents' club reduces the likelihood of the firm having a bank director, whereas Mitsubishi "crosses lines" to behave more like a newer postwar grouping. For DEPVAR(2), however, the Mitsubishi and Sumitomo dummies were no longer significant, while the Fuyo and Sanwa ones became significant. In the case of DEPVAR(3), only the Mitsui dummy was significant; it showed a consistently significant and negative effect across all of the regressions. As for industry effects, a number of industry dummy coefficients had positive signs and were significant in the DEPVAR(2) and DEPVAR(3) models, but this was so for only CONSTRUCT, MACHINE, and METAL in the DEPVAR(1) model. A speculation in the case of the construction industry is that the highly regulated nature of this industry and scope for managerial moral hazard leads to enhanced oversight by banks; alternatively, it may be that by giving them more director positions construction companies are allowing banks to share in their lucrative managerial rents.

V. Results for Restricted Sample

One possible problem in the above analysis is that zero observations of the two restricted dependent variables, DEPVAR(2) and DEPVAR(3), include firms that have bank directors but at the level of director or below and executive director or below respectively, as well as firms that have no bank directors. In order to avoid possible mis-specification in the dependent variable in treating these two kinds of firms as the same, the analysis was repeated on a restricted sample, in which firms having bank directors but not at the level specified in the dependent variable were eliminated. In the restricted-sample regressions then, a 0 for the dependent variable indicates a firm without any bank directors, and a 1 a firm with at least one bank director of the rank managing director, for DEPVAR(2), or executive director, in the case of DEPVAR(2). The results are shown in Tables 10 and 11.

The results are very similar to the ones obtained earlier but overall the models perform much better. LEVERAGE, TOPSHARE, INSIDEOWNER, LOANSHARE, ASSETS, and PROFIT all have the expected sign and are generally significant at the 1% level. FIRMAGE and LOANSHARE (2-3) have the expected sign and are generally significant at the 5 or 10% level. Thus when attention is restricted to the case where bank executives are in senior positions, there is some evidence that larger loan shares of the second and third largest lenders works against the firm's having bank directors; more discrepancy in leading loan shares — there being a major lender in relative as well as absolute loan share terms — works for it. PROFIT * INSIDE is positive as before but is hardly ever significant. A test of no structural change in the intercept and all slope coefficients between the two samples of firms with inside-ownership and those without, as above, was accepted for both models, but the hypothesis of no structural change in the intercept and the slope on PROFIT between the two samples was rejected at the 1% level for DEPVAR(3), although accepted for DEPVAR(2). As before, BANKSHARE and TOPLENDER have hardly any explanatory power. When attention is restricted to senior director positions, the presidents' club dummies perform better generally although the Mitsubishi dummy fails to be significant, and in terms of sign the group dummies divide into Mitsui/Sumitomo being negative, and Fuyo/Sanwa/Daiichi Kangin being positive. The main effect of restricting the sample is to improve the overall fit of the model, particularly for the DEPVAR(3) model: the R^2 rises from 0.166 in equation 9.4 to 0.269 in 11.4, and the pseudo-R^2 from 0.153 to 0.233.

Table 10

Probit Regressions for Presence of Bank Executive in Position of Managing Director or Above on Board of Listed Japanese Firms: Restricted Sample

