Institutional Isomorphism in Japanese Firms’ Compliance Activities

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Abstract: Japanese firms’ compliance activities have developed and become the norm to a certain extent. However, when we surveyed seven companies in various industries, including two firms that have experienced scandals, through interviews and public documents, we found that these seven firms’ compliance systems were surprisingly similar. This is because the institutionalization of compliance activities among Japanese firms has advanced under the influence of the Japan Business Federation and the Japanese government, and in fact, the mechanism of Dimaggio and Powell’s institutional isomorphism is at work. We believe that this is because the isomorphism in compliance activities that has developed independently of performance or of the ability to prevent scandals.

Keywords: compliance, institutional isomorphism, new institutionalism, corporate scandals
Introduction

Strengthening compliance activities is one of the important management issues for Japanese firms nowadays. Should a corporate scandal occur, people will ask if that firm’s compliance activities were adequate. Many Japanese companies have created specific departments to handle compliance matters, and companies have instituted many systems and rules as well as various types of training related to compliance.

However, there is some doubt as to whether these activities are effective. For example, in 2017, Kobe Steel, Ltd. was hit by news of a data tampering scandal. The company had implemented a number of measures to “reinforce thorough compliance” and had declared that it was trying to prevent scandals (Kobelco Steel Group, 2017). However, the data tampering itself had been happening for decades, and it continued in parallel with compliance activities. In addition, Toshiba Corporation was famous for being proactive with regard to compliance and had an extensive compliance system. However, between 2015 and 2017, accounting fraud issues surfaced, which resulted in this system being declared as ineffective and a mere formality (Toshiba Corporation Third Party Committee, 2015).

Why is it that compliance does not function effectively in Japanese firms? This paper considers this topic based on interviews with, and public documents from, seven companies in various industries, including two companies that have experienced scandals.

“Compliance Activities”

The Japanese language still has no actual term for the word “compliance,” so it uses a Japanese pronunciation of the English word. It is possible that Japanese people have been using the word
Institutional isomorphism in Japanese firms’ compliance activities

“compliance” so that it has now become common vernacular without really understanding what it means.¹

What types of activities actually fall under “compliance” at Japanese firms? Table 1 summarizes compliance activities at various companies. For comparison purposes, these seven companies include two companies that have experienced major scandals in the past. That said, all seven companies have implemented surprisingly similar compliance activities.

Each of these companies has created a specific compliance department and has enacted a code of ethics, distributing these

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¹ The term “compliance” probably came into use to describe certain corporate activities in 1991 when the U.S.’ Federal Sentencing Guidelines for Organizations were amended to give lighter sentences to organizations that had set up compliance programs. See https://www.ussc.gov/guidelines

Table 1. Japanese firms’ compliance activities

|   | specialized department | code of ethics** | committee of compliance | training | whistleblower system |
|---|------------------------|------------------|-------------------------|----------|----------------------|
| A | ☐                      | ☐                | ☐                       | ☐        | ☐                    |
| B | ☐                      | ☐                | ☐                       | ☐        | ☐                    |
| C | ☐                      | ☐                | ☐                       | ☐        | ☐                    |
| D | ☐                      | ☐                | ☐                       | ☐        | ☐                    |
| E | ☐                      | ☐                | ☐                       | ☐        | ☐                    |
| F | ☐                      | ☐                | ☐                       | ☐        | ☐                    |
| G | ☐                      | ☐                | ☐                       | ☐        | ☐                    |

Note: * A–E general firms, F–G firms that caused a scandal before; ** distributing compliance cards written with code of ethics to employees; *** established after the scandal.
codes of ethics to employees in a business-card-sized format. They have also have created compliance committees chaired by executive officers to review compliance matters. Training sessions are typically held once a year during a period known as “corporate ethics promotion month.” Although this has been influenced in part by the judicial system, all the companies have set up a compliance whistleblower system for employees to report on matters both inside and outside their firms.

These activities are all very similar, and we found no differences between the activities of those companies that have experienced scandals and those that have not. Moreover, but these seven companies started their compliance activities around the same time, with the structures having been put in place and institutionalized around 2002. What caused such a broad range of firms to set up such similar systems almost simultaneously?

**History**

When we interviewed the companies and looked at their public documents, we found that the Japan Business Federation and the government were influencing the actions of Japanese firms around 2002.