	10.1	10.2	10.3	10.4
CONSTANT	−0.636**	−0.573**	−0.490	−0.551
	(−2.559)	(−2.261)	(−1.630)	(−1.274)
LEVERAGE	0.0201***	0.0213***	0.0210***	0.0176***
	(6.00869)	(6.203)	(6.0860)	(3.151)
TOPSHARE	−0.0346***	−0.0361***	−0.0365***	−0.0364***
	(−7.810)	(−8.001)	(−8.0521)	(−6.370)
INSIDEOWNER	−0.497**	−0.628***	−0.633***	−0.611**
	(−1.893)	(−2.343)	(−2.358)	(−2.247)
LOANSHARE(1)	0.0107***	0.0105***	0.0106***	0.00907***
	(3.363)	(3.294)	(3.297)	(2.408)
LOANSHARE(2-3)	−0.00654	−0.00695*	−0.00723*	−0.00691*
	(−1.599)	(−1.679)	(−1.736)	(−1.649)
ASSETS	−0.220**	−0.266***	−0.275***	−0.262***
	(−2.500)	(−2.783)	(−2.863)	(−2.665)
PROFIT	−0.0666***	−0.0680***	−0.0696***	−0.0682***
	(−4.127)	(−4.155)	(−4.231)	(−4.103)
FIRMAGE	0.00759**	0.00611**	0.00596**	0.00593**
	(2.297)	(1.812)	(1.766)	(1.741)
TOPLENDER				0.0172
				(0.784)
PROFIT * INSIDE	0.0521	0.0663*	0.0675*	0.0644
	(1.313)	(1.652)	(1.678)	(1.593)
BANKSHARE				0.000627
				(0.115)
PRESCLUB(M)		−0.836**	−0.826**	−0.820**
		(−1.944)	(−1.911)	(−1.899)
PRESCLUB(MB)			0.250	0.245
			(0.423)	(0.415)
PRESCLUB(S)		−0.589*	−0.640*	−0.634*
		(−1.505)	(−1.605)	(−1.590)
PRESCLUB(F)		0.627**	0.609**	0.606**
		(1.760)	(1.716)	(1.700)
PRESCLUB(SA)		0.689**	0.701**	0.700**
		(2.298)	(2.313)	(2.310)
PRESCLUB(D)		0.649**	0.636**	0.641**
		(2.306)	(2.260)	(2.280)
PRESCLUB(1)	−0.650**			
	(−2.298)			
PRESCLUB(2)	0.623***			
	(3.276)			
FOOD		0.571**	0.518*	0.562*
		(2.209)	(1.752)	(1.865)
MINING			0.445	0.492
			(0.951)	(1.0360)
CONSTRUCT		1.257***	1.208***	1.246***
		(5.610)	(4.561)	(4.621)
TEXTILE			−0.284	−0.240
			(−0.896)	(−0.742)
CHEMICAL		0.366*	0.308	0.357
		(1.914)	(1.286)	(1.440)
METAL		0.766***	0.718**	0.763***
		(3.145)	(2.549)	(2.644)
MACHINE		0.624***	0.571**	0.607**
		(3.417)	(2.466)	(2.565)
COMMERCE		0.567***	0.518**	0.574**
		(2.794)	(2.110)	(2.244)
SERVICE		0.588**	0.541*	0.599*
		(2.0477)	(1.696)	(1.807)
INDUSTRY(2)	0.609***			
	(3.806)			
log likelihood	−431.8	−420.9	−419.6	−419.3
R^2	0.205	0.232	0.233	0.233
pseudo-R^2	0.114	0.137	0.139	0.140
% correct predictions	68.3	70.5	70.5	70.1
observations	767	767	767	767

Notes: t-ratios in brackets.
*** significantly different from zero at 1% confidence level
** significant at 5% level
* significant at 10% level

Table 11

Probit Regressions for Presence of Bank Executive in Position of Executive Director on Board of Listed Japanese Firms: Restricted Sample

	11.1	11.2	11.3	11.4
CONSTANT	−0.916***	−0.7804***	−0.799**	−0.845*
	(−3.305)	(−2.727)	(−2.322)	(−1.750)
LEVERAGE	0.0226***	0.0238***	0.0237***	0.0202***
	(6.260)	(6.334)	(6.259)	(3.282)
TOPSHARE	−0.0386***	−0.0411***	−0.0412***	−0.0413***
	(−7.435)	(−7.650)	(−7.651)	(−6.225)
INSIDEOWNER	−0.449***	−0.916***	−0.913***	−0.888***
	(−2.480)	(−2.958)	(−2.943)	(−2.816)
LOANSHARE(1)	0.0102***	0.00994***	0.00999***	0.00837**
	(2.880)	(2.759)	(2.767)	(1.949)
LOANSHARE(2-3)	−0.00912**	−0.00977**	−0.00975**	−0.00956**
	(−1.972)	(−2.0621)	(−2.0543)	(−2.000)
ASSETS	−0.196**	−0.239**	−0.243**	−0.230**
	(−2.128)	(−2.345)	(−2.357)	(−2.188)
PROFIT	−0.0669***	−0.0794***	−0.0794***	−0.0776***
	(−4.0185)	(−4.312)	(−4.301)	(−4.136)
FIRMAGE	0.00762**	0.00579*	0.00579*	0.00582*
	(2.0685)	(1.539)	(1.536)	(1.533)
TOPLENDER				0.0185
				(0.708)
PROFIT * INSIDE		0.0732	0.0728	0.0689
		(1.562)	(1.552)	(1.458)
BANKSHARE				0.000309
				(0.0513)
PRESCLUB(M)		−1.167**	−1.162**	−1.158**
		(−2.282)	(−2.267)	(−2.255)
PRESCLUB(MB)			0.353	0.350
			(0.560)	(0.555)
PRESCLUB(S)		−0.592	−0.623	−0.616
		(−1.431)	(−1.474)	(−1.459)
PRESCLUB(F)		0.649*	0.643*	0.646*
		(1.662)	(1.651)	(1.653)
PRESCLUB(SA)		0.533	0.531	0.535
		(1.552)	(1.534)	(1.547)
PRESCLUB(D)		0.615**	0.613**	0.619**
		(2.0307)	(2.0231)	(2.0448)
PRESCLUB(1)	−0.708**			
	(−2.286)			
PRESCLUB(2)	0.597**			
	(2.284)			
FOOD		0.642**	0.664*	0.705**
		(2.128)	(1.905)	(1.995)
MINING			0.312	0.345
			(0.536)	(0.586)
CONSTRUCT		1.520***	1.542***	1.577***
		(5.901)	(4.961)	(5.00822)
TEXTILE			−0.0332	0.126
			(−0.0918)	(0.0342)
CHEMICAL		0.562**	0.577**	0.622**
		(2.564)	(2.0567)	(2.160)
METAL		1.0761***	1.100***	1.140***
		(3.885)	(3.359)	(3.421)
MACHINE		0.754***	0.773***	0.805***
		(3.524)	(2.797)	(2.874)
COMMERCE		0.794***	0.818***	0.873***
		(3.444)	(2.847)	(2.933)
SERVICE		0.828***	0.852**	0.902**
		(2.584)	(2.346)	(2.404)
INDUSTRY(2)	0.786***			
	(4.215)			
log likelihood	−344.9	−332.8	−332.5	−332.2
R^2	0.234	0.269	0.269	0.269
pseudo-R^2	0.203	0.231	0.232	0.233
% correct predictions	73.9	75.7	75.1	75.7
observations	678	678	678	678

Notes: t-ratios in brackets.
*** significantly different from zero at 1% confidence level
** significant at 5% level
* significant at 10% level

VI. Concluding Discussion

Conventional wisdom has it that the board of directors in Japan is quite different in makeup and orientation from its Anglo-American counterpart: put starkly, whereas the board of directors in the U.S. is the representative instrumentality of stockholders, in Japan it is the operational superstructure of incumbent management.[23] The juxtaposition of various institutional features — a highly internalized managerial labor market, the lack of an active takeover market, the pervasiveness of interlocking shareholding, a low level of individual shareholding, and the perfunctory nature of annual stockholders meetings — has led many observers to doubt whether top corporate management in Japan faces any meaningful capital market oversight or discipline.

A different perspective has been put in the literature. Despite apparent institutional differences, the Japanese system has its own set of mechanisms for dealing with the agency problems associated with the separation of ownership and control in modern business enterprise. It has been argued that these "insider-based" mechanisms involving banks, boards, and blockholders perform the same kinds of functions as the more "market-oriented" mechanisms associated with an active market for corporate control (Aoki, Patrick, and Sheard, 1994; Aoki, 1988, ch.4; Aoki, 1994; Sheard, 1989, 1994b, 1994c; Kaplan, 1994; Kaplan and Minton, 1994; Morck and Nakamura, 1992). The data and analysis presented in this paper are consistent with this latter view. Although the majority of Japanese directors have risen up through the ranks of the "lifetime employment" managerial hierarchy, one quarter are entrants from outside the firm. The data presented here strongly suggest that these "outside directors" come mainly from the principal banks and firms that own or lend to the firm. It is tempting, but probably too simplistic, to characterize this situation as one in which the owners and financiers of Japanese firms are extensively "represented" on their boards. However the data caution against the equally simplistic view that the top managers of Japanese corporations are free to pursue their goals without oversight, checks, or intervention from those agents in the capital market with the largest direct financial stakes.

Two hypotheses were put forward as potential explanators of the extensive flow of executive personnel from leading banks to the top ranks of Japanese corporate management: one, that it reflects the executive managerial labor market at work, the other that it facilitates bank monitoring and the implementation of intervention strategies triggered by deteriorating corporate performance. As noted, these two economic functions are quite complementary, so the empirical analysis did not pit one hypothesis against the other. The two functions may be more than complementary; at times they may even be two sides of the same coin. When a bank arranges for a manager to enter a troubled client

[23] On the role of the board in corporate governance in the U.S., particularly U.S.-style "outside directors", *see* Kaplan and Reishus (1990), Shivdasani (1993), and Weisbach (1988).

firm as a senior executive, it is supplying a needed managerial resource, but using different words to describe the same thing, it is intervening in the firm to improve its management.