The Japan Business Federation created its first Charter of Corporate Behavior in 1991 (Nihon Keizai Shimbun, 1991; Nihon Keizaidantai Rengoukai, 1991), and later in the 1990s, it created Implementation Guidance for this charter (Nihon Keizai Shimbun, 1996; Nihon Keizaidantai Rengoukai, 1996). However, around 2002, several recalls and mislabelings of food were caused by well-know firms in succession, which quickly became a social issue. The Japan Business Federation took a hard look at the situation, and in 2002, it revised the Implementation Guidance it had issued in 1996 as an attachment to the Charter of Corporate Behavior (Nihon Keizaidantai
Institutional isomorphism in Japanese firms’ compliance activities

Rengoukai, 2002). This was the third version of the document and the first to use the term “compliance,” and “Reinforcing efforts to prevent corporate scandals” appeared, it set forth specific internal corporate policies, including questionnaires. Further, the federation published a document titled “Reinforcing Efforts to Prevent Corporate Misconduct,” which clarified and tightened up measures vis-a-vis companies involved in misconduct (Nihon Keizai Shimbun, 2002; Nihon Keizaidantai Rengoukai, 2002). In other words, until then, even if an incident occurred because a company did not abide by its charter of corporate behavior, the subsequent response was up to the individual company. This new publication suggested the possibility that the company’s membership in the Japan Business Federation would be suspended or that it could receive a warning or be expelled from the Japan Business Federation. There have been further revisions to the Charter of Corporate Behavior and Implementation Guidance since then, but the revisions made in 2002, after many instances of corporate misconduct, and the resultant policies carried a strong message of the Japan Business Federation’s endorsement of compliance activities.

As if in response to the actions of the Japan Business Federation, the government also began to take the lead on compliance, with the announcement of Guidelines for Voluntary Codes of Conduct by the Quality of Life Policy Council (Kokumin Seikatsu Shingikai Shouhishia Seisaku Bukai, 2002). The Quality of Life Policy Council, an advisory body to the Cabinet Office, is currently an administrative organization attached to the Consumer Affairs Agency. The Quality of Life Policy Council started up the Voluntary Code of Conduct Investigation Committee on October 5, 2001, with the goal of examining relationships between consumers and businesses and creating of guidelines for businesses.\(^2\) One of the members of the

\(^2\) Based on “Kokumin Seikatsu Shingikai Jishu Koudou Kijun Inkai Shiryou”
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Figure 1. The appearance frequency of “compliance” in newspapers

committee was Yoshikazu Miyabe (then president of Mitsubishi
Plastics, Inc), who chaired the Japan Business Federation’s
Committee on Economic Law’s Consumer Law Subcommittee. The
Voluntary Code of Conduct Investigation Committee used the third
version of the Japan Business Federation’s Implementation
Guidelines and “Reinforcement Efforts to Prevent Corporate Scandals”
(Naikakuhu Kokumin Seikatukyoku, 2002) as reference.

Almost simultaneously, the Japan Business Federation and
Japanese government began to increase pressure on corporations to
set up compliance systems. Figure 1 summarizes the number of
times the word “compliance” appeared in newspaper articles.3 We

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3 The term “compliance” first appeared in newspaper articles during the
1987 Toshiba COCOM incident. Toshiba Machine Co., Ltd., a subsidiary of
Toshiba Corporation, had exported machine tools to Communist bloc
countries, which became an international issue. At the time the incident
came to light, Toshiba Corporation announced it establish a “compliance
Discussion

The discussion of institutional isomorphism by DiMaggio and Powell (1983) is considered to be an example of the new institutionalism espoused by Meyer and Rowan (1977). According to that line of thinking, systems and activities effective for preventing scandals comprise competitive isomorphism, which has spread due to survival through natural selection, although isomorphism develops for reasons other than performance, namely institutional isomorphism. DiMaggio and Powell (1983) classified institutional isomorphism into three types, as seen in Table 2: coercive isomorphism, mimetic isomorphism, and normative isomorphism.

Japanese companies’ compliance activities have become so easy to understand that they could all be used as models. Coercive isomorphism is isomorphism imposed through external pressure, whether formal or informal. In the case of compliance at Japanese companies, there is an example of this. The United States had passed the Foreign Corrupt Practices Act (FCPA) in 1977, which was based on the British law of the 1960s. The FCPA is an example of a “program” that would be applied to all Group companies (Yomiuri Shimbun, 1987). COCOM is an acronym for Coordinating Committee for Multilateral Export Controls.