The empirical results do suggest however that there is more to the bank director phenomenon than the operation of a market for recycling early-retiring bank executives. The probability of a firm having a former bank executive in its senior management or as an inside auditor is systematically related to financial, ownership, and governance-related variables. Less profitable, higher leveraged, younger firms and firms with a prominent leading bank lender are more likely to have bank directors; larger firms and those with leading shareholders and inside-owners are more likely not to. Bank executives entering corporate boards in late career seems to be one important element in the Japanese system of corporate control. Further research is required in order in understand more fully the processes at work and how effective they are. This study points to the value of such an endeavour.

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Data Appendix

< List of Variables Used[24]>

Dependent variables:

DEPVAR (1): 1 if one or more former or concurrently-serving bank executives is a director or statutory auditor (*kansayaku*) of the firm; 0 otherwise (where "bank" refers to any city, trust, long-term credit, or regional bank, but does not include government financial institutions, insurance companies, agricultural financing cooperatives, or other financial institutions).

DEPVAR (2): 1 if one or more former or concurrently-serving bank managing is a director of rank managing director (*jomu*) or above; 0 otherwise (where "above" includes executive director, vice-president, president, vice-chairman, and chairman).

DEPVAR (3): 1 if one or more former or concurrently-serving bank executives is a director of rank executive director (*senmu*) or above; 0 otherwise.

Explanatory variables:

LEVERAGE: percentage ratio of total bank borrowings to total assets.

TOPSHARE: percentage shareholding of number one shareholder.

LOANSHARE (1): percentage share of total borrowings supplied by number one lender (zero if no borrowings) (government financial institutions are excluded from definition of top

[24]Unless otherwise stated, all variables are for the 1990 financial year (FY), usually end of March 1991. Data on the dependent variables is as of July 1991.

three lenders, but their loans are a component of total borrowings).

ASSETS: total assets of the firm (million million yen).

PROFIT: percentage ratio of operating income (*eigyo rieki*) to total assets for financial year in which bank executive entered firm or most recent executive entered in case that more than one bank executive on board.

FIRMAGE: year in which firm established (1900 normalized to 0).

FIRMAGE (2): year in which firm first listed on a stock exchange (1900 normalized to 0).

LOANSHARE (2-3): percentage share of total borrowings supplied by number two and number three lenders combined (zero if no borrowings).

TOPLENDER: percentage ratio of borrowings from number one lender to total assets [=LEVERAGE * LOANSHARE(1)].

PROFIT * INSIDE: interactive variable constructed by multiplying PROFIT by INSIDEOWNER.

BANKSHARE: percentage ratio of total shares of firm held by financial institutions.

FIRMSHARE: percentage ratio of total shares of firm held by non-financial domestic corporations.

DIRECTORSHARE: percentage ratio of total shares of firm held by its directors.

INSIDESHARE: percentage ratio of total shares of firm held by founder of company, individual related to founder, or related non-listed company ("family figure").

Inside owner dummy variables:

INSIDEOWNER: number one shareholder identified as "family figure".

INSIDEOWNER (2): one or more "family figures" present on board or among top 20 shareholders.

INSIDEOWNER (3): one or more "family figures" present on board.

INSIDEOWNER (4): president identified as founder of company or individual related to founder.

INSIDEOWNER (5): chairman identified as founder of company or individual related to founder.

INSIDEOWNER (6): president or chairman identified as founder of company or individual related to founder.

Presidents' club dummy variables:

PRESCLUB: member of one of the six presidents' clubs.

PRESCLUB (Z): member of Mitsui, Mitsubishi, or Sumitomo group presidents' clubs.

PRESCLUB (M): member of Mitsui group presidents' club (*Nimoku-kai*).

PRESCLUB (MB): member of Mitsubishi group presidents' club (*Kin'yo-kai*).

PRESCLUB (S): member of Sumitomo group presidents' club (*Hakusui-kai*).

PRESCLUB (F): member of Fuyo (Fuji Bank) group presidents' club (*Fuyo-kai*).

PRESCLUB (SA): member of Sanwa group presidents' club (*Sansui-kai*).

PRESCLUB (D): member of DKB (Daiichi Kangyo Bank) group presidents' club (*Sankin-kai*).

PRESCLUB (1): sum of PRESCLUB (M) and PRESCLUB (S).

PRESCLUB (2): sum of PRESCLUB (F), PRESCLUB (SA), and PRESCLUB (D).

PRESCLUB (3): sum of PRESCLUB (M), PRESCLUB (SA), and PRESCLUB (D).