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4 DiMaggio and Powell cited Weber’s concept of the “iron cage” in proposing that homogeneity influences corporate activities, but in recent years “iron cage” has come to be regarded as a mistranslation by Talcott Parsons of Weber’s original term, Gehause, which actually means “shell” (Takahashi, 2015).

5 See Scott (1995) for a detailed description of new institutionalism. According to Scott, the arguments of Meyer and Rowan (1977) should be differentiated from the previous arguments of Selznick (1957).

6 See Takahashi (2010) for a detailed explanation of institutional isomorphism.
firms, external pressure was applied by the Japanese Business Federation and the Japanese government. The influence from an organization such as the Japan Business Federation, on which firms themselves depend, was especially strong.

Similar to when Japanese firms were urged to take action on compliance, when uncertainty exists due to an inability to clearly recognize or understand the details or intent of conduct, simply imitating other organizations is the natural reaction. This is called mimetic isomorphism. Isomorphism in compliance activities can be promoted when mimetic isomorphism is combined with normative isomorphism. In normative isomorphism, specialization develops in certain professions, creating set formats, which then leads to

Table 2. Mechanism of isomorphic organizational change

| Mechanism = source of isomorphic organizational change | Mechanism of population ecology |
|--------------------------------------------------------|--------------------------------|
| Competitive isomorphism                                |                                 |
| Institutional isomorphism                              | Coercive isomorphism            |
| Coercive isomorphism                                   | Pressure from dependent organizations, cultural expectations in society ex. legal regulation |
| Mimetic isomorphism                                    | Organizations will similar organizations that are more legitimate or perceived to be more successful, uncertainty promotes mimetic. |
| Normative isomorphism                                  | Mainly attributed to professionalization, (1) formal education and legitimization by university experts, (2) growth and refinement of professional networks, and selection of personnel is also an important mechanism. |

*Note:* Translated by author.  
*Source:* Yasuda and Takahashi (2007)
isomorphism based on those forms. However, in the case of compliance activities, specialized compliance departments were created within companies, which soon gave rise to compliance professionals. These professionals exchanged information with their peers at other companies belonging to the Japan Business Federation, studied the manuals provided to them, and then institutionalized compliance activities in accordance with those manuals.

Similar phenomena are not uncommon in Japan. The “internal control panic” was one such case. In 2006, Japan’s Companies Act was rewritten and put into force in line with the previous revamping of the commercial code. Article 362 of the Companies Act requires major corporations to create internal control systems (Kunihiro, Ozawa, & Gomi, 2007). Beginning in 2008, the section of the Financial Instruments and Exchange Act, known as J-SOX for its similarity to the U.S. Sarbanes-Oxley Act (SOX Act), required publicly traded companies to submit internal control reports. However, at the time, it was not clear what these internal control reports would contain, so companies of course put specialists in charge, and they tended to over-institutionalize.

Conclusion

Some companies have been caught up in scandals due to their lack of compliance systems. However, it is also true that major Japanese corporations that were leaders in the business community, including

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7 This is one part of the Financial Instruments and Exchange Act. Its formal name is “Standards for Management Assessment and Audit Concerning Internal Control over Financial Reporting” (Kigyou Kaikei Shingikai, 2007).

8 With respect to the internal control reporting system, the Financial Services Agency published “11 Misunderstandings about the Internal Control Report System” due to “cases in the practice where excessively conservative attitudes are apparent” (Kinyu Chou, 2008).
in compliance programs, have also experienced scandals. This is not to say that all compliance activities are meaningless, although it is very likely that compliance activities without any fixed effectiveness became widely disseminated as a result of institutionalized isomorphism. If one truly wants to prevent corporate scandals, then one must constantly strive to make sure that compliance activities work to prevent scandals and ensure that only those activities proven to be effective are implemented. Given the many scandals caused by relationships between group companies and their business partners, such as those at Kobe Steel and Toshiba mentioned earlier in this paper, compliance activities such as trans-firm organization (Takahashi, 2014) may also be necessary, rather than just those compliance activities that can be implemented within a single company, as is the case today.

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