Industry dummy variables:

FOOD: food processing and marine products industries.

MINING: mining, petroleum, and coal industries.

CONSTRUCT: construction industry.

TEXTILE: textiles industry.

CHEMICAL: chemical, pharmaceuticals, paper/pulp, rubber, and glass industries.

METAL: metal and steel industries.

MACHINE: machinery, electrical, transportation, and precision equipment industries.

COMMERCE: commerce, financial, and securities industries.

SERVICE: real estate and services industries.

TRANSPORT: transport and utilities industries.[25]

INDUSTRY (1): sum of CONSTRUCT, METAL, and MACHINE.

INDUSTRY (2): sum of FOOD, CONSTRUCT, CHEMICAL, METAL, MACHINE, COMMERCE, and SERVICE.

<Descriptive Statistics of Variables>

Dependent variables:

	zero's	one's	sample
DEPVAR(1)	479	585	1064
DEPVAR(2)	698	366	1064
DEPVAR(3)	796	268	1064

Explanatory variables:

Continuous variables[a]

	Mean	Standard deviation	Minimum	Maximum
LEVERAGE	0.170	0.174	0.000	0.936
TOPSHARE	14.843	13.395	2.300	72.030
LOANSHARE(1)[b]	23.666	17.790	0.000	100.000
ASSETS	0.352	0.896	0.00333	11.088
PROFIT[c]	4.634	4.0798	−25.032	53.445
FIRMAGE	38.213	16.601	−31.000	85.000
FIRMAGE(2)	60.249	11.179	49.000	89.000
LOANSHARE(2−3)[d]	23.374	13.510	0.000	66.667
TOPLENDER[b]	4.236	5.0456	0.000	52.764
PROFIT*INSIDE[c]	0.711	2.367	− 7.108	21.659
BANKSHARE	41.204	13.627	1.565	78.344
FIRMSHARE	27.982	15.734	1.273	79.783
DIRECTORSHARE	2.165	4.0857	0.000	38.595
INSIDESHARE	3.394	7.548	0.000	63.950

[25]This is the omitted industry dummy in the regressions, any effect of which is captured in the intercept term.

Dummy variables

	zero's	one's
INSIDEOWNER	937	127
INSIDEOWNER(2)	683	381
INSIDEOWNER(3)	691	373
INSIDEOWNER(4)	799	265
INSIDEOWNER(5)	901	163
INSIDEOWNER(6)	735	329
PRESCLUB	910	154
PRESCLUB(Z)	1007	57
PRESCLUB(M)	1045	19
PRESCLUB(MB)	1042	22
PRESCLUB(S)	1048	16
PRESCLUB(F)	1041	23
PRESCLUB(SA)	1028	36
PRESCLUB(D)	1026	38
PRESCLUB(1)	1029	35
PRESCLUB(2)	967	97
PRESCLUB(3)	971	93
FOOD	1002	62
MINING	1048	16
CONSTRUCT	967	97
TEXTILE	1018	46
CHEMICAL	875	189
METAL	977	87
MACHINE	764	300
COMMERCE	916	148
SERVICE	1019	45
INDUSTRY(1)	580	484
INDUSTRY(2)	136	928

Notes: a. The sample is 1064 unless otherwise stated.
b. The sample is 1025.
c. The sample is 985.
d. The sample is 1016.

<Data Sources>

Data for the dependent variables, bank borrowings and loan shares, shareholdings of the top shareholder, membership of a presidents' club, and for the construction of industry dummy variables were obtained from Toyo Keizai Shinposha (1991), *Kigyo Keiretsu Soran*.

Data on total shareholdings of financial institutions, non-financial corporations, and directors, and on total assets for 1990 FY and operating income from 1985 FY were obtained from the NEEDS-Kigyo zaimu (Corporate Financial) electronic data base. Data on total assets before 1990 FY and operating income before 1985 were obtained from Nihon Keizai Shinbunsha (various issues), *Kaisha Nenkan*.

Data on the presence of an inside owner and inside owner shareholdings were obtained from Toyo Keizai Shinposha (1991), *Kigyo Keiretsu Soran* and Nihon Keizai Shinbunsha (1991), *Nikkei Kaisha Joho*.

Data on the year of establishment of firms and year of stock exchange listing were obtained from Nihon Keizai Shinbunsha (1991), *Nikkei Kaisha Joho*.

Data on the year that the bank executive became a corporate director were obtained from Keizai Chosa Kyokai (1993), *Nenpo Keiretsu no Kenkyu: Daiichibu Jojo Kigyohen*.

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